TITLE 26—INTERNAL REVENUE

Chapter I—Internal Revenue Service, Department of the Treasury

SUBCHAPTER A—INCOME AND EXCESS PROFITS TAXES

[Regulations 118]

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39.3780-3 Allowance of adjustments.
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39.3801 (e) Statutory provisions; mitigation of effect of limitation and other provisions in income tax cases; adjustment unaffected by other items.

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39.3808 Statutory provisions; mitigation of effect of renegotiation of war contracts or on account of disbursement or reimbursement.

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39.3809–1 Verification of returns; penalties of perjury.

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39.3813–1 Denial of exemption to organizations engaged in prohibited transactions.

39.3813–2 Future status of organization denied exemption.

39.3814 Statutory provisions; denial of exemption under section 101 (6) in the case of certain organizations accumulating income.

39.3814–1 Denial of exemption under section 101 (6) in the case of certain organizations accumulating income.

39.4014 Statutory provisions; issue of instructions, regulations, and forms.

39.4014 (a) Statutory provisions; penalties for disclosure of information by officers and employees of the United States.

SUBPART G—MISCELLANEOUS PROVISIONS

39.6000–1 Extension of time for making certain elections.


SUBPART A—INTRODUCTORY PROVISIONS (CHAPTER I, INTERNAL REVENUE CODE) § 39.1 Statutory provisions; application of Chapter 1.

Sec. 1. Application of chapter. This chapter shall apply only to taxable years beginning on or after January 1, 1938. Income, war-profits, and excess-profits taxes for taxable years beginning prior to January 1, 1938, not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1926 and prior revenue acts, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1938.

§ 39.1–1 Scope and applicability of regulations. (a) The regulations in this part deal with (1) the taxes imposed by chapter 1 of the Internal Revenue Code, except the excess profits tax imposed under subchapter D, (2) the surtax imposed by chapter 2 (sections 500 to 511, inclusive) upon the undistributed subchapter A net income of personal holding companies, and (3) administrative provisions relating to such taxes.

(b) The regulations in this part are applicable only with respect to taxable years beginning after December 31, 1951.

§ 39.2–3 Statutory provisions; cross references in Chapter 1, classification of provisions.

Sec. 2. Cross references. The cross references in this chapter to other portions of the chapter, where the word “see” is used, are made only for convenience, and shall be given no legal effect.

§ 39.3–3 Classification of provisions. The provisions of this chapter are herein classified and described.

Subchapter A—Introductory provisions.

Subchapter B—General provisions, divided into Parts and sections.

Subchapter C—Supplemental provisions, divided into Supplements and sections.

Subchapter E—Tax on Self-Employment Income (the Self-Employment Contributions Act), divided into sections.

[Sec. 3 as amended by sec. 172 (b), Rev. Act 1942; sec. 6 (b), Individual Income Tax Act 1944; sec. 203 (d), Social Security Act Amendments 1960]


§ 39.4–1 Statutory provisions; classes of taxpayers. A taxpayer is subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estates and trusts and the beneficiaries thereof—Supplement E.

(b) Members of partnerships—Supplement F.

(c) Insurance companies—Supplement G.

(d) Nonresident alien individuals—Supplement H.

(e) Foreign corporations—Supplement I.

(f) Individual citizens of any possession of the United States who are not otherwise citizens of the United States and who are not residents of the United States—Supplement J.

(g) Individual citizens of the United States or domestic corporations, satisfying the conditions of section 11 of this chapter, deriving a large portion of their gross income from sources within a possession of the United States—Supplement K.

(h) China Trade Act corporations—Supplement L.

(i) Foreign personal holding companies and their shareholders—Supplement F.

(j) Regulated Investment companies—Supplement S.

(k) Shareholders of personal service corporations—Supplement S.

(l) Individuals with adjusted gross income of less than $5,000—Supplement T.

[Sec. 4 as amended by sec. 103 (c), Rev. Act 1941; sec. 170 (b), Rev. Act 1942; sec. 6 (b), Individual Income Tax Act 1944]

§ 39.4–1 Application of regulations to special classes of taxpayers. With respect to certain special classes of taxpayers, the application of the provisions of Subpart B of this part is subject to certain exceptions and additional provisions, which appear in Subpart C of this part, in connection with the provisions of the Internal Revenue Code:

Estates and trusts—sections 101 to 173, inclusive.

Partnerships—sections 101 to 191, inclusive.

Insurance companies—sections 201 to 297, inclusive.

Nonresident alien individuals—sections 211 to 211, inclusive.

Foreign corporations—sections 231 to 236, inclusive.

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

China Trade Act corporations—sections 261 to 265, inclusive.

Foreign personal holding companies—sections 265 to 266, inclusive.

Regulated investment companies—sections 261 and 292.

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

Individuals entitled to elect to pay the tax under Supplement T—sections 400 to 404, inclusive.

Tax-exempt organizations with taxable business income under Supplement U—sections 421 to 424, inclusive.

SUBPART B—GENERAL PROVISIONS (CHAPTER I, INTERNAL REVENUE CODE) RATES OF TAX § 39.11 Statutory provisions; normal tax on individuals.

Sec. 11. Normal tax on individuals—(a) Taxable years beginning after September 30, 1950. In case of taxable years beginning after September 30, 1950, the tax levied, collected, and paid for each taxable year upon the net income of every individual, being a normal tax of $3 per centum of the amount of the net income in excess of the credits against such net income provided in section 35, shall be levied, collected, and paid for each taxable year upon the net income of every individual, being a normal tax of $3 per centum of the amount of the net income in excess of the credits against such net income provided in section 35, for alternative tax which may be elected if adjusted gross income is less than $5,000, see supplement T.

(b) Taxable years beginning before October 1, 1950. * * * [Not applicable.]
individuals, see sections 211 to 221, may receive no income from sources
of the income. Exceptions and additional provisions as to permanent and
of "surtax net income" As defined in section 116 (1).
39.11-2 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 he may wholly derive his income from sources outside the United States. A nonresident alien individual who is a bona fide resident of Puerto Rico during the entire taxable year is, in general, liable to the tax in the same manner as a resident alien individual. See sections 116 (1) and 220. As to nonresident alien individuals, see sections 211 to 221, inclusive.

§ 39.11-3 Who is a citizen. Every person born or naturalized in the United States, and subject to its jurisdiction, is a citizen. For rules governing the expatriation of citizens by birth and naturalized citizens, see sections 340 to 347, inclusive, of the Nationality Act of 1940 (52 U. S. C. 1411-1439). A foreigner who has filed his declaration of intention of becoming a citizen but who has not yet been admitted to citizenship by a final order of a naturalization court is an alien. See §§ 39.211-2 to 39.211-5, inclusive, for distinction between a resident alien individual and a nonresident alien individual.

§ 39.12 Statutory provisions; surtax on individuals.

Sect. 12. Surtax on individuals.—(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 (a).

(b) Rates of surtax. (1) Calendar year 1951. * [not applicable.]
(2) Taxable years beginning after October 31, 1951, and before January 1, 1954. In the case of taxable years beginning after October 31, 1951, and before January 1, 1954, there shall be levied, collected, and paid, for each taxable year upon the surtax net income of every individual (other than a head of a household to whom subsection (c) applies) the surtax shown in the following table:

<table>
<thead>
<tr>
<th>If the surtax net income is—</th>
<th>The surtax shall be—</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $5,000.............</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $5,000 but not over $10,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $10,000 but not over $15,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $15,000 but not over $20,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $20,000 but not over $25,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $25,000 but not over $30,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $30,000 but not over $35,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $35,000 but not over $40,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $40,000 but not over $45,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $45,000 but not over $50,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $50,000 but not over $55,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $55,000 but not over $60,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $60,000 but not over $65,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $65,000 but not over $70,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $70,000 but not over $75,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $75,000 but not over $80,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $80,000 but not over $85,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $85,000 but not over $90,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $90,000 but not over $95,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $95,000 but not over $100,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $100,000 but not over $125,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $125,000 but not over $150,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $150,000 but not over $175,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $175,000 but not over $200,000</td>
<td>17 percent of the surtax net income.</td>
</tr>
</tbody>
</table>

(c) Rates of surtax; head of household—(1) Taxable years beginning after October 31, 1951, and before January 1, 1954. In the case of taxable years beginning after October 31, 1951, and before January 1, 1954, there shall be levied, collected, and paid, for each taxable year upon the surtax net income of every individual who is the head of a household the surtax shown in the following table:

<table>
<thead>
<tr>
<th>If the surtax net income is—</th>
<th>The surtax shall be—</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $8,000.............</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $8,000 but not over $12,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $12,000 but not over $16,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $16,000 but not over $20,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $20,000 but not over $25,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $25,000 but not over $30,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $30,000 but not over $35,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $35,000 but not over $40,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $40,000 but not over $45,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $45,000 but not over $50,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $50,000 but not over $55,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $55,000 but not over $60,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $60,000 but not over $65,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $65,000 but not over $70,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $70,000 but not over $75,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $75,000 but not over $80,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $80,000 but not over $85,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $85,000 but not over $90,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $90,000 but not over $95,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $95,000 but not over $100,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $100,000 but not over $105,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
<tr>
<td>Over $105,000 but not over $110,000</td>
<td>19.3 percent of the surtax net income.</td>
</tr>
</tbody>
</table>

§ 39.12
§ 39.12-1

Surtax on individuals. (a) There is imposed, in addition to the normal tax imposed by section 11, a surtax on the net income of every individual subject to the tax imposed by section 11 if the net income net income is the net income minus the credits provided in section 25.

(b) The surtax for any amount of surtax net income is the amount of excess over $200,000, plus 46 percent of excess over $22,000, plus 39 percent of excess over $12,000, plus 33 percent of excess over $10,000, plus 28 percent of excess over $8,000, plus 23 percent of excess over $4,000, plus 18 percent of excess over $2,000, plus 12 percent of excess over $1,000, plus 8 percent of excess over $500, plus 6 percent of excess over $300, plus 4 percent of excess over $100, plus 3 percent of excess over $50, plus 2 percent of excess over $25, plus 1 percent of excess over $10, plus $1,000,000.

(c) The surtax shall be determined in accordance with the applicable surtax table contained in section 12 (b) or (3) for treatment of taxable years beginning in 1953 and ending in 1954.

(d) For computation of tax in the case of a joint return of husband and wife, see § 39.12-3.

§ 39.12-2 Limitation on amount of tax. The combined normal tax and surtax computed before the application thereof of the credit provided in section 31 to the credit for foreign income tax section 11 (relating to the credit for tax withheld at the source under section 112) for treatment of taxable years ending in 1952 (2) or (3) the combined normal tax and surtax shall not exceed an amount equal to the following percent of the tax-payer's net income for the taxable year:

<table>
<thead>
<tr>
<th>Net Income</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000</td>
<td>1.0%</td>
</tr>
<tr>
<td>$5,000</td>
<td>1.5%</td>
</tr>
<tr>
<td>$10,000</td>
<td>2.0%</td>
</tr>
<tr>
<td>$20,000</td>
<td>2.5%</td>
</tr>
<tr>
<td>$50,000</td>
<td>3.0%</td>
</tr>
<tr>
<td>$100,000</td>
<td>3.5%</td>
</tr>
<tr>
<td>$200,000</td>
<td>4.0%</td>
</tr>
<tr>
<td>$400,000</td>
<td>4.5%</td>
</tr>
<tr>
<td>$1,000,000</td>
<td>5.0%</td>
</tr>
<tr>
<td>$2,000,000</td>
<td>5.5%</td>
</tr>
<tr>
<td>$4,000,000</td>
<td>6.0%</td>
</tr>
<tr>
<td>$10,000,000</td>
<td>6.5%</td>
</tr>
</tbody>
</table>

For taxable years beginning before Jan. 1, 1954, see § 39.12-3.

§ 39.12-3 Combined normal tax and surtax in case of joint return of husband and wife. (a) In the case of a joint return of husband and wife (see section 51) (b) the combined normal tax and surtax under section 11 and section 12 shall be twice the combined normal tax and surtax which would be determined if the net income and the applicable credits were those provided by section 25 were reduced by one-half.

(3) For method of computing gross income and adjusted gross income on a joint return, see § 39.81-1.
The method of computing, under section 12 (d) the tax of husband and wife in the case of a joint return is as follows:

1. The net income and applicable credits (other than personal credits) have a net long-term capital gain in excess of a net long-term capital loss, the partial tax shall be computed under sections 11 and 12 as stated above but with not inclusion of 50 percent of such excess in net income and the total tax shall be such partial tax plus a specified percent of such excess (20 percent for taxable years beginning before November 1, 1953, and 25 percent for all other taxable years) as provided in such section 117 (c) (2).

2. Net income reduced one-half, is then multiplied by two, to produce the tax imposed in the case of the joint return.

The limitation under section 12 (f) of the combined normal tax and surtax to an amount not in excess of a specified percent of the net income for the taxable year is to be applied before the fourth step above, that is, the limitation to be applied upon the combined normal tax and surtax is determined under section 21.6 (3) as the applicable specified percent of one-half of the net income for the taxable year (such one-half of the net income being the actual aggregate net income of the spouses reduced by one-half). For the percent applicable in determining the limitation under section 12 (f) of the combined normal tax and surtax, see § 39.12-2. After such limitation is applied, then the combined normal tax and surtax so determined are aggregated. Fourth, this aggregate, which is the combined normal tax and surtax determined in item (3) plus credits so reduced, is then multiplied by one-half, is then multiplied by two, to produce the tax imposed in the case of the joint return.

In this example, the joint net income is $8,200 and the surtax determined in item (3) is $2,500. The normal tax computed under section 12 (c) is $3,500. The credits against net income under section 25 (b) are $600. Therefore, the combined normal tax and surtax determined in item (3) is $3,100. After the 50 percent limitation is applied, the combined normal tax and surtax is $1,550. For the percent applicable in determining the limitation under section 12 (f) of the combined normal tax and surtax, see § 39.12-2. After such limitation is applied, then the combined normal tax and surtax so limited is multiplied by one-half, as provided in section 12 (d).

(3) The following computation illustrates the method of application of section 12 (d) in the determination of the tax of a husband and wife filing a joint return for the calendar year 1952.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>$8,200</td>
</tr>
<tr>
<td>Net income reduced by one-half</td>
<td>$4,100</td>
</tr>
<tr>
<td>Credits against net income under sec. 25 (b)</td>
<td>$1,200</td>
</tr>
<tr>
<td>Credits in item 3 reduced by one-half</td>
<td>$600</td>
</tr>
<tr>
<td>Net income reduced by one-half</td>
<td>$1,600</td>
</tr>
<tr>
<td>Normal tax computed under sec. 11 on amount in item 5 (3 percent of $3,600)</td>
<td>$108</td>
</tr>
<tr>
<td>Surtax computed under sec. 25 (b) on amount in item 5 ($300 plus 21.6 percent of excess of $3,600 over $2,000)</td>
<td>$708</td>
</tr>
<tr>
<td>Combined normal tax and surtax computed on net income and credits reduced by one-half</td>
<td>$813</td>
</tr>
<tr>
<td>Twice the combined normal tax and surtax determined in item 8</td>
<td>$1,626</td>
</tr>
</tbody>
</table>

(4) If the alternative tax is computed under section 117 (c) (2), relating to the alternative tax where a taxpayer (other than a corporation) has a net long-term capital gain in excess of a net long-term capital loss, the partial tax shall be computed under sections 11 and 12.
such other person must occupy the household for the entire taxable year of the taxpayer. They will be considered as occupying the household for such entire taxable year not withstanding temporary absence from the household due to special circumstances. A nonpermanent failure to occupy the common abode by reason of illness, education, business, vacation, military service, or custody agreement under which a child or step-child is absent for less than six months in the taxable year of the taxpayer, shall be considered a temporary absence due to special circumstances. Such absence will not prevent the taxpayer from qualifying as the head of a household if (1) it is reasonable to assume that the taxpayer or such other person will return to the household, and (2) the taxpayer continues to maintain such household or a substantially equivalent household in anticipation of such return. The taxpayer will not be deprived of the benefits of section 12 (c) because such other person dies during the taxable year of the taxpayer if the household constitutes the principal place of abode of such other person during that part of such taxable year preceding death.

(d) Cost of maintaining a household.
The taxpayer shall be considered as maintaining a household if he pays or provides for in section 12 (c) more than one-half the cost thereof for his taxable year. The cost of maintaining a household shall be the expenses incurred for the mutual benefit of the occupants thereof by reason of its operation as the principal place of abode of such occupants for such taxable year. Such expenses include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance, and food consumed on the premises. The cost of maintaining a household shall not include expenses otherwise incurred. Thus, such cost does not include expenses incurred for clothing, education, medical treatment, vacations, life insurance, and transportation. In addition, maintaining a household shall not include any amount which represents the value of services rendered by the household by the taxpayer or by a person specified in section 12 (c) (2) or provided for in section 12 (c) (3) (B).

§ 39.13 Statutory provisions; normal tax on corporations.

Sec. 13. Normal tax on corporations—(a) Definitions. For the purposes of this chapter—

(1) Adjusted net income. The term “adjusted net income” means the net income minus the credit for dividends received on the preferred stock provided in section 28 (b) and (h), relating to interest on certain obligations of the United States and Government corporations.

(2) Normal-tax net income. The term “normal-tax net income” means the adjusted net income minus the sum of the following credits:

(A) The credit for dividends received provided in section 28 (b);

(B) In the case of a public utility, the credit for dividends paid on its preferred stock provided in section 28 (h); and

(C) In the case of a western hemisphere trade corporation (as defined in section 109), the credit provided in section 28 (1).

(b) Imposition of tax. There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation (except a corporation subject to a tax imposed by section 231 (a), Supplement G, or Supplement Q)—

(1) A Corporation. * * *

(2) Taxable years beginning after March 31, 1951, and before January 1, 1955. In the case of taxable years beginning after March 31, 1951, and before April 1, 1954, a tax of 30 per centum of the normal-tax income.

(3) Taxable years beginning after March 31, 1954. In the case of taxable years beginning after March 31, 1954, a tax of 25 per centum of the normal-tax income.

(c) Exempt corporations. For corporations exempt from taxation under this chapter, see section 101.

(d) Tax on personal holding companies. For surtax on personal holding companies, see section 500.

(e) Improper accumulation of surplus. For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

(f) Mutual savings banks conducting life insurance business. For special tax, in lieu of the taxes imposed under section 26 (b) and section 15, in the case of a mutual savings bank conducting a life insurance business, see section 116.


§ 39.13-1 Tax on corporations in general. (a) Section 13 imposes an income tax on corporations generally. Every corporation is liable to tax imposed by such section, except (1) corporations expressly exempt from all taxation under chapter 1 (see section 101) (2) corporations subject to tax under Supplement U (see section 421) (3) foreign corporations not engaged in trade or business within the United States (see section 131 (a) (1) (A)) (4) insurance companies (see Supplement Q) and (5) investment companies (see Supplement Q).

(b) It makes no difference that a domestic corporation subject to any tax derived from income sources within the United States. The tax imposed by section 13 for a taxable year is computed upon the “normal-tax net income” for the taxable year, that is, the adjusted net income for such year minus (1) the credit for dividends received provided in section 28 (b) for such year, (2) in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 28 (h) and (b), relating to interest on certain obligations of the United States and its instrumentalities, and (c) for all other corporations, the amount of the tax imposed by section 13 is payable upon the basis of returns rendered by the corporations liable therefor, except that in some cases a tax is to be paid at the source of the income (see also sections 47, 52, 53, 144, and 235).

(1) For what the term “corporation” includes and for the difference between domestic and foreign corporations, see section 3797 (a).

(2) For treatment of the tax imposed on foreign corporations engaged in trade or business within the United States, see § 39.231–1 (a).

(3) In the case of foreign corporations not engaged in trade or business within the United States, the tax is as provided in section 231 (a). In the case of insurance companies, the tax is as provided in Supplement G (sections 201 to 297, inclusive). In the case of regulated investment companies, the tax is as provided in Supplement Q (sections 361 and 362). In the case of corporations subject to tax under Supplement U, the tax is as provided in sections 421 to 424, inclusive. For surtax on corporations generally, see § 39.15-1. For surtax on personal holding companies, see sections 500 to 511, inclusive. For surtax on corporations improperly accumulating surplus, see section 102. For treatment of capital gains and losses out of income, see section 117. For treatment of mutual savings banks conducting life insurance business, see section 144.

(d) (1) The tax imposed by section 13 is computed by applying to the “normal-tax net income” the rate in effect for the taxable year. The rates of tax under section 13 applicable for the respective taxable years are as follows:

<table>
<thead>
<tr>
<th>Year Beginning</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before April 1, 1954</td>
<td>50</td>
</tr>
<tr>
<td>After March 31, 1954</td>
<td>50</td>
</tr>
</tbody>
</table>

(2) The computation of the tax under section 13 may be illustrated by the following example:

Example. The A Corporation, a domestic corporation (which is neither a public utility, a Western Hemisphere trade corporation, nor a regulated investment company) for the calendar year 1953 has for the calendar year 1952 a net income of $110,000, including interest on United States obligations (allowable as a credit under section 28 (a) in the amount of $10,000 and cash dividends received (allowable as a credit in section 28 (a)) in the amount of $33,450. The corporation’s tax under section 13 for the calendar year 1953 is $33,056.26, computed as follows:

Net income: $110,000

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

Adjusted net income: $100,000

Less credit for dividends received: $33,450

(85 percent of $10,000) ---- 8,500

Normal-tax net income: $66,056.26

Tax under sec. 13 (b) (3) (30 percent of $111,500) ---- $33,450

§ 39.14–15 Statutory provisions; tax on special classes of corporations; surtax on corporations.

Sec. 14. Tax on special classes of corporations in case of taxable years (other than the calendar year 1950) beginning before July 1, 1950. [Repealed by see. 121 (g), Rev. Act 1951]
Sect. 15. Surtax on corporations.—(a) Corporation surtax net income. For the purposes of this chapter, the term "corporation surtax net income" means the net income (as defined in section 109), subject to tax under section 26 (b), minus the sum of the following credits:

(1) The credit for dividends received provided in section 26 (b) (1).

(2) In the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26 (b).

(3) In the case of a Western hemisphere trade corporation (as defined in section 109), the credit provided in section 26 (1).

(b) Impose a surtax. There shall be levied, collected, and paid for each taxable year upon the corporation surtax net income of every corporation the surtax at the rate of 22 percent and is upon the corporation surtax net income for any taxable year.

(c) Disallowance of surtax exemption and minimum excess profits credit. If any corporation transfers, on or after January 1, 1951, all or part of its property (other than money) to another corporation which was created for the purpose of acquiring such property or which was not actively engaged in business at the time of such transfer and if after such transfer the transferor corporation or its stockholders, or both, are in control of such corporation or stockholders in the case of any part of the taxable year of such transfer, such transferor corporation or corporation may be deemed to be "doing business" even though such corporation or stockholders are not doing business at the time of such transfer, the transferor corporation or corporation shall be liable to the extent not inconsistent with the provisions of this chapter, the term "corporation surtax net income" means the net income (as defined in section 109), subject to tax under section 26 (b), minus the sum of the following credits:

(1) The credit for dividends received provided in section 26 (b) (1).

(2) In the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26 (b) (2).

(3) In the case of a Western hemisphere trade corporation (as defined in section 109), the credit provided in section 26 (1).

(d) The computation of the surtax on corporations shall be illustrated by the following example:

**Example.** The A Corporation, a domestic corporation (which is neither a public utility referred to in section 26 (b) nor a Western hemisphere trade corporation referred to in section 26 (1)), has for the calendar year 1952 a net income of $600,000. The net income includes cash dividends received from a corporation (allowable as a credit under section 26 (b) (1)) in the amount of $10,000, and also includes $80,000 statutory obligations (allowable as a credit under section 26 (c) in determining adjusted net income for the purpose of the surtax). For the purposes of this chapter, the amount of the surtax is $77,500. The A Corporation's surtax for the calendar year 1953 is $112,550, computed as follows:

- **Net income.** $600,000
- **Less credit for dividends received.** $10,000
- **85 percent of $80,000.** 8,500
- **Corporation surtax net income.** 71,500

For surtax on personal holding companies, see sections 500 to 511, inclusive. For surtax on corporations improperly accumulating surplus, see section 102. For treatment of capital gains and losses, see sections 117, 118, and subsections of subchapter C of chapter 117. For treatment of savings banks conducting life insurance business, see section 110.

(4) The Commissioner allows such exemption or such credit pursuant to the authority provided in section 15 (c) and section 129 (b).

(b) Purpose of section 15 (c)

(1) The purpose of section 15 (c) is to prevent avoidance or evasion of the tax on corporation surtax net income imposed by section 15 (b) or of the excess profits tax imposed by section 430. It is not intended, however, that section 15 (c) be interpreted as delimiting or abrogating any principle of law established by judicial decision, or any existing provisions of the Internal Revenue Code, including sections 15 (b) and 430. This section is designed for the purpose of effecting the prevention of avoidance or evasion of Income or excess profits taxes. Such principles of law and such provisions of the Code, including section 15 (c), may be applicable in appropriate cases they may operate together or they may operate separately.

(2) The provisions of section 129 (b) and the authority of the Commissioner thereunder, to the extent not inconsistent with the provisions of section 15 (c), are applicable to cases covered by section 15 (c). Pursuant to the authority provided in section 129 (b) the Commissioner may allow to the transferee any part of a surtax exemption or minimum excess profits credit for a taxable year for which such exemption or credit would otherwise be disallowed under section 15 (c), or he may apportion such exemption or credit among the corporations involved (see § 33.129-4). For example, Corporation A, on or after January 1, 1951, all its property to Corporations B and C in exchange for all the stock of such corporations. Immediately thereafter, Corporation A is no longer in existence. Corporation A, however, has authority under sections 15 (c) and 15 (b) to allow one such exemption or credit and to apportion such exemption and credits between Corporations B and C.

(3) For the purpose of section 15 (c) and this section, a corporation maintaining an office for the purpose of preserving its corporation existence is not considered to be "actively engaged in business" even though such corporation may be deemed to be "doing business" for other purposes. Similarly, for the purpose of section 15 (c) and this section, a corporation engaged in winding up its affairs, prior to an acquisition to
which section 15 (c) is applicable, is not considered to be "actively engaged in business.

(c) Meaning and application of the term "control". For the purpose of section 15 (c) and this section, the term "control" means the possession of either (1) at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or (2) at least 60 percent of the total value of shares of each class of stock of such corporation. In determining whether stock possession at least 80 percent of the total combined voting power of all classes of stock entitled to vote is owned, all classes of stock shall be considered together; it is not necessary that 80 percent of each class of voting stock be owned. Likewise, in determining whether stock possessing at least 80 percent of the total value of shares of all classes of stock is owned, all classes of stock of the corporation shall be considered together; it is not necessary that 80 percent of the value of shares of each class be owned. The fair market value of a share shall be considered as the value to be used for the purpose of this computation. The ownership of stock shall be determined in accordance with section 503 and the regulations thereunder, except that constructive ownership under section 503 (a) (2) shall be determined only with respect to the individual's spouse and minor children. For example, in addition to stock held directly or under an option to purchase, an individual is deemed to own stock held directly or indirectly through a corporation, partnership, estate, or trust in which he holds an interest as a shareholder, partner, or beneficiary.

Disallowance of the exemption and credit under section 15 (c) is not limited to the taxable year of the transferee corporation in which the transfer of property occurs or any subsequent taxable year. In determining whether the transfer of property was for the purpose of section 15 (c), whether a corporation, its stockholders, or both, are in control of a transferee corporation, it is not necessary that the stock be acquired on or after the day on which Corporation F on June 1, 1950, owns 70 percent of the voting stock of Corporation G, and, thereafter, on January 2, 1952, Corporation F acquires an additional 10 percent of such stock, control within the meaning of section 15 (c) is acquired by Corporation F on January 2, 1952.

(d) Nature of transfer. A transfer made by any corporation of all or part of its assets, whether or not such transfer qualifies as a reorganization under section 112 (g) is within the scope of section 15 (c) except that section 15 (c) does not disallow the deduction of money only. For example, the transfer of cash for the purpose of expanding the business of the transferee corporation through the formation of a new corporation is not a transfer within the scope of section 15 (c) irrespective of whether the new corporation uses the cash to purchase from the transferee corporation stock in trade or similar property.

(e) Purpose of transfer. In determining, for the purpose of section 15 (c) whether the securing of the exemption from surtax or the excess profits credit constituted a "major purpose" of the transfer, all circumstances relevant to the transfer shall be considered. For disallowance of the excess profits credit under section 15 (c) it is not necessary that the obtaining of either such credit or exemption or both have been the major purpose of the transfer of the property. It is sufficient if it appears, in the light of all the facts and circumstances, that the obtaining of such exemption or credit, or both, was a major purpose of the transfers that prompted the transfer. Thus, the securing of the excess profits credit or the minimum excess profits credit may constitute "a major purpose" of the transfer, notwithstanding that such transfer was effected for a valid business purpose and qualified as a reorganization within the meaning of section 112 (g). The taxpayer's burden of establishing the clear preponderance of the evidence that the securing of either such exemption or credit or both was not a `major purpose' of the transfer may be met, for example, by a showing that the obtaining of such exemption, or credit, or both, was not a major factor in relationship to the other consideration or considerations which prompted the transfer.

(f) Taxable years to which applicable. Section 15 (c) and this section do not apply to any taxable year with respect to which the excess profits tax imposed by subsection D of chapter 1 of the Internal Revenue Code is not in effect. For treatment of taxable years beginning before April 1, 1954, and ending after March 31, 1954, see § 39.109–2. For computation of the excess profits tax for certain fiscal years, see § 40.430–2 (b) and (c) of Regulations 130 (Part 40 of this chapter)

§ 39.21 Computation of net income

(a) Statutory provisions: net income. Sec. 21. Net income—(a) Definition. "Net income" means the gross income computed without regard to the deductions allowed by section 22, less the deductions allowed by section 23.

(b) Cross references. For definition of "adjusted net income" and "normal-tax net income," see section 13.

§ 39.21–1 Meaning of net income. (a) The tax imposed by chapter 1 is upon income. Neither income exempted by statute or fundamental law, nor expenses incurred in connection therewith, other than interest, enter into the computation of net income as defined by section 21. (See section 24 (a) (3)). In the computation of net income, the excess profits of all classes of income must be considered:

(1) Income (in the broad sense), meaning all wealth which flows to the owner of the property in excess of the reasonable return on the property. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always reflect income, for the Internal Revenue Code recognizes as income-determining factors other items, among which are in-process inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. (See sections 22, 23, 24, and 117.)

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

(3) Net income, meaning gross income less statutory deductions in excess of statutory credits. Although statutory credits are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. (See sections 23 and 24.)

(4) Net income less certain credits. (See sections 25, 26, 27, and 28.)

(b) The normal taxes and surtaxes imposed on individuals and on corporations are computed upon net income less certain credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications, statutory net income is commercial net income. This appears from the fact that ordinary income is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. (See section 41.)

(c) The net income of corporations is determined in general in the same manner as the net income of individuals, but the deductions allowed corporations are not precisely the same as those allowed individuals. (See sections 23, 24, 102,
§ 39.22 (a) Statutory provisions; definition of gross income.

Sec. 22. Gross income—(a) General definition. “Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service (whether of a domestic or foreign character), partnership interests, dividends, interest, rents, royalties, accounts, notes, or other obligations payable in money, money's worth, or in property, payments for the use of money, payments for services, gains or profits from the dealings in property, and other income of whatever kind and nature.

(b) In computing the gain or loss from the subsequent sale of such property, the difference between the amount paid for the property and the amount of its fair market value is to be included in the gross income of the person making the subsequent sale.

(c) Except as otherwise provided in section 130A, if property is transferred by an employer to an employee for an amount less than its fair market value, regardless of whether the transfer is in the form of a sale or exchange, the difference between the amounts so paid by the employee to the employer and the fair market value of the property is to be included in the gross income of the employee, and the regulations prescribed thereunder for special rules with respect to stock transferred from an employer to an employee pursuant to the timely exercise of a restricted stock option.

(d) The fact that a dividend is declared shortly after the sale of corporate stock and the sale price is influenced by the fact that a dividend will be paid, or that a dividend has been declared, does not make such dividend when paid taxable to the vendor as a dividend.

§ 39.22 (a)-1 What included in gross income. (a) Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. See sections 22 (b) and 116. In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profits gained through a sale or conversion of capital assets.

Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income for the year in which they are made for nonresident aliens and foreign corporations by sections 211 to 238, inclusive, and, in certain cases, by section 251, if domestic corporations deriving income from sources within possessions of the United States. Income may be in the form of cash or of property.

(b) If property is transferred by a corporation to a shareholder, for an amount less than its fair market value, regardless of whether the transfer is in the form of a sale or exchange, the shareholder shall include in gross income the difference between the amount paid for the property and the amount of its fair market value to the extent that such difference is attributable to the value of earnings or profits taxable as a dividend.

In computing the gain or loss from the subsequent sale of such property its basis 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 § 59.22 (a)-8.

§ 39.22 (a)-2 Compensation for personal services. (a) Compensation paid in cash. (1) Payments made to employees in the form of wages, salaries, commissions on insurance premiums, tips, pay of persons in the military or naval forces of the United States, retired pay of persons in the military or naval forces of the United States, retired pay of persons in the military or naval forces of the United States, or any other compensation received for services rendered on or before June 30, 1932, shall be included in the gross income of the employee if the amount paid is included in such income.

(2) The value of services need not be determined unless the employee is not covered by the Civil Service Retirement Act or section 130A. In the case of members of a legislative body covered by the Civil Service Retirement Act or section 130A, the compensation received shall be presumed to be the fair value of the services performed.

(3) As to the determination of gain or loss from the sale or other disposition of property, see sections 111 to 113, inclusive. Payments received as loans from the Commodity Credit Corporation, see section 132.

(b) As to the amount of income tax payable in respect of wages, salaries, commissions, tips, pay of persons in the military or naval forces of the United States, retired pay, and other compensation received for services rendered from the basic salary, pay, or compensation to which the employee is entitled, the compensation received shall be included in the gross income of the employee, and the regulations prescribed thereunder for special rules with respect to stock transferred from an employer to an employee pursuant to the timely exercise of a restricted stock option shall be applicable.

(c) As to income upon a recovery in respect of war losses, see section 157 (c). As to insurance companies and foreign corporations, see sections 201 to 207, inclusive, and section 231.

§ 39.22 (a)-3 Compensation paid other than in cash. If services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary, such price shall be presumed to be the fair market value of the compensation received.

If a corporation transfers to its employees its own stock as compensation for services rendered, the value of such compensation shall be included in the gross income of the employee and the fair market value of the stock at the time of the transfer shall be presumed to be the fair market value of the compensation received.

§ 39.22 (a)-4 Compensation paid in notes. Notes or other evidences of indebtedness received by Federal officers and employees (including members of a legislative body and a judge or officer of a court) are included in the gross income of the officer or employee, regardless of the nature of the office or employment.

Notwithstanding the foregoing, is to be included in gross income, regardless of the nature of the office or employment.

Note: The value of services need not be included in gross income when rendered directly and gratuitously to an organization described in section 23 (a) where, however, pursuant to an agreement or understanding the services are rendered to a person for the benefit of an organization described in section 23 (a) and an amount for such services is paid to such organization by the person to whom the services are rendered, the amount so paid constitutes income to the person performing the services even though the amount so paid is not includible in gross income.

§ 39.22 (a)-4 Compensation paid in notes. Notes or other evidences of indebtedness received by Federal officers and employees (including members of a legislative body and a judge or officer of a court) are included in the gross income of the officer or employee, regardless of the nature of the office or employment.

Notwithstanding the foregoing, is to be included in gross income, regardless of the nature of the office or employment.
discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted at the full face value less discount computed at the prevailing rate for such transactions. If the payment of the note is discounted at an interest rate and the discounted value of the note at such time. The recipient shall include such note in respect of the difference between the cost and the face value of the note at such time.

§ 39.22 (a)–5 Gross income from business. In the case of a manufacturing, merchandising, or mining business, “gross income” means the total sales, less the cost of goods sold, plus any income from investments and other incidental or outside operations or sources. In determining gross income, subtractions should not be made for depreciation allowed for based on discovery value or percentage of income, selling expenses, or losses, or for other items not ordinarily used in computing cost of goods sold. But see § 39.23 (m)–(e)

§ 39.22 (a)–6 State contracts. The profit from a contract with a State or political subdivision thereof must be included in gross income. If warrants are issued by a city, town, or other political subdivision of a State, and are accepted or 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 loss 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.

§ 39.22 (a)–7 Gross income of farmers. (a) 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 livestock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any livestock or other items which were purchased, and (3) gross income from all other sources. The profits from the sale of livestock 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 occurred. The cost shall be the amount of any excess of the sales price over the amount representing the difference between the cost and the depreciation theretofore allowed (but not less than the amount allowable) in respect of such property as a deduction in computing net income.

(b) 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 sales price of livestock and products on hand at the end of the year the amount received from the sale of livestock and products, and miscellaneous receipts for hire of teams, machinery, or draft animals, stored during the year, and deducting from this sum the inventory value of livestock and products on hand at the beginning of the year and to the gross products purchased during the year. In such cases all livestock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also livestock acquired, for draft, breeding, or dairy purposes and not for sale, may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the taxpayer. In the case of the sale of any livestock and products in the year during which their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory. (c) In the case of the sale of machinery, farm equipment, or any other property (except stock in trade of the taxpayer, or 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, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business) the proceeds of the sale or the adjusted basis of such property determined under section 115 and the regulations thereunder shall be included in the taxpayer’s gross income for the taxable year in which such sale is made. If farm produce is exchanged for merchandise, groceries, or the like, the market value of the article received is to be included in gross income. Rents received in crop shares shall be returned as of the year in which the crop shares were assigned in exchange for money or the equivalent of money. For purposes of determining loss, book value, insurance, such as hail and fire insurance on growing crops, should be included in gross income to the amount received in cash or its equivalent for the crop injured or destroyed. If a farmer is engaged in producing crops which take more than a year from the time of planting to the time of gathering and disposing, the income therefrom may, with the consent of the Commissioner (see § 39.41–2) be computed upon the crop basis; but in any such cases the entire cost of producing the crop must be taken as a deduction for the year in which the gross income from the crop is realized.

(d) As used in this section, the term “farm” embraces the farm in the ordinary acceptation of the term: stock, poultry, dairy, file, and farm farms; also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate or raise crops for gain or profit, either as owners or tenants, are designated as farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, may be considered as a farmer.

(e) Form 1040F should be filled in and attached to his income tax return by every farmer who either keeps no records or only records of certain receipts and disbursements, or keeps records of the income and disbursements of such receipts and disbursements. (See further §§ 39.23 (a)–11, 39.23 (e)–5, and 39.23 (l)–10.)

§ 39.23 (a)–8 Sale of stock and rights. (a) If shares of stock in a corporation are sold from lots purchased at different dates or at different prices, the amount that would be determined by the cost or other basis of the lot cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. In the determination of the earliest purchases of such stock the rules prescribed in section 117 (h) (relating to the period for which property has been held) shall apply. The excess of the amount realized on the sale of the stock over the cost or other basis shall be included in gross income, and the stock will constitute gain. With respect to the basis for determining gain or loss from the sale or other disposition of stock acquired as a stock dividend or the stock will constitute gain. The excess of the amount realized on the sale of such stock over the cost or other basis shall be included in gross income, and the stock will constitute gain.

(b) Although the issuance by a corporation to its shareholders of rights to subscribe to its stock may not arise, the proceeds of sales shall have been recovered the total cost.

(c) If the shareholder does not exercise, but sells, his rights to subscribe, 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 respective values thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on the 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 1977 purchased 500 shares of common stock at $125 a share, and in 1982, 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.
Instead of subscribing to the additional
shares, he sold the right at $4 each. The
profit is computed as follows:

500 (shares) × $120 = $60,000, cost of old stock
(stock in respect of which the rights were
acquired).

500 (shares) × $60 = $30,000, market value of
additional shares.

500 (rights) × $3 = $1,500, market value of
rights.

$60,000

$30,000

$1,500

$91,500

$91,500

$11,524.39

$2,000

$1,524.39

$475.61, profit.

For the purpose of determining the gain or
loss from the subsequent sale of the stock
respect of which the rights were acquired,
the adjusted cost of each share is $121.95
(that is, $60,975.61 ÷ 500).

(2) If the shareholder exercises his
rights to subscribe, the basis for deter-
miming gain or loss from a subsequent
sale of a share of the stock in respect of
which the rights were acquired shall be
determined as in subparagraph (1) of
this paragraph. The basis for deter-
mimed gain or loss from a subsequent
sale of a share of the stock obtained
through exercising the rights, shall be
determined by dividing the part of
the cost or other basis of assets (includ-
ing goodwill) which represents the
shares assigned to the rights, plus the
subscription price of the new shares,
by the number of new shares acquired.

Example. A taxpayer in 1949 purchased
500 shares of common stock at $120 a share,
and in 1952, by reason of the ownership of
such stock, acquired 500 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 sub-
scribe to the additional stock and sold one
of such shares for $140. The profit is
computed as follows:

$120 (cost of old stock apportioned to
rights pursuant to the computation in
the example under subparagraph (1) of
this paragraph) × 100,000 (subscription price
of additional shares) = $11,524.39, basis for
determining gain or loss from sale of
additional shares.

$11,524.39 — $100,000 (subscription price of
additional shares) = $111,524.39, basis for
determining gain or loss from sale of
additional shares.

$111,524.39 — $110,000 (subscription price of
additional shares) = $11,524.39, basis for
determining gain or loss from sale of
additional shares.

$11,524.39 (cost of old stock apportioned to
rights pursuant to the step in the example
under subparagraph (1) of this paragraph)
× 100,000 (subscription price of additional
shares) = $11,524.39, basis for
determining gain or loss from sale of
additional shares.

(3) 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 deter-
mimed, or if the stock in respect of which
the rights were acquired was purchased at
different times or at different prices and
the stock rights acquired in respect of
such stock cannot be identified as having
been acquired in respect of any particu-
lar lot of such stock, the basis for de-
termining the gain or loss from the sale
or other disposition of the old shares, or
the rights in cases in which the rights
or stock were sold, upon different lots or
disperses, will be the average of the
basis of the old or new shares in cases
in which the rights are exercised, shall be
ascertained in accordance with the prin-
ciples laid down in §§ 39.111 (a) (14)-1.

(a) 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 § 39.23
(2)-1.

§ 39.22 (a) — 9 Sale of patents and
copyrights. A taxpayer disposing of
patents or copyrights by sale should deter-
mine the gain or loss arisng therefrom
by computing the difference between
the selling price and the cost or other
basis, with proper adjustment for deprecia-
tion, as provided in §§ 39.111-1, 39.113
(a), (14)-1, and 39.113 (b) (1) — 1 to 39.113
(b) (4) (-1), inclusive.

§ 39.22 (a) - 10 Sale of good will. Gain
or loss from a sale of good will results
when the business or a part of it, to
which the goodwill attaches is sold, in
which case the gain or loss will be deter-
mimed by comparing the sale price
with the cost or other basis of good will,
including goodwill.

(See §§ 39.111-1, 39.113 (a), (14)-1, and
39.113 (b) (1) — 1 to 39.113 (b) (4) (-1),
inclusive.) If specific payment was not
made for good will, the gain or loss
shall be considered 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 goodwill 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 sold.

§ 39.22 (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 ap-
portioned among the lots or parcels
and made a matter of record on the
books of the taxpayer, to the end that
any gain derived from the sale of any
such lots or parcels which constitutes
taxable income may be returned as in-
come for the year in which the sale is
made. This rule contemplates that
there will be gain or loss on every lot or
parcel sold and not that the capital in
the entire tract may be recovered be-
fore any taxable income shall be re-
turned. The sale of each lot or parcel
will be treated as a separate transaction,
and gain or loss determined accordingly.

§ 39.22 (a) - 12 Annuities and insur-
cance policies. Annuities paid by re-
ligious, charitable, and educational
organizations under an annuity contract
are, in general, subject to tax in the
year of receipt. Annuities paid from other
sources paid under similar contracts,
See section 22 (b) (2) and § 39.22 (b)
(2) — 2. 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 charge upon the
income of the land. See section 22 (b)
(3) and § 39.22 (b) (3)-1. As to certain
cases in which an annuity charged upon
devised land is taxable in full to a spouse
upholding a marital separation, see sec-
tion 22 (b). 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 or to claim as a tax-exempt income
any sums paid to the annuitant. Amounts
received as a return of premiums paid
under life insurance, endowment, or an-
nuity contracts, and the income there-
der, of a mutual insurance company
which may be credited against the
current premium, are not subject to tax.

§ 39.22 (a) — 13 Cancellation of indebted-
ness.— (A) In general. The cancella-
tion of indebtedness, in whole or in part,
may result in the realization of income.
If, for example, an individual performs
services for a creditor, who in considera-
tion thereof cancels the debt, income in
the amount of the debt forgiven shall be
taxable as income from other sources
as provided in §§ 39.111-1, 39.113
(b) (12)-1.

(B) Income realized from the sale or
exchange of bonds or stocks by the cred-
btor as consideration for services per-
fomed by the debtor may be taxable as
income from other sources under
§§ 39.111-1, 39.113 (b) (12)-1.

(C) In the case of an individual
organization or arrangement or wage
employee plan of corporate reorganiza-
tion confirmed under Chapter X of the
Bankruptcy Act (11 U. S. C., c. 10)

(2) an "arrangement" or a "real
property arrangement" confirmed under
Chapter XI or XII, respectively, of the
Bankruptcy Act (11 U. S. C., c. 11, 12)

(2) a "wage earner's plan" confirmed
under Chapter XIII of the Bankruptcy
Act (11 U. S. C., c. 13).

If, however, such plan of corporate re-
organization or arrangement or wage

§ 39.22 (a)-13

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§ 39.22 (a)-14 Creation of sinking fund by corporation. If a corporation, in order solely to secure the payment of its bonds or other indebtedness, places property in trust or sets aside certain amounts in a sinking fund under the control of a trustee who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held thereby for the purpose of being used for the retirement of its bonds, the excess of the present fair value thereof is income of the corporation and shall be included as such in its gross income.

§ 39.22 (a)-15 Acquisition or disposition by a corporation of its own capital stock. (a) Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained under all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

(b) However, if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in shares of another corporation, and also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

§ 39.22 (a)-16 Contributions to corporation by shareholders. If a corporation requires additional funds for conducting its business, it obtains such needed money through voluntary proprietary payments by its shareholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts not to be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments under such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. (See §§ 39.22 (a)-13 and 39.24 (a)-2.)

§ 39.22 (a)-17 Sale and purchase by corporation of its bonds. (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. 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. If, however, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(b) If, subsequent to February 28, 1913, bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. If the corporation pur- chases any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. If, however, the corporation purchases any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or of the face value minus any amount of premium not yet returned as income) over the purchase price 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 should be prorated or amortized over the life of the bonds. If the corporation pur- chases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) it is a deductible expense for the taxable year. If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year.
factors are set forth in section 22 (a) although no; payable to the grantor unless the satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (see on a or former spouse under this section, the income of a trust is attributable to him if such event is the practical equivalent of the expiration of a period less than 10 or 15 years, as the case may be. For example, a grantor is taxable on the income of a trust if the corpus is to return to him or his estate on the graduation from college or prior death of his son, who is 18 years of age at the date of the transfer in trust. Trust income is, however, not attributable to the grantor where such reversionary interest is to take effect in possession or enjoyment at the death of the person named to whom the income is payable.

(3) In general, a reversionary interest may reasonably be expected to take effect in possession or enjoyment within a period of 10 or 15 years, as the case may be, where the corpus or the income therefrom is to be reacquired if the grantor survives any stated contingency which is of an unsubstantial character. Thus, the grantor is taxable where the trust income is to be paid to the grantor's wife for three years, and the corpus is then to be returned to the grantor if he survives that period, or to be paid over to A or his estate.

(4) Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement.

Example. A places property in trust for the benefit of his son B. Upon the expiration of 12 years or the earlier death of B the property is to be paid over to A or his estate. Neither A nor his wife has any power of administration over the trust corpus or income. After the expiration of nine years A extends the term of the trust for an additional two years. A is considered to have made a new transfer in trust for a term of five years. He is not taxable on the income for the first three years of such term because such income would not be taxable to him in the absence of such postponement. This may be illustrated by the following example:

within 10 years commencing with the date of the transfer, or

(ii) Within 15 years commencing with the date of the transfer if the income is or may be payable to a beneficiary other than a donee described in section 22 (b) and if any one or more of the following powers of administration over the trust corpus or income are exercisable solely by the grantor, or spouse (living with the grantor, and not having a substantial adverse interest in the corpus or income of the trust) or both, whether or not exercisable as trustees: a power to vote or direct the reinvestment of stock or other securities, a power to control the investments of the trust funds either by direct

§ 39.22 (a)–(21) Trust income taxable to the grantor as substantial owner thereof—(a) Introduction. Income of a trust is taxable to the grantor under section 22 (a) although no; payable to the grantor unless the satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (see on a or former spouse under this section, the income of a trust is attributable to him if such event is the practical equivalent of the expiration of a period less than 10 or 15 years, as the case may be. For example, a grantor is taxable on the income of a trust if the corpus is to return to him or his estate on the graduation from college or prior death of his son, who is 18 years of age at the date of the transfer in trust. Trust income is, however, not attributable to the grantor where such reversionary interest is to take effect in possession or enjoyment at the death of the person named to whom the income is payable.

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(4) Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement.

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within 10 years commencing with the date of the transfer, or

(ii) Within 15 years commencing with the date of the transfer if the income is or may be payable to a beneficiary other than a donee described in section 22 (b) and if any one or more of the following powers of administration over the trust corpus or income are exercisable solely by the grantor, or spouse (living with the grantor, and not having a substantial adverse interest in the corpus or income of the trust) or both, whether or not exercisable as trustees: a power to vote or direct the reinvestment of stock or other securities, a power to control the investments of the trust funds either by direct

(iii) To a power if such power is exercisable by a trustee or trustees, none of whom is the grantor, spouse living, the grantor or subordinate trustee of the type and under all the conditions referred to in subdivision (iv) of this subparagraph, and the exercise of the power is not subject to the approval or consent of any person other than such trustee or trustees, and if such power is one:

(a) To distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries,

(b) To pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries, whether or not income beneficiaries.

The powers hereinafter described include all the powers described in subdivision (iv) of this subparagraph, since the latter powers are more limited than those hereinafter described:

(iv) To a power,

(a) Which is exercisable:

(1) By the grantor or spouse living with the grantor, or both, whether or not as trustee; or

(2) (i) Solely by a trustee or trustees who include the father, mother, issue, brother, sister or employee of the grantor, or a subordinate employee of a corporation in which the grantor is an executive or in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control and (ii) in a manner which may affect the interests of beneficiaries which include the spouse or any child of the grantor (see subdivision (ii) of this subparagraph) or (iii) for a period of time in which the trust corpus consists of stock or securities of a class of beneficiaries, whether or not in the capacity of trustee, and has not completely repaid the loan, including any interest, before the beginning of the taxable year; or

(3) By any person or persons other than as trustee.

(4) By any trustee or trustees, and the exercise of the power is subject to the approval or consent of any person or persons (other than such trustee or trustees) of the grantor or spouse living with the grantor, or both, in the capacity of trustee—and

(5) If such power is one:

(a) To pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite external standard. Such standard must be set forth in the trust instrument and must consist of needs and circumstances of the beneficiaries.

(b) To pay out corpus to or for any current income beneficiary, if the power is not limited by a reasonably definite external standard, provided that any such payment must be chargeable against the proportionate share of corpus held in trust for the payment of income to such beneficiary as if such corpus constituted a separate trust;

(c) To distribute or apply income to or for any current income beneficiary or to accumulate such income for him, provided that any accumulated income must ultimately be applied to or for the beneficiary from whom distribution or application is withheld, to his estate or to his appointees (or persons named as alternate takers in default of appointment) provided that such power over income beneficiaries is a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors or the conditions of his estate; or, if payable upon the termination of the trust or in conjunction with a distribution of corpus which distribution is augmented by such accumulated income, is ultimately payable to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument. Accumulated income shall be considered so payable although it is the case that if any beneficiary does not survive a date of distribution which may reasonably be expected to occur within the beneficiary’s lifetime, the accrued benefit is to be paid to such persons as the beneficiary may appoint, or is to be paid to one or more designated alternate takers (other than the grantor or the grantor’s spouse living with the grantor) or such alternate taker or the shares of such alternate takers have been irrevocably specified in the trust instrument;

(d) Exercisable only during (i) the existence of a power exercisable by a related or subordinate trustee of the class hereinafter described where the exercise of the power does not affect the interest of the spouse or any child of the grantor or where the power is exercisable only with the concurrence of an unrelated and nonsubordinate trustee) or

(5) By any person or persons other than as trustee.

(4) By any trustee or trustees, and the exercise of the power is subject to the approval or consent of any person or persons (other than such trustee or trustees) of the grantor or spouse living with the grantor, or both, in the capacity of trustee—and

(5) If such power is one:

(a) To pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite external standard. Such standard must be set forth in the trust instrument and must consist of needs and circumstances of the beneficiaries.

(b) To pay out corpus to or for any current income beneficiary, if the power is not limited by a reasonably definite external standard, provided that any such payment must be chargeable against the proportionate share of corpus held in trust for the payment of income to such beneficiary as if such corpus constituted a separate trust;

(c) To distribute or apply income to or for any current income beneficiary or

§ 59.22 (a)–(2)
change, or otherwise deal with or dis-possess the trust property or income for less than a reasonable and full consideration in money or money's worth, or is authorized to lend the trust property or income to third persons for the use of the interest. On the other hand, such authority may be indicated by the actual administration of the trust.

(c) Limitations of section. Despite the limitations of section (b), the grantor of a trust directing the payment or application of the income therefore in satisfaction of the grantor's legal obligations shall continue to be taxable on the income. The grantor may also be taxable on the income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the trust as such as defined in paragraphs (c) (d) and (e) of this section. Thus, the provi-sions of this section do not affect the principles governing the taxability of future income to the assignee thereof, whether or not the assignment is by means of a trust. Nor, for example, do the provisions of this section affect the applicability of section 9 (a) (1) to the creator of a family partnership. See also sections 168 and 167.

§ 39.22 (a)–22 Trust income taxable to person other than grantor Where a person other than the grantor of property transferred in trust has a power exercisable at any time to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person. Even though such a power has been partially or otherwise modified, so that the person holding it can no longer vest the corpus or the income of the trust in himself, the income shall continue to be taxable to such person, if after such release or modifications, he has retained such control of the trust as would, within the principles of § 39.22 (a)–21, subject a grantor of such a trust to tax on the income thereof; if such attachment or release were to the extent of the extent to which the taxability of such amounts is in no way dependent upon the method of accounting employed by the patron or upon the basis, cash, accrual or other-wise, upon which the net income of such patron is computed.

(b) Exemptions (1) Amounts allocated to a patron on a patronage basis by a cooperative association with respect to products marketed for such patron, or with respect to supplies, equipment, or other property the cost of which was deductible by the patron under section 23, shall be included in the computation of the gross income of such patron to the following extent: (i) If the allocation is in cash, in the amount of cash received. (ii) If the allocation is in merchandise, to the extent of the fair market value of such merchandise at the time of receipt by the patron. (iii) If the allocation is in the form of capital stock, revolving fund certificates, certificates of indebtedness, letters of ad-dress, revolving certificates or similar docu-ments—

(a) To the extent of the face amount of such documents, if the allocation was made subject to the provisions of section 60 or a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the coop-erative association of the amount allocated. For this purpose, it is immaterial whether such allocation was made within the time required by § 39.101 (12)–4 (a) (2).

(b) To the extent of the face amount of such documents, if the allocation was made with respect to patronage of a year preceding the taxable year from amounts retained as "reasonable reserves" under § 39.101 (12)–4 (a).

(c) To the extent of the cash or mer-chandise received in redemption or satis-faction of such documents (except those which are negotiable instruments) at the time of receipt, or of the face amount of such cash or mer-chandise by the patron, where such allocation was not made in pursuance of the valid obligation referred to in subdiv-sion (a) of this subparagraph, or of reasonable reserves under § 39.101 (12)–4 (a), re-ferring to subdivision (b) of this para-graph. Where, in such case, the documents allocated are negotiable instru-ments, such documents shall be includible in the income of the patron to the extent of their fair market value at the time of their receipt.

(2) Amounts which are allocated on a patronage basis by a cooperative association with respect to supplies, equipment, or services the cost of which was not de-ductible by the patron under section 23, are not includible in the computation of the gross income of such patron; how-ev-er, in the case of such amounts which are allocated with respect to capital assets defined by subdivision 117 (a) (1) or property used in the trade or business within the meaning of section 117, (j), shall, to the extent set forth in subdivi-sions (1) (ii), and (iii) of subparagraph (a) of this paragraph, be taken into section 113 the cost or other basis of the assets or property purchased for the patron.
ance policies, paid by reason of the death of an insured to his estate or to a beneficiary (individual, partnership, trust, or corporation) held by an express contract, to the estate or to a beneficiary, except in the case of certain amounts paid by reason of the death of a deceased employee by a profit-sharing plan established by an employer under an agreement making provision for the employer to pay interest thereon, the interest payments must be included in gross income.

§ 39.22 (b) (1)–(2) Death payment by employer—amounts paid by reason of the death of an employee

(a) Amounts, not in excess of $5,000, paid by an employer in pursuance of an express contract to the estate or to a beneficiary (individual, partnership, trust, or corporation) held by an express contract, to the estate or to a beneficiary, except in the case of certain amounts paid by reason of the death of a deceased employee by a profit-sharing plan established by an employer under an agreement making provision for the employer to pay interest thereon, the interest payments must be included in gross income.

(b) Where a payment is made on account of the death of an employee by a profit-sharing plan established by an employer, the amount paid by the employer shall be deemed to exist only if (1) the employer, at the time of the death of the employee, had an established plan (or program having the effect of a plan) making provision for such payments in the case of his employee generally, or for a class or classes of his employees. In the latter case, the contract will be deemed to exist between the employer and the members of the class or classes of employees to whom the plan payments paid under such plan had been communicated to such employees and had not been rescinded before the death of the employee to whom the particular payment relates. Communication of an employer's plan or program to his employees may be made in different ways, such as by publishing or distributing to the employees concerned printed notices approved by the board of directors which created the plan, or by distributing to the employees a booklet containing an explanation of the plan and the rights of the participants. The difference of $5,000 ($5,600 ($8,000 minus $2,400) payable to the beneficiary of B only by reason of the death of B, is considered an amount payable solely by reason of B's death. Accordingly, $5,000 may be excluded from the gross income of the beneficiary receiving such payment.

Example (1). The X Corporation established a profit-sharing plan, the benefits of which were payable to the beneficiary of A only by reason of the death of B. No exclusion from gross income may be made by the beneficiary with respect to such payment since A, prior to his death, had a nonforfeitable right to the payment.

§ 39.22 (b) (2) Statutory provisions; exclusions from gross income; annuities, etc.

(1) The following items shall not be included in gross income and shall be excluded from taxation under this chapter:

(a) Annuities, etc.—(A) In general. Amounts received (other than amounts paid in respect of the death of an employee or interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, if such amounts are treated as payments of amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not awarded to the employee, (B) In the case of payments for life, 120 months certain, or on account of the death of the insured, 10 percent interest per annum on the amount received shall be excluded from the gross income of such beneficiary. Where such payments are made by reason of the death of an employee by a profit-sharing plan established by an employer under an agreement making provision for the employer to pay interest thereon, the interest payments must be included in gross income.

(b) Where a payment is made on account of the death of an employee by a profit-sharing plan established by an employer, the amount paid by the employer shall be deemed to exist only if (1) the employer, at the time of the death of the employee, had an established plan (or program having the effect of a plan) making provision for such payments in the case of his employee generally, or for a class or classes of his employees. In the latter case, the contract will be deemed to exist between the employer and the members of the class or classes of employees to whom the plan payments paid under such plan had been communicated to such employees and had not been rescinded before the death of the employee to whom the particular payment relates. Communication of an employer's plan or program to his employees may be made in different ways, such as by publishing or distributing to the employees concerned printed notices approved by the board of directors which created the plan, or by distributing to the employees a booklet containing an explanation of the plan and the rights of the participants. The difference of $5,000 ($5,600 ($8,000 minus $2,400) payable to the beneficiary of B only by reason of the death of B, is considered an amount payable solely by reason of B's death. Accordingly, $5,000 may be excluded from the gross income of the beneficiary receiving such payment.

Example (1). The X Corporation established a profit-sharing plan, the benefits of which were payable to the beneficiary of A only by reason of the death of B. No exclusion from gross income may be made by the beneficiary with respect to such payment since A, prior to his death, had a nonforfeitable right to the payment.

§ 39.22 (b) (2) Statutory provisions; exclusions from gross income; annuities, etc.

(1) The following items shall not be included in gross income and shall be excluded from taxation under this chapter:

(a) Annuities, etc.—(A) In general. Amounts received (other than amounts paid in respect of the death of an employee or interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, if such amounts are treated as payments of amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not awarded to the employee, (B) In the case of payments for life, 120 months certain, or on account of the death of the insured, 10 percent interest per annum on the amount received shall be excluded from the gross income of such beneficiary. Where such payments are made by reason of the death of an employee by a profit-sharing plan established by an employer under an agreement making provision for the employer to pay interest thereon, the interest payments must be included in gross income.

(b) Where a payment is made on account of the death of an employee by a profit-sharing plan established by an employer, the amount paid by the employer shall be deemed to exist only if (1) the employer, at the time of the death of the employee, had an established plan (or program having the effect of a plan) making provision for such payments in the case of his employee generally, or for a class or classes of his employees. In the latter case, the contract will be deemed to exist between the employer and the members of the class or classes of employees to whom the plan payments paid under such plan had been communicated to such employees and had not been rescinded before the death of the employee to whom the particular payment relates. Communication of an employer's plan or program to his employees may be made in different ways, such as by publishing or distributing to the employees concerned printed notices approved by the board of directors which created the plan, or by distributing to the employees a booklet containing an explanation of the plan and the rights of the participants. The difference of $5,000 ($5,600 ($8,000 minus $2,400) payable to the beneficiary of B only by reason of the death of B, is considered an amount payable solely by reason of B's death. Accordingly, $5,000 may be excluded from the gross income of the beneficiary receiving such payment.

Example (1). The X Corporation established a profit-sharing plan, the benefits of which were payable to the beneficiary of A only by reason of the death of B. No exclusion from gross income may be made by the beneficiary with respect to such payment since A, prior to his death, had a nonforfeitable right to the payment.
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, or any interest therein, shall be included in the income of the employee. In all other cases, if the annuity required to be included in income under subparagraph (3) is paid any of the consideration for the annuity, the annuity shall be included in his income. In the case of a transfer for a valuable consideration, if any, that may be considered as such, of such contract or interest thereunder, the consideration for such annuity or endowment contract for taxable years ending before but not on December 31, 1948. Appropriate adjustment will be required with respect to such payments, or portion thereof, so included as form the basis of a pending or successful claim or suit for refund. For definition of "annuity" see § 39.22 (b) (2)–2.

§ 39.22 (b) (2)–2 Annuities. (a) As used in section 22 (b) (2) (A), "annuities amounts received as an annuity under an annuity or endowment contract" means annuities based upon the life expectancy and survival expectancy tables payable over a period longer than one year received in periodical installments whether annually, semiannually quarterly, monthly, or otherwise. For purposes of determining the taxable amounts of annuity payments to be received 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 annuitant is paid the annuity amount received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. Annuities paid to retired employees pursuant to the Civil Service Retirement Act of May 29, 1930, as amended and to section 22 (b) (2) (B), the aggregate premiums or consideration paid for such annuities being the total of the amounts previously withheld from the compensation of the employees.

(c) Joint and survivor annuities. For purposes of subparagraphs (A) and (B) of this paragraph, where annuities are paid by a surviving annuitant under a joint and survivor annuity contract and the basis of such survivor annuity contract is deductible under section 23 (p) (1) (B), an annuity contract is purchased for an employee by an employer section 101 (1) the annuitant shall include in his income the amounts received under such contract for the year received except that if the employee paid any of the consideration for the annuity, 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 employee for the first annuitant and the number of months in respect of which the installment is paid. As soon as the annuitant is paid the annuity amount received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income.

The application of this paragraph may be illustrated by the following examples:

Example (1). A bought an annuity on August 1, 1947, each contributed $3,000 toward the purchase of a joint and survivor's annuity of $125,000 per year, payable in monthly installments. On the date of his death, $500 being insurance and policy.
RULES AND REGULATIONS

12. The full amount of the annuity will not become includible in gross income until $60,000 shall have been recovered.

Example (2). H, an employee of the M Corporation, transferred to C Corporation, on January 1, 1959, a single premium whole life insurance policy with a face amount of $10,000 in consideration of $6,000 previously paid by H, and the premiums, which were guaranteed to be paid for 20 years, were subsequently paid by C Corporation in instalments. If C Corporation transferred the policy to the N Corporation at $10,000, the $10,000 contributed by the transferor would be exempt. If the transferor, however, transferred the policy to N Corporation at $10,000 for a single premium of $600, the $600 contributed by the transferor would be includible in his gross income.

§ 39.22 (b) (2)–3 Transfers of life insurance, endowment, or annuity contracts. (a) In the case of a transfer for a valuable consideration, to a spouse or former spouse, or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, to which section 22 (k) or (l) applies, the only actual value of the consideration given for such transfer and the amount of the premiums and other sums subsequently paid by the transferee shall be excluded from gross income, in lieu of the amounts provided in §§ 39.22 (b) (1)–1, 39.22 (b) (2)–1, or 39.22 (b) (2)–2 to be excluded with respect to payments under such life insurance, endowment, or annuity contract. In the event of such death of the transferee (other than to the insured), the rule stated in the preceding sentence transforms the exemption applicable under section 22 (b) (1) or (b) (2) to a transferee without valuable consideration (as stated in the preceding sentence) to such transferee were without valuable consideration.

Thus, where a corporation acquires a life insurance policy, or an annuity contract, or any interest therein, from another corporation in a tax-free reorganization, if the proceeds received under the policy by reason of the death of the insured would be exempt from taxation in the hands of the transferee transferred by the transferor, such proceeds would be exempt from taxation in the hands of the transferee, because the basis is determined with reference to the basis in the hands of the transferor.

(b) The following examples illustrate the application of the provisions of paragraph (a).

Example (1). The A Corporation procures, for the full amount of a life insurance policy in the face amount of $1,000 upon the life of X, one of its officers, naming the B Corporation as beneficiary. During the time the policy is held by the corporation, the proceeds of the policy paid by reason of the death of X are made available to the corporation. If the A Corporation transfers the policy to the B Corporation for a consideration of $1,000, the consideration paid by the B Corporation for a single premium of $600 in cash, and not pursuant to a tax-free exchange or reorganization, the proceeds paid to the B Corporation by reason of the death of X would be taxable to the extent of $400 ($1,000 minus $600). Similarly, if, before the death of X, the B Corporation had transferred the policy to the C Corporation in a tax-free reorganization, the proceeds in the hands of the C Corporation would be taxable to the extent of $400, this consideration paid by C Corporation to B Corporation, would be exempt.

Example (2). In 1956, Y took out an annual premium 20-year endowment policy having a maturity value of $20,000. After payment of premiums totaling $6,500, Y assigned the policy to the M Corporation for a consideration of $4,000. If the M Corporation held the policy and paid the premiums thereon, the $20,000 received at maturity of the policy (while A is still alive) would be includible in the income of the M Corporation, except to the extent of $6,500 consideration paid by it and the premiums which it paid after the transfer. If, prior to the maturity of the policy, the C Corporation transferred its assets, including the policy, to the N Corporation in a tax-free reorganization, the N Corporation would hold the policy until maturity (1862), paying all premiums due thereon after such transfer, the $6,500 received by the N Corporation would be includible in its gross income, except to the extent of the $4,000 consideration paid by the M Corporation for the transfer of the policy from Y and the aggregate premiums paid by the M and N Corporations upon the policy.

§ 39.22 (b) (2)–4 Annuity, etc., payments in discharge of alimony obligation. The full amount of any periodic payment received under a life insurance, endowment, or annuity contract shall be includible in the income of the employee, but any amount received or made available to the employee under the annuity contract shall be includible in the gross income of the employee in the taxable year in which received or made available, except that if the employee contributed any of the consideration for the annuity, the annuity shall be included in his income as provided in § 39.22 (b) (2)–2, the consideration for the annuity being considered the amount of such contribution.

Example (2). If an employee purchases an annuity contract which is not under a plan with respect to which his contribution is deductible under section 23 (p) (1) or (2) the employee is not required to include such amount in his income in the taxable year in which such contribution is made. The amount received under the annuity contract based on the employee's service prior to the time such contract was purchased shall be includible in the income of the employee in the taxable year in which such contribution is made.

Example (3). If an employee purchases an annuity contract which is not under a plan with respect to which his contribution is deductible under section 23 (p) (1) or (2) and such contribution is made for the life of the employee, such contribution shall be includible in the income of the employee in the taxable year in which such contribution is made.

(a) The amount of the annuity required to be included in the income of the employee under section 23 (b) (2) (A) if the employee's rights under the annuity contract in such a case were forfeitable at the time the employee's contribution was made for the annuity contract, even though they become nonforfeitable at a later date, the amount of such contribution is not required to be included in the income of the employee, but any amount received or made available to the employee under the annuity contract shall be includible in the gross income of the employee in the taxable year in which received or made available, except that if the employee contributed any of the consideration for the annuity, the annuity shall be included in his income as provided in § 39.22 (b) (2)–2. The fact that an employee may not live a sufficient length of time to enjoy any benefits under the annuity contract, or that no payments will be
made under any circumstances to his estate or other beneficiary, will not make the annuity contract forfeitable.

(b) If an employer has purchased annuity contracts and transferred the same to a trust, the employee may not make contributions to a trust for the purpose of providing annuity contracts for his employees as provided in section 165 (d) (see § 39.165–7) the amount so paid or contributed from such proceeds shall be included in the income of the employee, but any amount received or made available to the employee under the annuity contract shall be includable in the gross income of the employee in the taxable year in which received or made available. In such case the amount paid or contributed by the employer shall not constitute consideration paid by the employee for such annuity contract in determining the amount of annuity payments required to be included in the gross income of the employee unless the employee has paid income tax for any taxable year beginning prior to January 1, 1949, with respect to such payment or contribution by the employer for such year and such amount is credited or refunded to the employee. In the event such tax has been paid and not credited or refunded the amount paid or contributed by the employer for such year shall constitute consideration paid by the employee for the annuity contract in determining the amount of the annuity required to be included in the income of the employee. Any amount paid or contributed to a trust or if an employer has made under any circumstances to his estate or other beneficiary, will not make the annuity contract forfeitable.

(c) By a will, a bequest, a gift, a bequest, a devise, or an inheritance.

§ 39.22 (b) (3) Statutory provisions; exclusions from gross income; gifts, bequests, devises, and inheritances,

(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) Gifts, bequests, devises, and inheritances. The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it is considered a gift, bequest, devise, or inheritance of income from property.

§ 39.22 (b) (4) Statutory provisions; exclusions from gross income; tax-free interest.

(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) Tax-free interest. Interest upon (A) obligations of a corporation, (B) obligations of a trust or estate, (C) obligations of a State, (D) obligations of a political subdivision thereof, or (E) obligations of a corporation, (F) obligations of a trust or estate, (G) obligations of a State, (H) obligations of a political subdivision thereof, or (I) obligations of a corporation.
Section 7 of the Federal Reserve Act of 
December 23, 1913 (12 U. S. C. 531), provides that Federal reserve banks, 
including the capital stock and surplus 
therein and the income derived there-
from, shall be exempt from taxation, 
except taxes upon real estate. Section 4 of the Federal Home Loan Bank Act (12 
U. S. C. 1433) provides that the Federal 
Home Loan Bank including its franchise, 
its capital, surplus, and surplus, its ad-
vanced, and its income, except taxes from 
all taxation, except taxes upon real 
state. Section 5 (b) of the Homestead 
Act of 1933 (12 U. S. C. 1442 (b)) provides that shares of Fed-
eral savings and loan associations shall, 
both as to their value and the income 
therefrom, be exempt from all taxation 
(except surtaxes, estate, inheritance, and 
gift 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, and Federal reserve banks held 
in the case of shares issued before March 
28, 1942, subject to the income tax; and 
income consisting of dividends on share 
issues on or after March 28, 1942, subject 
as to their value and the income therefrom, 
and held in the case of shares issued before March 28, 1942, subject to the 
income tax.
mediate credit banks, and the income de-
U. S. passbook containing a certificate issued prior
clude Treasury certificates of indebted-
States after September
generally exempt from tax, m the case
act of Congress, if such corporation is an
interest upon the obligations of the United
before March 1, 1941.

Interest on promissory notes held
joint-stock land banks, or Federal inter-

Example (2). The X Bank, a member of a
Federal reserve bank, owns 50 shares of
Federal reserve bank stock, evidenced by
Federal reserve bank issues a 10-share certifi-
May 28, 1942. On December 31, 1942, the X Bank
reduces the amount of its capital stock, as a
result of which it is required to reduce the
amount of its Federal reserve bank stock. The
Federal reserve bank issues a 10-share certifi-
the 10 new certificates, evidencing the
new stock issued, evidenced evidence by such certificate are deemed to
have been issued before March 28, 1942. On
December 31, 1942, the X Bank increases the
amount of its capital stock, as a result of which it
is required to purchase 10 additional shares of
the Federal reserve bank stock. The
Federal reserve bank issues a 10-share certifi-
the 10 shares evidencing the
new stock issued, evidenced evidence by such certificate are deemed to
taxable before March 28, 1942.

Example (3). A, the owner of a
savings share account, in the amount of $100, in 40
shares. The payment of the 40-share certifi-
cate to the Federal reserve bank and receives a
new 10-share certificate. The 40 shares evidences evidencing evidence by such certificate are deemed to
taxable before March 28, 1942.

Invested upon notes secured by mortgages executed to
Federal agencies or instrumentalities.

Section 26 of the Federal Farm Loan Act of July 17, 1916 (12 U. S. C. 391) and section 210 of such act, as
added by section 2 of the act of March 4, 1922 (12 U. S. C. 1111), provide that
mortgage loans issued by Federal land banks and
Federal Intermediate credit banks, the amount of
such bonds is subject to surtax and must
be included in gross income.

Interest on Treasury bonds is exempt from Federal income taxes except
surtaxes imposed upon the income
on profits of individuals, associations, or corporations. However, interest on
an aggregate of not exceeding $5,000 prin-
cipal amount of such bonds is also
exempt from surtaxes. Interest in excess of this aggregate of not exceeding $5,000 prin-
cipal amount of such bonds is subject to surtax and must
taxable income.

Interest credited to postal savings accounts upon moneys deposited before
March 1, 1941, in postal savings banks is exempt from income taxes.

Issued on or after March 1, 1941. (1) By virtue of the provisions of sections
4 and 5 of the Public Debt Act of 1911, the
exemption provided in paragraph
(a) of this section is limited to such bonds, debentures, notes, or certificates of
indebtedness as have been issued be-
fore March 1, 1941. Under such provi-
sions interest upon obligations issued on
or after March 1, 1941, by the United States, or any agency or instrumentalty
thereof, shall not have any exemption, as
such, from Federal tax except in respect
of any such obligations which the United States Maritime Commission or the Fed-
eral Housing Administration has, before
March 1, 1941, contracted to issue at a
future date. The interest on such obli-
gations so contracted to be issued shall bear such tax-exemption privileges as
were at the time of such contract pro-
vided in the law authorizing their issu-
ance. For the purposes hereof, under
sections 4 (a) of the Public Debt Act of
1941, a Territory, a possession of the
United States, and the District of Colum-
bia, and any agency or instrumentalty
of, and any agency or instrumentalty of
any one or more of the foregoing, shall
be considered as an agency or instrumen-
tality of the United States.

(2) In the case of obligations issued as
the result of a refunding operation, as,
for example, where a corporation
exchanges bonds for previously issued
bonds, the refunding obligations are
exempt, for the purposes of this section,
to have been issued at the time
exchange rather than at the time the
original bonds were issued.

Interest upon Treasury certificates of indebtedness is entirely exempt from Federal income taxes. Interest upon
Treasury notes is exempt only to the extent provided in the acts authorizing the issue thereof, as amended and
supplemented.

§ 39.22 (b) (4)-6 Interest upon United States obligations in the case of nonresident aliens and foreign corporations, not engaged in business in the United States. Every interest, or any part thereof, shall be exempt from tax.

§ 39.22 (b) (5) Statutory provisions; exclusions from gross income; compensation for injuries or sickness.

§ 39.22 (b) (5) Compensation for injuries or sickness. Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 22 (a) (1) of the Act of May 12, 1924, the amount so attributable, together with the amount, if any, of any other compensation, shall be considered as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness received by any person who served in the armed forces of any country.
§ 39.22 (b) (8)-9 Statutory provisions; exclusions from gross income; ministers; income exempt under treaty; miscellaneous; income from discharge of indebtedness.

Sec. 22. Gross income. * * *

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

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

(9) Income exempt under treaty. Income of any kind, to the extent required by any treaty obligation entered into by the United States; 

Sec. 39.113 (b). Income from discharge of indebtedness.

(a) Section 22 (b) (9) provides a method whereby a corporation may elect to have excluded from its gross income the amount of the income attributable to a discharge, within the taxable year, of its indebtedness or of indebtedness for which it is liable, as for example, in the case of a debt arising from an assumption of liability of another corporation. To be entitled to the benefits of section 22 (b) (9) a corporation must file with its return for the taxable year a certificate or statement certifying that it has satisfied the conditions prescribed in the regulations in effect at the time of the discharge of any indebtedness for which it is liable and that each such discharge was not included in gross income and shall be exempt from taxation under this chapter:

(10) Income from discharge of indebtedness of a railroad corporation. The amount of any income attributable to the discharge, within the taxable year, of any indebtedness of a railroad corporation, as defined in section 77 of the National Bankruptcy Act, is to be included in the gross income and the amount of 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 be included in gross income and shall be exempt from tax.

§ 39.22 (b) (8)-9 Statutory provisions; exclusions from gross income; ministers; income exempt under treaty; miscellaneous; income from discharge of indebtedness.

Sec. 22. Gross income. * * *

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

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

(9) Income exempt under treaty. Income of any kind, to the extent required by any treaty obligation entered into by the United States;

Sec. 39.113 (b). Income from discharge of indebtedness.

(a) Section 22 (b) (9) provides a method whereby a corporation may elect to have excluded from its gross income the amount of the income attributable to a discharge, within the taxable year, of its indebtedness or of indebtedness for which it is liable, as for example, in the case of a debt arising from an assumption of liability of another corporation. To be entitled to the benefits of section 22 (b) (9) a corporation must file with its return for the taxable year a certificate or statement certifying that it has satisfied the conditions prescribed in the regulations in effect at the time of the discharge of any indebtedness for which it is liable and that each such discharge was not included in gross income and shall be exempt from taxation under this chapter:

(10) Income from discharge of indebtedness of a railroad corporation. The amount of any income attributable to the discharge, within the taxable year, of any indebtedness of a railroad corporation, as defined in section 77 of the National Bankruptcy Act, is to be included in the gross income and the amount of 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 be included in gross income and shall be exempt from tax.

§ 39.22 (b) (8)-9 Statutory provisions; exclusions from gross income; ministers; income exempt under treaty; miscellaneous; income from discharge of indebtedness.

Sec. 22. Gross income. * * *

(b) Exclusions from gross income. The following items shall not be included in
cross income and the amount of the de-
duction attributable to such discount
shall be disallowed as a deduction. The
amortization premium and unamortized
discount, as the case may be, is in each
instance to be computed as of the first
lay of the taxable year in which the
charge of undedenting occurred.

(e) The provisions of section 22 (b) 
and this section are applicable with
respect to any discharge occurring in a
taxable year beginning before January
1, 1955.

§ 39.22 (b) (11) Statutory provisions;
exclusions from gross income; improve-
ments by lessee on lessor's property.
Sec. 22. Gross income. * * *
(b) Exclusions from gross income. The
following items shall not be included in gross
income and shall be exempt from taxation
under this chapter: * * *
(11) Improvements by lessee on lessor's
property. Income, other than rent, derived
by a lessee of real property upon the termina-
tion of a lease, representing the value of such
property attributable to buildings erected or
other improvements made by the lessee.
[Sec. 22 (b) (11) as added by sec. 115 (a),
Rev. Act 1942]

§ 39.22 (b) (11) Exclusion from gross
income of lessor of real property of
value of improvements made by the
lessee. (a) Income derived by a lessor of real
property upon the termination, through
forfeiture or otherwise, of the lease of such property and attributable to-buildings or other
improvements made by the lessee upon the
leased property is excluded from gross
income. However, where the facts dis-
close 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 liquid-
ation. The exclusion applies only with
respect to the income realized by the
lessee upon the termination of the lease
and has no application to income, if any,
in the form which may be derived
by a lessor during the period of the
lease and attributable to buildings
erected or other improvements made by
the lessee. It has no application to
income which may be derived by the
lessee upon the termination of the
lease but not attributable to the value of such
buildings or improvements. Neither
does it apply to income derived by the
lessee subsequent to the termination of
the lease incident to the ownership of
such buildings or improvements.
(b) The provisions of this section may be
illustrated by the following example:
Example. The A Corporation leased in
1945 for a period of 80 years an unimproved
real property to the B Corporation under a
lease providing that the B Corporation erect
on the leased property a building costing
$600,000, in addition to paying the
A Corporation a lease rental of $10,000 per
annum beginning on the date of completion
of the improvements. The sum of $600,000
being placed in escrow for the payment of
the rental. The building was completed on
January 1, 1948. Building improvements made
by the lessee on the leased property would become the absolute property of the A Corporation on the termin-
ation of the lease by forfeiture or otherwise
and that the lessor would become entitled on
such section 102, or such Subchapter A. As
used in this subparagraph to refer to
Chapter 1, section 102, and Subchapter A in
the case of taxable years not subject to the
Internal Revenue Code, shall be held to be
made to corresponding provisions of prior
revenue Acts.
[Sec. 22 (b) (12) as added by sec. 116 (a),
Rev. Act 1942]

§ 39.22 (b) (12) Recovery of certain
items previously deducted—(a) In gen-
eral. Section 22 (b) (12) provides that
income attributable to improvements dur-
ing any taxable year of bad debts, prior
taxes, and delinquency amounts shall be
excluded from gross income to the extent
of the "recovery exclusion" with respect to
such items. The rule of exclusion so
prescribed by statute applies equally with
respect to all other losses, expenditures,
and accruals made the basis of deduc-
tions from gross income for prior taxable
years, including war losses referred to in
section 127, but not including deductions
with respect to depreciation, depletion,
amortization, or amortizable bond pre-
miums. See Section 39.113 (b) 
320 U. S. 489. The term "recovery exclu-
sion" as used in this section means
accordingly an amount equal to the port-
ion of the "recovery exclusion", of bad
debts, prior taxes, and delinquency amounts (the items specifically referred to in section 22 (b) (12)) and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction of any tax of the taxpay-
er under chapter 1 of the Internal
Revenue Code (other than a tax under
section 102 or under corresponding pro-
visions of prior revenue laws.
(1) Section 22 (b) (12) items. The
term "section 22 (b) (12) items" as used
in this section means those bad debts,
prior taxes, delinquency amounts, and all
other items subject to the rule of exclu-
sion, for which a deduction or credit was
allowed for a prior taxable year. If a
bad debt was previously charged against
a reserve by a taxpayer under the method
of treating bad debts, it was not
deducted, and is therefore not con-
sidered a section 22 (b) (12) item. Bad
debts, prior taxes, and delinquency amounts are defined in section 22 (b)
(12) (A) (B), and (C) respectively. A
typical example of a delinquency amount
described in that section is interest upon
delinquent taxes. A typical example of
the other items not expressly referred to
in section 22 (b) (12) but nevertheless
subject to the rule of exclusion is a loss
sustained upon the sale of stock and later
collected, in whole or in part, through an
action against the party from whom
such stock had been purchased.
(2) Definition of "recovery exclusion.
Recovers result from the receipt of amounts in respect of the previously deducted or credited section 22 (b) (12) items, such as from the collection or sale of a bad
debt, refund or credit of taxes paid, or
cancellation of taxes accrued. Care
should be taken in the case of bad debts
which were treated as only partially
worthless in prior years to distinguish
between the item described in section
22 (b) (12), that is, the part of such bad
debt which was deducted, and the part

§ 39.22 (b) (12)
not previously deducted, which is not a section 22 (b) (12) item, and shall be considered as collected. The collection of the part not deducted is not considered a "recovery." Furthermore, the term "recovery" does not include the sale of any bond purchased for $40 and later recovered of an amount on account of a section 22 (b) (12) item which, together with previous such receipts, exceeds the deduction or credit previously allowed for such item. For instance, if a corporate bond purchased for $40 and later recovered of $50 or $100 or more, the term "recovery" does not include the $40 recovery of a section 22 (b) (12) item. Such gain is in no case excluded from gross income under section 22 (b) (12) regardless of whether the $40 recovery is or is not excluded.

(3) Treatment of debt deducted in more than one year by reason of partial worthlessness. In the case of a bad debt deducted in parts in two or more years, such deduction as a part of the debt is considered a separate section 22 (b) (12) item. A recovery with respect to such debt is considered first a recovery of the item for the year of the recovery (even though, as the normal tax and surtax) other than the tax imposed on corporations by section 102 for the improper accumulation of surplus, or in any tax imposed under the section 22 (b) (12) item. For the purpose of such recovery exclusions, consideration must be given to the effect of net operating loss carry-backs or capital loss carry-overs.

(4) Special provisions as to worthless bonds, etc., which are treated as capital losses. Bad debts on account of certain worthless bonds, etc., which are treated as capital losses, are considered recovered in the order of the taxable years for which they were deducted, beginning with the latest. The recovery exclusion for any such item is determined by considering the recovery of such item under this subdivision, the computations under both (1) and (2) of (a) for such item.

(5) Capital losses and credits are considered separately from recoveries of any items which were deducted or credited under section 22 (b) (12) items. This recovery is excluded from gross income under section 22 (b) (12) items for such original year.

(6) A taxpayer claiming a recovery exclusion shall submit, at the time the exclusion is claimed, the computation of the aggregate amount of such deductions and credits which could be disallowed without causing an increase in any tax of the taxpayer imposed under section 22 (b) (12) item and the computation showing the amount recovered in intervening years on account of all section 22 (b) (12) items deducted or credited for such original year for which such items were deducted or credited, and computations showing the amount recovered in intervening years on account of all section 22 (b) (12) items deducted or credited for such original year.
received for active service as a commissioned officer in the armed forces of the United States for service during any part of which such officer—

(i) Served in a combat zone after June 24, 1950, and prior to January 1, 1954, or

(ii) Was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone before January 1, 1954; but this clause shall not apply for any month during any part of which there are no combatant activities in any combat zone.

(c) Definitions. For the purposes of this paragraph:

(1) The term "commissioned officer" does not include a commissioned warrant officer;

(2) The term "combat zone" means any area which the President of the United States by Executive Order designates, for the purposes described in section 22 (b) (13), as an area in which armed forces of the United States are or have been engaged in combat; and

(3) The term "compensation" does not include pensions and retirement pay.

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whether or not it is received outside a combat zone or while the recipient is hospitalized or in a year (including a part of a year) after 1953. Except from that in which the service was rendered for which the compensation is paid, service is performed in a combat zone only if it is performed in an area which the President of the United States has designated by Executive order, for the purpose of section 22 (b) (13), as an area in which armed forces of the United States are or have engaged in combat, and it is performed on or after the date designated by the President by Executive order as the date of the commencing of combatant activities in such zone (except that the date June 24, 1950, in the combat zone designated in Executive Order 10195, shall be considered the date of the commencing of combatant activities in such zone).\]
the exclusion allowed to enlisted personnel under section 22 (b) (13) (A). The term "compensation," for the purpose of this section, does not include_pensions and retirement pay. As to who are members of the armed forces, see §3.3787-11.

(g) These exclusions are applicable without regard to the marital status of the recipient of the compensation, and if a husband and wife both meet the requirements of the statute, then each is entitled to an exclusion. In the case of a husband and wife domiciled in a State recognized for Federal income tax purposes as a community property State, any exclusion from gross income under section 22 (b) (13) operates before apportionment of the gross income of the spouses in accordance with community property law. For example, a man and his wife are domiciled in a community property State and he is enlisted as a commissioned officer, to the benefit of the exclusion of $100 for each month under section 22 (b) (13) (B). He receives $500 for active service for three months in a combat zone. Of such amount, $500 is excluded from gross income under section 22 (b) (13) (B) and only $400 is taken into account in determining the gross income of both husband and wife.

(b) A member of the armed forces is in active service if he is actually serving in the armed forces. Periods during which a member of the armed forces is absent from duty on account of sickness, wounds, leave, internment by the enemy, or other lawful cause are periods of active service. A member of the armed forces in active service in a combat zone who there becomes a prisoner of war or missing in action is deemed, for the purpose of section 22 (b) (13) and this section, to continue in active service in the combat zone for the period for which he is entitled to such status for military pay purposes. These exclusions apply to compensation received by a member of the armed forces rendered while in active service even though payment is received subsequent to discharge or release from active service. Compensation credited to a member of the armed forces in active service for a period subsequent to the established date of his death and received by his estate will be excluded under section 22 (b) (13) from the gross income of the estate to the same extent that it would have been excluded from the gross income of the decedent if he had lived and received such compensation.

§ 39.22 (b) (14) Statutory provisons; exclusions from gross income; mustering-out payments for military and naval personnel.

Sec. 22. Gross income. * * *

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

(14) Mustering-out payments for military and naval personnel. Amounts received during taxable years as mustering-out payments with respect to service in the military or naval forces of the United States:

[Sec. 22 (b) (14) as added by sec. 109, Rev. Act 1943]
§ 39.22 (b) (16) Statutory provision; exclusions from gross income; sports programs conducted for the American National Red Cross.

Sec. 22. Gross income. (b) Exclusions from gross income. The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(16) Sports programs conducted for the American National Red Cross. In the case of a taxpayer who is engaged in the furnishing of sports programs, amounts received as proceeds from a sports program conducted by the taxpayer if:

(A) The taxpayer agrees in writing with the American National Red Cross to conduct such sports program for the benefit of the American National Red Cross;

(B) The taxpayer turns over to the American National Red Cross all funds maintained for such sports program, minus the expenses paid or incurred by the taxpayer (1) which would not have been so paid or incurred but for such sports program, and (2) which would be allowable as deductions under section 28 (a) (1) (A) but for the last sentence thereof; and

(C) The facilities used for such program are not regularly used during the taxable year for the conduct of sports programs to which this paragraph applies.

Expenditures attributable to such amount paid by the taxpayer shall, as provided in section 113, increase the basis of the taxpayer's property, to the extent of such repayment as such expenditures had been made at the time of such repayment. Such expenditures shall be the expense of the payment of scholarship or fellowship aid, and the proceeds received on such payment shall be allowable as deductions under section 163 (a).

§ 39.22 (c) Statutory provision; gross income; inventories.

Sec. 22 Gross income. * * *

(c) Inventories. Whenever in the opinion of the Commissioner the use of Inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, shall prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income of the taxpayer. Inventories shall be made in writing and filed with the Commissioner as provided in § 39.41.2. Goods taken in the inventory which have been so intermingled with or fabricated from goods ordered for future delivery, transfer of title to which has not yet been effected, shall be included in the inventory at cost of the goods so intermingled with or fabricated from, or transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year in which the quantity of goods in the inventory has been acquired. See § 39.41.2 (d) as to last-in-first-out inventories. Where goods are carried on hand in a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased and transferred, or sold, the cost thereof will be the actual cost of the goods purchased and transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such books inventories shall be verified by an examination of the books of account at reasonable intervals and adjusted to conform therewith.

Inventories should be recorded in a legible manner, properly computed and summarized, and should be reported as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted.

The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with the regulations in this part, viz:

(1) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(2) Taking work in process, or other parts of the inventory, at a nominal price or at less than the proper valuation.

(3) Omitting portions of the stock on hand.

Using a constant price or nominal value for so-called normal quantity of materials or goods in stock.
§ 39.22 (c)-3 Inventories at cost. Cost means: (a) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(b) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except that cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(c) In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the production thereof, (2) expenditures for labor, (3) indirect expenses incident to and necessary for the production of the particular article, including such indirect expenses a reasonable proportion of which is not allowable as a direct cost of the production of the particular article, including in such indirect expenses material, labor, and burden) in goods purchased and on hand, exclusive, however, of materials, labor, and burden, which varies materially from the actual prices so ascertained will not be accepted as reflecting the market.

(d) Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.

§ 39.22 (c)-5 Inventories by dealers in securities. A dealer in securities who in his books of account regularly inventories such securities on hand either:

(a) At cost,

(b) At cost or market, whichever is lower, or

(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that at the end of each calendar year and at such additional times as may be required by the Commissioner pursuant to a written application therefor, filed with the Commissioner as provided in § 39.22 (c)-5, a dealer in securities in whose books of account separate computations of the gain or loss from the sale of the various lots of securities sold are made on the basis of the cost of each lot shall be required to report the gain or loss from such sales on the basis of cost or market, whichever may be the lower, and to compute the gain or loss from the sale of securities on the basis of such method as the Commissioner may require.

§ 39.22 (c)-6 Inventories of livestock raisers and other farmers. (a) A farmer may make his return upon an inventory basis instead of the cash receipts and disbursements basis or the current market basis. It is optional with the taxpayer which of these methods of accounting is used, but, having elected one method, the option so exercised 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 as provided in section 39.41 (a)-2.

(b) In any change of accounting from the cash receipts and disbursements basis to an inventory basis, adjustments shall be made, at the option of the taxpayer, in accordance with one of the two methods outlined in (1) and (2) below.

(1) Opening and closing inventories shall be used for the year in which the change is made. There should be included in the opening inventory all farm products (including 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 the tax shall be assessed and paid (if any be due) at the rate of tax in effect for that year. Ordinarily an adjustment sheet for the preceding year will be sufficient, but if, in the opinion of the Commissioner, such adjustment is not sufficient clearly to reflect income, adjustments for earlier years may be accepted or required. If it is impossible to render complete inventories for the preceding year or years, the Commissioner will accept estimates which, in his opinion, substantially reflect the income on the inventory basis for such preceding year or years; but inventories must not include real estate, buildings, permanent improvements, or any other assets subject to depreciation.

(2) In any event, adjustment sheets will be required, but the net income for the taxable year in which the change is made must be computed without deducting from the sum of the closing inventory and the sales and other receipts, the inventory of livestock, crops, and products at the beginning of the year; provided, however:

(1) That if any livestock, grain, or other property on hand at the beginning of the taxable year had been purchased and the cost thereof not charged to expense, only the difference between the cost and the selling value should be reported as income for the year in which sold;

(2) That if the cost of such property had been charged to expense for a previous year, the entire amount thereof must be reported as income for the year in which sold;

(3) Because of the difficulty of ascertaining the cost of livestock or other farm products, farmers who render their returns upon an inventory basis may value their inventories according to the "farm-price method," and farmers raising livestock may value their inventories as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase of farm products to which the taxpayer is a party in the regular course of business which has offered for sale such merchandise at prices lower than the current price as defined, the inventory may be valued at such prices less direct cost of delivery or disposition, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

(4) Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.
of animals according to either the "farm-price method" or the "unit-livestock-price method."

(d) The "farm-price method" provides for the valuation of inventories at market price less direct costs of production. If this method of valuing inventories is used, it must be applied to the entire inventory except as to livestock inventoried, at the taxpayer's election, under the "unit-livestock-price method." If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of valuing inventories from that employed in prior years, permission for such change shall first be secured from the Commissioner as provided in § 39.41-2.

(e) The "unit-livestock-price method" provides for the valuation of the different classes of animals in the inventory at a standard unit price for each animal within a class. A livestock raiser electing this method of valuing his animals must adopt a reasonable classification of the animals in his inventory with respect to the age and kind included so that the unit prices assigned to the several classes will reasonably account for the normal costs incurred in producing the animals within such classes. Thus, if a cattle raiser determines that it costs approximately $15 to produce a calf, and $75.50 each year to raise the calf to maturity, his classifications and unit prices would be as follows: calves, $15; yearlings, $98.50; 2-year-old steers, $124; 3-year-old steers, $37.50. The classification selected by the livestock raiser, and the unit prices assigned to the several classes, are subject to approval by the Commissioner upon examination of the taxpayer's return.

(f) A taxpayer who elects to use the "unit-livestock-price method" must apply it to all livestock raised, whether for sale or for breeding, draft, or dairy purposes. Once established, the unit prices and classifications selected by the taxpayer must be consistently applied in all subsequent years in the valuation of livestock inventories. No changes in the classification of animals or unit prices will be made without the approval of the Commissioner.

(g) A livestock raiser who uses the "unit-livestock-price method" must include in his inventory at cost any livestock purchased, except that animals purchased for breeding, dairy, or draft purposes can, at the election of the livestock raiser, be included in inventory or be treated as capital assets subject to depreciation after maturity. If the animals purchased do not mature at the time of purchase, the cost should be increased at the end of each accounting period in accordance with the established unit prices, except that the increase is to be made in the year of purchase if the animal is acquired during the last six months of that year. If the records maintained permit identification of a purchased animal, the cost of such animal will be equal to the cost of the inventory animal in the event of its sale or loss. Otherwise, the first-in-first-out method of valuing inventories must be applied.

If a taxpayer using the "farm-price method" desires to adopt the "unit-livestock-price method" in valuing his inventories of livestock, permission for the change shall first be secured from the Commissioner as provided in § 39.41-2. However, a taxpayer who has filed returns on the basis of inventories at cost, or cost or market whichever is lower, may adopt the "unit-livestock-price method" of valuing livestock without formal application for permission, but the classifications and unit prices selected are subject to approval by the Commissioner upon examination of the taxpayer's return. A livestock raiser who has adopted a constant unit price method of valuing livestock inventories and filed returns on that basis will be considered as having elected the "unit-livestock-price method."

(i) If returns have been made in which the taxable net income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding year. In this statement such adjustments or corrections are necessary to bring the closing inventory for the preceding year into agreement with the opening complete inventory for the current taxable year. If necessary, clearly to reflect income, similar adjustments may be made as at the beginning of the preceding year or years, and the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such year or years.

§ 39.22 (c)-7 Inventories of miners and manufacturers. A taxpayer engaged in mining or manufacturing who by a single process or uniform series of operations produces a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product, which in the aggregate will absorb the total cost of production, may, with the consent of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such method bears a reasonable relation to the respective selling values of the different kinds, sizes, or grades of product. See section 36 (d) as to last-in-first-out inventories.

§ 39.22 (c)-8 Inventories of retail merchants. (a) Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided the use of such a method is authorized by the Commissioner as provided in § 39.41-2. Under this method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs, less.

(2) The cost of the goods included in the opening inventory plus the cost of the goods purchased during the year, bears to (1).

The result 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.

(b) For further adjustments to be made in the case of a retail merchant using the last-in-first-out inventory method authorized by section 22 (d), see § 39.22 (d)-1.

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

(d) A taxpayer (other than one using the last-in-first-out inventory method) who previously has determined inventories in accordance with the method authorized, except that, to obtain a basis of approximate cost or market, whichever is lower, the practice has been followed, consistently and uniformly, of adjusting the retail selling prices included in the opening inventory and purchased during the year for mark-ups but not for mark-downs, may continue such practice subject to the conditions described in this section. The adjustments must be bona fide and consistent and uniform. Where mark-downs are not included in the adjustments, mark-ups made to cancel or correct mark-downs shall not be included; and the mark-ups included must be reduced by the mark-downs made to cancel such mark-ups.

(e) In no event shall mark-downs be based on actual reduction of retail sale prices, such as mark-downs based on depreciation and obsolescence, be recognized in determining the cost of the goods on hand at the end of the year.

(f) A taxpayer (other than one using the last-in-first-out inventory method) 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 permission to do so is obtained in accordance with, and subject to the terms provided by, § 39.41-2. A taxpayer filing a first return of income may adopt such practice subject to approval by the Commissioner upon examination of the return.

(g) A taxpayer using the last-in-first-out inventory method in conjunction with retail computations must adjust retail sales prices for mark-ups and mark-downs, in order that there may be reflected the approximate cost of the goods on hand at the end of the year regardless of market values.

§ 39.22 (c)-8
§ 39.22 (d) Statutory provisions; gross income; last-in-first-out inventory method.

SEC. 22. Gross income. * * *

(d) [Last-in-first-out inventory method.] (1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (e) in inventorying goods specified in the applicable regulations adopted under this subsection)

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year (other than those acquired after December 31, 1943, in the case of a taxpayer described in paragraph (A) of this subsection) as having been acquired at the same time and determined their cost by the average cost method.

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

(A) Only in inventorying goods (required under subsection (a) to be inventoried) specified in an application to use such method filed 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 had a reasonable expectation as to the type of inventory method that was prescribed in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss for the first taxable year beginning after December 31, 1943, in the case of a taxpayer who (i) is a shareholder, partner, or other proprietor, (ii) is a corporation subject to the provisions of this chapter and the regulations prescribed thereunder, or (iii) is the spouse of such a taxpayer.

The method described in paragraph (1) shall be used in the closing inventory of a subsequent taxable year, ending prior to January 1, 1948, if the taxpayer determines that such method is first used and if the taxpayer elects at such time and in such manner as the Commissioner, by the average cost method.

Inventory of the taxable year in which such method is first used as having been acquired at the same time and determined their cost by the average cost method.

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

(A) Only in inventorying goods (required under subsection (a) to be inventoried) specified in an application to use such method filed 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 had a reasonable expectation as to the type of inventory method that was prescribed in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss for the first taxable year beginning after December 31, 1943, in the case of a taxpayer who (i) is a shareholder, partner, or other proprietor, (ii) is a corporation subject to the provisions of this chapter and the regulations prescribed thereunder, or (iii) is the spouse of such a taxpayer.

The method described in paragraph (1) shall be used in the closing inventory of a subsequent taxable year, ending prior to January 1, 1948, if the taxpayer determines that such method is first used and if the taxpayer elects at such time and in such manner as the Commissioner, by the average cost method.

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

(A) Only in inventorying goods (required under subsection (a) to be inventoried) specified in an application to use such method filed 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 had a reasonable expectation as to the type of inventory method that was prescribed in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss for the first taxable year beginning after December 31, 1943, in the case of a taxpayer who (i) is a shareholder, partner, or other proprietor, (ii) is a corporation subject to the provisions of this chapter and the regulations prescribed thereunder, or (iii) is the spouse of such a taxpayer.

The method described in paragraph (1) shall be used in the closing inventory of a subsequent taxable year, ending prior to January 1, 1948, if the taxpayer determines that such method is first used and if the taxpayer elects at such time and in such manner as the Commissioner, by the average cost method.

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

(A) Only in inventorying goods (required under subsection (a) to be inventoried) specified in an application to use such method filed 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 had a reasonable expectation as to the type of inventory method that was prescribed in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss for the first taxable year beginning after December 31, 1943, in the case of a taxpayer who (i) is a shareholder, partner, or other proprietor, (ii) is a corporation subject to the provisions of this chapter and the regulations prescribed thereunder, or (iii) is the spouse of such a taxpayer.

The method described in paragraph (1) shall be used in the closing inventory of a subsequent taxable year, ending prior to January 1, 1948, if the taxpayer determines that such method is first used and if the taxpayer elects at such time and in such manner as the Commissioner, by the average cost method.

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

(A) Only in inventorying goods (required under subsection (a) to be inventoried) specified in an application to use such method filed 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 had a reasonable expectation as to the type of inventory method that was prescribed in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss for the first taxable year beginning after December 31, 1943, in the case of a taxpayer who (i) is a shareholder, partner, or other proprietor, (ii) is a corporation subject to the provisions of this chapter and the regulations prescribed thereunder, or (iii) is the spouse of such a taxpayer.

The method described in paragraph (1) shall be used in the closing inventory of a subsequent taxable year, ending prior to January 1, 1948, if the taxpayer determines that such method is first used and if the taxpayer elects at such time and in such manner as the Commissioner, by the average cost method.

§ 30.22 (d)

Involuntary liquidation and replacement of inventory—(A) Adjustment of net income and resulting tax: years beginning prior to 1948. If for any taxable year beginning after December 31, 1940, and prior to January 1, 1948, the closing inventories of a taxpayer subject to the provisions of this paragraph, the closing inventory of the taxpayer for a taxable year, subject to the provisions of this paragraph, shall be adjusted as follows:

(i) Increased by an amount equal to the excess, if any, of the aggregate cost of such goods reflected in the closing inventory of the year of involuntary liquidation over the aggregate replacement cost, or

(ii) Decreased by an amount equal to the excess, if any, of the aggregate replacement cost of such goods over the aggregate cost of such goods reflected in the closing inventory of the year of involuntary liquidation.

The taxes imposed by this chapter and by chapter 2 for the year of the involuntary liquidation or replacement, and if the liquidation of the goods was an involuntary liquidation, the taxes imposed by this chapter and by chapter 2 for the year of involuntary liquidation and for all determinations for prior and subsequent taxable years insofar as they are related to the year of liquidation or replacement.

(E) Election irrevocable. An election by the taxpayer to have the provisions of this paragraph apply, once made, shall be irrevocable. Any change in the provisions of this paragraph for the year of the involuntary liquidation and for all determinations for prior and subsequent taxable years insofar as they are related to the year of liquidation or replacement.

If the adjustments specified in subparagraph (A) are, with respect to any taxable year, prescribed under this section, the closing inventory of the taxpayer for the year of the involuntary liquidation or replacement, or within three years from such date, by any provision or rule of law (other than subparagraphs (A) and (B) of section 3761, relating to compromises), such adjustments shall not be made if, in the case of any such compromise, a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within three years from the filing of the income tax return for the year of such involuntary liquidation or replacement. If, at the time of the mailing of such notice of deficiency or the filing of such claim for refund, the adjustment is so prevented, then the amount of the adjustment authorized by this paragraph shall be limited to the increase or decrease of the tax imposed by this chapter and by chapter 2 during such taxable year which results solely from the effect of subparagraph (A), and such amount shall be assessed and collected, or credited or refunded, in the same manner and subject to the same restrictions, if any, as if it were a deficiency or to be credited or refunded in the same manner as if it were an overpayment, as the case may be, for such taxable year and as if, on the date of the filing of the income tax return for the year of the replacement, three years had not expired before the expiration of the periods of limitation upon assessment of or a claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with section 761 (d). The amount to be assessed and collected under this paragraph in such manner as if it were a deficiency, or to be credited or refunded in the same manner as if it were an overpayment shall not be diminished by any credits or setoff based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of subparagraph (A). Such amount, if paid, shall not be recovered by a claim or suit for refund, or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of subparagraph (A).
of such liquidation, for preceding taxable years, and for any years intervening between the year of liquidation and the year of replacement shall be determined, giving effect to such adjustments as may be made in such agreements. Any such taxes resulting from such adjustments shall be assessed and collected as a deficiency in the order of liquidation of the taxpayer, so resulting shall be credited or refunded to the taxpayer without interest.

(a) Definition of involuntary liquidation. As used in this paragraph the words "involuntary liquidation" shall have the meaning given to them in subparagraph (B) of section 39.22 (d) of the Code, provided that for the purposes of this paragraph the meaning given to them in subparagraph (B) of section 39.22 (d) of the Code shall be interpreted, pursuant to regulations prescribed by the Secretary, in such a way as to apply to circumstances, occurrences, and conditions, ceasing of a state of war, which are similar, by virtue of a state of national preparedness, to those which would exist under a state of war.

(b) Definitions. Unless otherwise provided in this subparagraph, all terms used in this subparagraph shall have the meanings given to them in subsection (a) of section 39.22 (c) of the Code, except that for the purposes of this subparagraph, the word "involuntary liquidation" shall have the meaning given to it in subparagraph (B) of section 39.22 (d) of the Code, and, in addition, the term "taxpayer" when used herein shall mean the taxpayer as of the close of any taxable year.

(c) Computation of loss by involuntary liquidation. The taxpayer shall determine his loss by involuntary liquidation by applying the method prescribed in subparagraph (B) of section 39.22 (d) of the Code.

This last-in-first-out 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. (b) If the last-in-first-out inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedging 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 fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that such practice is regularly and consistently adhered to by the taxpayer and that, in the opinion of the Commissioner, income is clearly reflected thereby.

(1) A manufacturing or processor who has adopted the last-in-first-out inventory method as to a class of goods may elect to have such method apply to the raw materials only (including those included in goods in process and in finished goods) expressed in terms of appropriate proportions.

Example (2). Assume the opening inventory had 10 units of raw material, 10 units of goods in process, and 10 units of finished goods, with raw material costs as in the closing inventory in example (1). The adjustment in example (1) would be as follows: In so far as the raw material is concerned:

Raw material, 20 at 6 cents. $1.20
Goods in process, 15 at 6 cents. 90
Finished goods, 10 at 10 cents. .50
Total adjustment. $2.60

This excess is subject to determination of price under section 22 (d) (1) and § 22.22 (d) (2) of the Code.

(d) For the purposes of this section, raw material in the opening inventory must be compared with similar raw material in the closing inventory. There may be several types of raw materials, depending upon the character, quality, character, or price, and each type of raw material in the opening inventory must be compared with a similar type in the closing inventory.

(1) In the cotton textile industry there may be different raw materials depending upon marked differences in length of staple, in color or grade of the cotton. But where different staple lengths or grades of cotton are being used at different times in the same mill to produce the same class of goods, such differences would not necessarily require the classification of different raw materials.

(f) As to the pork packing industry a live hog is considered as being composed of various raw materials, different cuts of a hog varying markedly in price and use. Generally a hog is processed into approximately 10 primal cuts and several miscellaneous articles. However, due to similarity in price and use, these may be grouped into fewer classifications, each group being classified as one raw material.

(2) When the finished product contains two or more different raw materials as in the case of cotton and rayon mixtures, each raw material is treated

§ 39.22 (d)-(1)
separately and adjustments made accordingly.

(b) Upon written notice addressed to the Commissioner by the taxpayer, a taxpayer who has heretofore adopted the last-in first-out inventory method with respect to any goods may adopt the method authorized in this section and limit the election to the raw material taxpayer who has heretofore adopted the method. The election may also apply to any raw material, when two or more raw materials enter into the composition of the finished product, for example, in the case of cotton and rayon yarn the taxpayer may elect to inventory the cotton only. However, a taxpayer who has already made an election to use the last-in first-out inventory method may not now elect to exclude any raw materials that were covered by such previous election.

(k) If a taxpayer using the retail method of pricing inventories, authorized by § 39.22 (c)-3, elects to use in connection therewith the last-in first-out inventory method authorized by section 28 (d) the apparent cost of the goods on hand at the beginning of the year, determined pursuant to § 39.22 (c)-8, shall be adjusted to the extent of price changes therein taking place subsequent to the close of the preceding taxable year. The amount of such apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indices established to the satisfaction of the Commissioner. Price indices prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indices which are based upon inadequate records, or which are not subject to complete and detailed audit within the Internal Revenue Service, will not be approved.

(l) If a taxpayer uses consistently the so-called dollar-value method of pricing inventories, or any other method of computing inventory which is reasonably adaptable to the purpose and intent of section 22 (d) and if such taxpayer elects under section 22 (d) to use the

last-in first-out inventory method authorized by such section, the taxpayer's opening and closing inventories shall be determined under section 22 (d) by the use of the appropriate adaptation.

§ 39.22 (d)-2 Requirements incident to adoption of last-in first-out inventory method. Except as otherwise provided in § 39.22 (d)-1 with respect to raw material computations, with respect to retail inventory computations, and with respect to "dollar-value" and other methods of computation established to the satisfaction of the Commissioner as reasonably adapted to the purpose and intent of section 22 (d) the adoption and use of the last-in first-out inventory method in, by section 22 (d) and the 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.

(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 time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual 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 respect 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 invoices and regardless of specific cost accounting records, at costs determined pursuant to the provisions of Rule 1 or Rule 2, dependent upon the character of the transactions in which the taxpayer is engaged:

(1) Rule 1. In the case of a taxpayer engaged in the purchase and sale of merchandise, such as a retail grocer or druggist, or engaged in the initial production of merchandise and its sale without processing, such as a miner selling his ore output without smelting or refining, such costs shall be determined—

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

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

(iii) 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 being listed in such inventory increase being considered for the purposes of section 22 (d) as having been acquired all at the same time; or

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

(b) The application of Rule 1 may be illustrated by the following examples:

Example (1). Suppose that the taxpayer adopts the last-in first-out inventory method for the taxable year 1952 with an opening inventory of 10 units at 10 cents per unit, that it makes 1952 purchases of 10 units as follows:

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<tbody>
<tr>
<td>January</td>
<td>April</td>
<td>July</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 at $0.11</td>
<td>3 at $0.13</td>
<td>3 at $0.12</td>
<td>4 at $0.14</td>
<td>4 at $0.13</td>
</tr>
<tr>
<td>Totals</td>
<td>$4.00</td>
<td>$3.60</td>
<td>$3.60</td>
<td>$5.60</td>
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and that it has a 1952 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(c) Most recent purchases—

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<tbody>
<tr>
<td>10 at $0.10</td>
<td>4 at $0.14</td>
<td>2 at $0.10</td>
<td>1 at $0.11</td>
<td>5 at $0.13</td>
</tr>
<tr>
<td>Totals</td>
<td>$1.00</td>
<td>$0.56</td>
<td>$0.20</td>
<td>$0.11</td>
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or

(1) In order of acquisition—

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<th></th>
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<tbody>
<tr>
<td>10 at $0.10</td>
<td>3 at $0.12</td>
<td>1 at $0.14</td>
<td>2 at $0.13</td>
<td>1 at $0.11</td>
</tr>
<tr>
<td>Totals</td>
<td>$1.00</td>
<td>$0.36</td>
<td>$0.20</td>
<td>$0.26</td>
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or

(c) At an annual average—

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</tr>
</thead>
<tbody>
<tr>
<td>10 at $0.10</td>
<td>3 at $0.12</td>
<td>1 at $0.14</td>
<td>2 at $0.13</td>
<td>1 at $0.11</td>
</tr>
<tr>
<td>Totals</td>
<td>$1.00</td>
<td>$0.36</td>
<td>$0.20</td>
<td>$0.26</td>
</tr>
</tbody>
</table>

Example (2). Suppose that the taxpayer's closing inventory for 1953, the year following that involved in Example (1), reflects an inventory decrease for the year, and not an increase; suppose that there is, accordingly, a 1953 closing inventory of 18 units. Inasmuch as the decreased closing inventory will be determined wholly by reference to the 15 units reflected in the opening inventory for the year, and will be taken "in the order of acquisition" pursuant to section 22 (d) (1) (B), inasmuch as the character of the taxpayer's opening inventory for the year will be dependent upon its method of valuing its 5-unit inventory increase for the preceding year, the closing inventory for 1953 will be computed as follows:

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<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>10 at $0.10 (from 1951)</td>
<td>1 at $0.13 (July 1952)</td>
<td>2 at $0.14 (October 1952)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>$1.00</td>
<td>$0.26</td>
<td>$0.28</td>
<td></td>
</tr>
</tbody>
</table>
(b) In case the increase for the preceding taxable year was taken in the order of acquisition:

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>$1.00</td>
</tr>
<tr>
<td>1952</td>
<td>$1.11</td>
</tr>
<tr>
<td>1953</td>
<td>$1.24</td>
</tr>
</tbody>
</table>

(c) In case the increase for the preceding taxable year was taken on the basis of average cost:

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>$1.00</td>
</tr>
<tr>
<td>1952</td>
<td>$1.11</td>
</tr>
<tr>
<td>1953</td>
<td>$1.24</td>
</tr>
</tbody>
</table>

(2) Rule 2. In the case of a taxpayer engaged in manufacturing, fabricating, or otherwise producing merchandise, such costs shall be determined—

(d) In the case of raw materials purchased or initially produced by the taxpayer, in the manner elected by the taxpayer under Rule 1 to the same extent as if the taxpayer were engaged in purchase and sale transactions; and

(e) In the case of goods in process, regardless of the stage to which the manufacture, fabricating, or processing may have advanced, and in the case of finished goods, pursuant to any proper method which, in the opinion of the Commissioner, clearly reflects income.

(e) 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 last-in-first-out 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 at variance with that referred to in §39.22(d)–1 and requires of the taxpayer a change to a different method for such taxable year or any taxable year thereafter.

(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 §39.22(d)–1, and such inventory method and detailed inventory records 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.

§39.22(d)–3 Time and manner of making election. (a) The last-in-first-out inventory method may be adopted and used only if the taxpayer files with the Commissioner a statement of his election to use such method. Each such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the last-in-first-out inventory method is proposed first to be used, and also as of the beginning of the preceding taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use finished products. Each group of products shall be clearly described.

(b) The taxpayer shall submit for the Commissioner a statement of his election to use such method, or incident to the use of such method, or incident to the use of such method, in the inventories of prior taxable years or otherwise, as the Commissioner may designate, and requires of the taxpayer's returns may deem necessary in order that the true income of the taxpayer will be clearly reflected for the years involved.

§39.22(d)–5 Revocation of election. An election made to adopt and use the last-in-first-out inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method be approved, and whether or not such method be approved by the Commissioner, authorized by him pursuant to a written application therefor filed with him as provided in §39.41–2.

§39.22(d)–6 Change from last-in-first-out inventory method. If the taxpayer is granted permission by the Commissioner to discontinue the use of last-in-first-out method of taking inventories, and thereafter to pursue some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the last-in-first-out method by reason of the taxpayer's failure to conform to the requirements detailed in §39.22(d)–5, the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken—

(a) In conformity with the method used by the taxpayer under section 2 and in inventorying goods not included in his last-in-first-out inventory computations; or

(b) If the last-in-first-out inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method used by the taxpayer prior to his adoption of the last-in-first-out method;

(c) If the taxpayer had not used inventories prior to his adoption of the last-in-first-out inventory method and had no goods currently subject to inventory by a method other than the last-in-first-out inventory method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

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

§39.22(d)–7 Involuntary liquidation and replacement. (a) If prevailing war conditions beyond the control of the taxpayer, or certain prescribed post-war conditions beyond his control, should impose upon the taxpayer the necessity during the period of the war or within the prescribed post-war period for a taxpayer using the last-in-first-out inventory method to have on hand a stock of merchandise in kind and description like that included in the opening inventory for the

§39.22(d)–7
year, or in a quantity equal to that of the opening inventory, the resulting inventory decrease for the year will be regarded, at the election of the taxpayer, as reflecting an involuntary liquidation subject to replacement. If the taxpayer notifies the Commissioner at any time not later than six months after the time of filing his income tax return for the year of liquidation, or at any time not later than the time of the filing his income tax return for the year of liquidation, in the case of the year of liquidation being a taxable year ending before March 1, 1952, that he intends to effect a replacement of the liquidated stock, in whole or in part, and that he desires to have applied in his case, the involuntary liquidation and replacement provisions of section 22 (d) and if he establishes to the satisfaction of the Commissioner the involuntary character of the liquidation to which his stock has been subjected, effect shall be given, when replacement has been made, to any adjustment of income for the year of liquidation, to the extent of the difference between the replacement costs incurred and the original inventory cost of the inventorily liquidated. For extensions of time, see Subpart G of the regulations in this part. If the replacement costs exceed such inventory costs, the net income of the taxpayer otherwise computed shall be reduced by an amount equal to such excess. If the replacement costs are less than the inventory costs, net income otherwise computed shall be increased to the extent of such difference. Any deficiency in the income or excess profits tax of the taxpayer, or any overpayment of such taxes, attributable to such adjustment shall be assessed and collected by the Commissioner or credited or refunded to the taxpayer without interest.

(b) The statutory provisions affording recognition to the involuntary character of inventory decreases which become apparent in war years and authorizing for tax purposes a replacement of the items of merchandise so liquidated are limited in their application to liquidations occurring in taxable years beginning before January 1, 1948, and to inventory replacements effected in taxable years ending before January 1, 1950. The statutory provisions affording recognition to the involuntary character of inventory decreases which become apparent in post-war taxable years and authorizing for tax purposes a replacement of the items of merchandise so liquidated are limited in their application to liquidations occurring in taxable years ending after June 30, 1950, and before January 1, 1952. The replacement provisions in paragraph (a) of this section shall apply. For the purpose of such rules, the words "enemy" and "war" shall be interpreted to apply to circumstances pertaining to the existence of a state of war which are similar to those existing during which an item is not subject to allotment, or to the exercise of any of the rules and requirements prescribed in the preceding paragraphs, including the requirement that the taxpayer establish to the satisfaction of the Commissioner the cause of the involuntary liquidation.

(c) If the taxpayer would have the involuntary liquidation and replacement provisions applicable with respect to any inventory decrease, he must so elect to have them applied in his case. If the Commissioner or the taxpayer establish to the satisfaction of the Commissioner the involuntary character of the liquidation, the circumstances relied upon as rendering the taxpayer unable to maintain throughout the taxable year a normal inventory of the items involved, including evidence of the applicable National Production Authority inventory control figures for the beginning and the close of the taxable year (or if none, a statement to that effect), allotments applied for, allotments received, and allocations; (4) detailed proof of such circumstances to the extent that they may not be the subject-matter of common knowledge; (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; and (6) in the case of an election made pursuant to an extension of time sought under Subpart G of the regulations in this part more than six months after the filing of the return for the year of liquidation, the circumstances relied upon as justifying the election at such time, together with a disclosure of the extent, if any, to which replacements have already been made.

(d) 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 for a given year, shall be irrevocable with respect to the particular decrease involved and its replacement, goods acquired in violation of such directives, orders, regulations, or allotments, such decrease shall not be considered as such an involuntary liquidation, with respect to an inventory decrease occurring after June 30, 1950, and before January 1, 1954, due directly and exclusively to a disruption of normal trade relations between countries, including, but not limited to, such inventory decreases considered as an involuntary liquidation subject to the rules and requirements prescribed in the preceding paragraphs, including the requirement that the taxpayer establish to the satisfaction of the Commissioner the cause of the involuntary liquidation. A disruption of normal trade relations between countries referred to in such a decrease involves unusual export limitations imposed by a foreign government, by unusual exchange restrictions, or by other unusual circumstances or conditions beyond the control of the taxpayer.

§ 39.22 (d-7)
and shall be binding for the year of liquidation, the year of replacement, and all prior, intervening, and subsequent taxable years by reason of adjustments in carry-overs. Adjustments are to be made for the several years affected consistent with the adjustments made for the year of liquidation. Detailed records shall be maintained such as will enable the Commissioner, in his examination of the taxpayer's returns for the year of replacement, to determine the extent to which the inventory decrease claimed to be involuntary in character and the facts upon which such claim is based, all subsequent inventory increases and decreases, and other facts material to the replacement adjustment authorized.

(g) Notwithstanding the ultimate purchase price or the cost of production ultimately incurred by the taxpayer in offering for sale or sale of replacement of a stock involuntarily liquidated, the merchandise reflecting the replacement shall be taken into inventory and included in the closing inventory for the year of replacement, and shall be included in the inventories of subsequent taxable years, at the inventory cost figure of the merchandise replaced.

(b) 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 their acquisition, as having been acquired by the taxpayer in offering for sale or sale of replacement of like goods most recently liquidated and not previously replaced; however, in a case involving involuntary liquidations of goods of the same class subject to the provisions of both section 22 (d) (6) (A) and section 22 (d) (6) (F) the involuntary liquidations of such goods subject to the provisions of section 22 (d) (6) (A) and section 22 (d) (6) (F) are allocated to items liquidated voluntarily and subsequent taxable years affected with respect to inventories computations for the year of replacement and all subsequent taxable years.

(ii) In some cases it may appear that, at the time of the filing of the income tax return for the year of replacement, or within due time thereafter, an adjustment with respect to the income or excess profits taxes for the year of the involuntary liquidation, or for some prior, intervening, or succeeding taxable year, is prevented by the running of the statute of limitations, by the execution of a closing agreement, by virtue of a court decision which has become final, or by reason of some other provision or rule of law other than section 3761 (relating to compromises) and other than the inventory replacement provisions. The adjustments provided for in connection with the involuntary liquidation and replacement of inventory shall nevertheless be made, but only if, within a period of three years after the date of the filing of the income tax return for the year of replacement, a notice of deficiency is mailed or a claim for refund is filed. No credit or refund will be allowed under this subparagraph, whether or not the tax is paid before the three-year period, in the absence of a claim for refund duly filed; nor will a resulting deficiency be assessed or collected until such time as a claim for refund or a claim for refund or a claim for refund or a claim for refund has been filed. The amount of the adjustment shall be computed by reference to the amount of the tax previously determined, and without regard to factors affecting the taxable year involved to which no effect was given in such prior determination. The tax previously determined shall be ascertained in accordance with the principles stated in sections 452 (d) and 755 (d) (3) (A), (B) and (C) (Part 40 of this chapter) and § 35.734-4 of Regulations 122 (26 CFR, 1943 Cum. Supp., Part 35) Any deficiency paid or any overpayment credited or refunded under these circumstances shall not be subject to recovery on a claim for refund or a suit for the recovery of an erroneous refund in any case in which such claim or suit is based upon factors other than those giving rise to the adjustments made.

§ 39.23 (d)-(e) Statutory provisions; cross references; alimony, etc., income.

Sec. 22. Gross income. • • •

(e) Determination of gain or loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

(i) Determination of gain or loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

(g) Determination of gain or loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

(h) Determination of gain or loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

(i) Determination of gain or loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

(j) Determination of gain or loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

§ 39.23 (d)-(e) Statutory provisions; cross references; alimony, etc., income.
RULES AND REGULATIONS

maintenance. Such periodic payments may be received from either of the two former marital estates and trusts provided in sections 22 (k) and 39.22 (k-I)
(1) In discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by the husband or wife, or, as the case may be, the decree or instrument incident thereto, see section 171 (a) and §39.171-1.

(2) In the court's decree had been made to the antenuptial agreement, agreement and H's obligation to support W. Therefore, the divorce decree is silent as to such obligation, which is made specific by the instrument or decree. Thus, section 22 (k) does not apply to that part of any periodic payment which is attributable to an agreement by the husband of, for example, a bona fide loan previously made to him by the wife, the satisfaction of which is specified in the divorce decree as a part of the settlement between the husband and wife.

(3) The obligation of the husband must be imposed upon him or assumed by him (or made specific) under either of the following:

(a) A court order or decree divorcing or legally separating the husband and wife.

(b) A written instrument incident to such divorce or legal separation.

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 §39.171-1 in cases where such periodic payments are attributable to property held in trust.

(4) The purpose and effect of section 22 (k) is illustrated, in general, by the following examples, in which it is assumed that the husband and wife make their income tax returns on the calendar year basis:

Example (1). W sues H for divorce in 1952. The court awards W temporary alimony of $25 a week pending the final decree. On September 1, 1952, the court grants W a property settlement of $500 a month permanent alimony. No part of the $25 a week temporary alimony received prior to the decree is includible in W's income under section 22 (k), but the $500 a month received during the balance of 1952 by W is includible in her income for 1952. Under section 23 (u), if H is entitled to deduct such $500 payments from his income.

Example (2). W files suit for divorce from H. In consideration of W's promise to relinquish all marital rights and to not make public H's financial affairs, H makes a legally binding written promise in writing to W during the marriage to pay to her $200 a month if a final decree of divorce is granted without any provision for alimony. H does not pay the $200 a month alimony and no provision for alimony is made under a final decree of divorce. During 1953, H pays W $200 a month, which is includible in her income for 1953. Under section 23 (u), if H is entitled to deduct such $200 payments from his income.

Example (3). H and W enter into an antenuptial agreement, under which, in consideration of W's relinquishment of all marital rights (including dowry) in H's property, and, if H pays W $200 a month for support and household expenses, H promises to pay W $200 a month for 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 H's obligation to support W. Section 22 (k) applies to such case. If, however, the decree was modified so as to refer to the antenuptial agreement, agreement, or property transferred under section 22 (k), then of such payments received under the circumstances described in section 22 (k) is required to be included in the gross income of the recipient whether such amounts are derived, in whole or in part, from income received by the husband from the property contemplated of or as an incident to the divorce or separation without adequate and full consideration for money or money's worth, other than the release of the husband or his property from marital obligations. An example of the first rule is a case where the husband and wife transfer securities, which were owned by them jointly in trust to pay annuity to the wife. In this case, the full amount of that part of the annuity received by the wife in discharge of the husband's obligation under the decree, or instrument incident thereto, is taxable to her under section 22 (k), while that portion of the annuity attributable to the wife's interest in the securities so transferred is taxable to her only to the extent it is out of trust income as provided in section 165. If, however, the husband's transfer of an interest in his property to the wife as consideration for a promise to transfer such property in discharge of his obligation, is made in an attempt to avoid the application of section 22 (k) to payments received by his wife, such transfers will be considered as a part of the same transfer by the husband of his property in discharge of his obligation. In such a case, section 22 (k) will be applied to the full amount received by the wife. As to periodic payments received under a joint purchase of a commercial annuity contract, see §39.25 (b) (3)-4.

(c) Alimony installment payments.

(1) In general, installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property specified in the decree of divorce or legal separation, or an instrument incident thereto, are not considered "periodic payments" and therefore are not to be included under section 22 (k) in the wife's income. On application to this general rule is provided, however, in cases where such principal sum, by the terms of the decree or such instrument, may be received within a period ending more than 10 years from the date of such decree or instrument. In such cases, the installment payment is considered a periodic
payment for the purposes of section 22 (k) but only to the extent that the installment payment, or sum of the installment payments, received during the wife’s taxable year, excludes 10 percent of the principal sum. This 10 percent limitation applies to installment payments made in advance but does not apply to delinquent installment payments for a prior tax year of the wife made during her taxable year.

(2) The rule as to installment payments may be illustrated by the following examples:

Example (1). Under the terms of a divorce decree, it is to pay W a gross sum of $100,000 in four annual installments. No part of the $100,000 is includible in W’s income under section 22 (k) nor deductible by H.

Example (2). A divorce decree in 1953 provides that H is to pay W $20,000 each year for the next five years, beginning with the date of the decree, and then $5,000 each year for the next ten years. Assuming the wife makes her returns on the calendar year basis, each payment received in the years 1952–1956, inclusive, is a periodic payment under section 22 (k) and is deductible by the husband under section 22 (k). For the first year, H makes his return and reports $20,000 in gross income. This amount is includible in her income under section 22 (k) in satisfaction of not only his back alimony arrearage agreement incident to divorce but also his back alimony arrearage agreement incident to divorce. The payment is deductible for such year.

Example (3). Under the terms of a separation agreement incident to divorce granted in December 1951, H agrees to pay W $500 on the 10th day of each month, beginning with the month after the decree, for 12 years. W makes her income tax returns on the calendar year basis and H makes his returns on the basis of the fiscal year ending June 30. H makes the promised payment in 1952 and, in addition, on December 31, 1952, pays W $1,500 as an advance payment of installments for the next three months. In the calendar year 1953, H makes his returns at all of the payments of $1,500 as advance payment of installments for the last nine months of 1953 but also his alimony installments for the next 21 months. The result is as to H and W are as follows:

As to W: In the calendar year 1952, W received $7,500. Since 10 percent of $72,000 (the principal sum of $75,000, only $7,500 of the $7,500 so received is includible in her income for 1952. For 1953 nothing is includible in her income under section 22 (k). In 1954, W received $15,000. Of this amount $4,500 is in payment of back installments and, therefore, is includible in her income for 1954. Of the balance of $10,500, only $2,000 is includible in her income for 1954.

As to H: For the taxable year ended June 30, 1953, H paid $3,000, all of which is deductible by H. In the taxable year ended June 30, 1955, H paid $4,500, of which $2,000 of the $2,000 so received is attributed to W. For the taxable year ending June 30, 1956, H paid $4,500, which is deductible by H.

(D) Payments for support of minor children. Section 22 (k) does not apply to that part of any periodic payment made (1) in respect of the divorce or the written instrument under section 22 (k) specifically designated as a sum payable for the support of minor children of the husband. The statute prescribes the treatment in cases where an amount or portion is so fixed but the amount or portion is less than the amount of the periodic payment specified to be made. In such cases, to the extent of the amount which would be payable for the support of such children, the husband is required to make periodic payments, which periodic payment is considered a payment for such support.

Thus—for such taxable years, only the payments made in advance but does not exceed 30 percent of the principal sum. This 30 percent of the principal sum is deductible for such year.

§39.22 (n) Statutory provisions; adjusted gross income

Sec. 22. Gross Income. • • •

(1) Income of decedents. For inclusion in gross income of certain amounts which constituted gross income in respect of a decedent, see section 126.

Sec. 23. Gross Income. • • •

(m) Services of child. (1) Amounts received in respect of the care of a child shall be included in his gross income and not in the gross income of the parent, even though such amounts are not received by the child.

(2) All expenditures by the parent or the child attributable to amounts which are includible in the gross income of the child and not of the parent solely by reason of paragraph (1) shall be deemed to have been paid and incurred by the parent.

(n) Adjusted gross income. (1) Definition of “adjusted gross income” which, by the changed rules, is defined as the “adjusted gross income” means the gross income minus—

§ 39.22 (n)
5818

RULES AND REGULATIONS

(1) Trade and business deductions. The
deductions allowed by section 23 which are
attributable to a trade or business carried
on by the taxpayer, if such trade or business
does not consist of the performance of services by the taxpayer as an employee;
(2) Expenses of travel and lodging in connection with employment. The deductions
allowed by section 23 which consist of expenses of travel, meals, and lodging while
away from home, paid or incurred by the
taxpayer in connection with the performance
by him of services as an employee;
(3) Reimbursed expenses in connection
with employment. The deductions allowed
by section 23 (other than expenses of travel,
meals, and lodging while away frony home)
which consist of expenses paid or incurred
by the taxpayer, in connection with -theperformance by him of services as an employee,
under a reimbursement or other expense allowance arrangement with his employer;
(4) Deductions, attributable to rents and
royalties. The deductions (other than those
provided in paragraph (1), (5), or (6)) allowed by section 23 which areattributable to
property held for the production of rents or
royalties;
(5) Certain deductions of life tenants and
income beneficiaries of property. The deductions (other than those provided in paragraph (1)) for depreciation and depletion,
allowed by section 23 (1) and (m) to a life
tenant of property or to an income beneficiary of property held in trust;
(6) Losses from sales or exchange of property. The deductions (other than those provided in paragraph 11)) allowed by, section 23 as losses from the sale or exchange of
property; and
(7) Long-term capital gains. The deduction allowed by section 23 (ee).
[Sec. 22 (n) as added by see. 8 (a), Individual Income Tax Act 1944; amended bysee.
322 (c), Rev. Act 1951]
§ 39.22 (n)-1

Adjusted gross income.

(a) The term "adjusted gross income"
means the gross income computed under
section 22 minus such of the deductions
allowable under section 23 as are specified in section 22 (n)
Adjusted gross
income is used as the basis for the determination of the following: The tax under Supplement ,T; the amount of the
'standard deduction; the amount of the
deduction for charitable contributions
under section 23 (o) and the amount of
the deduction for medical and dental
expenses under section 23 (x)
(b) Section 22 (n) does not create any

new deductions, but merely

specifies

which of the deductions provided in section 23 shall be allowed in computing
adjusted gross income. The circum-

stance that a particular item is specified
in one of the clauses under section 22 (n)
and is also embraced within the terms of
another of such clauses does not permit
the item to be twice deducted in com-

puting adjustdd gross income.
(c) The deductions specified in section 22 (n) for the purpose of computing
adjusted gross income are: (1) Deductions allowable under section 23, which
are attributable to a trade or business
carried on by the taxpayer not consisting of services performed as an employee;
(2)
deductions allowable by
section 23 which constitute expenses of
travel, meals, and lodging while away
from home, paid or incurred by the taxpayer in connection with the performance by him of services as an employee;
(3) deductions allowable by section 23

(other than expenses of travel, meals,
and lodging while away from home)
which consist of expenses paid or incurred in connection with the performance of services as an employe under a
reimbursement or other expense-allowance arrangement with his employer;
(4) deductions allowable under section
23 which are attributable to rents and
royalties; (5) deductions for depreciation and depletion allowable under section 23 (1) and (m) to a life tenant of
Property or to an income bendficiary of
property held in trust; (6) deductions
which are allowable under section,23 as
losses from the sale or exchange of property, and (7) the deductions for longterm capital gains allowed by sections
23 (ee) aid 117 (b)
(d) For the purpose of the deductions
specified in section 22 (n) the performance of personal services as an employee
does not constitute the carrying on of a
trade or business. The practice of a profession, not as an employee, is considered
'the conduct of a trade or business within
the meaning of such section. To be deductible for the purposes of determining
adjusted gross income, expenses must be
those directly, and not those merely remotely, connected with the conduct of
the trade or business. For example,
taxes are deductible in arrivmg at ad3usted gross income only if they constitute expenditures directly attributable to
the trade or business or to property from
which rents or -royalties are derived.
Thus, property taxes paid or incurred on
real property used in the trade or business are deductible but State income
taxes are not deductible even though the
taxpayer's income is derived from the
conduct of a trade or business,
(e) Traveling expenses paid or incurred- by an employee in connection
with his employment while away from
-home which. are deductible from gross
income in computing net income may be
-deducted from gross income .in computing adjusted gross income. Among the
items included in traveling expenses are
charges for transportation of persons
or baggage, expenditures for meals and
lodging, and payments for the use of
sample rooms for the display of goods.
See § 39.23 (a)-2.
Cf) Expenses, other than traveling ex-penses, paid or incurred by an employee
which are deductible from gross income
in computing net income and for which
he is reimbursed by the employer under
an express agreement for reimbursement
or pursuant to an expense allowance
arrangement may also be deducted from
gross income in computing adjusted

gross income.

§ 39.22 (o) StatutoryProvisions;gross

valued on any basis other than cost, the coat
of securities sold (as defined in piaragraph
'(2) (B)) during such year shall be reduced
by an amount equal to the amortizable bond
premium that would be disallowed as a de.
duction for such year pursuant to section
125 (a) (2) if the definition In section 125
.(d) of the term "bond" did not exclude such
short-term municipal bond, or
(B) If the gross income of the taxpayer
from such trade or business is computed
without the use of inventories, or by use of
inventories valued at cost, and the short-term municipal bond is sold or otherwise
disposed of during such year, the adjusted
basis (computed without regard to this subparagraph) of the short-term municipal
'bond shall be reduced by the amount of the
adjustment that would be required under
section 113 (b) (1) (H) If the dcfliiltion In
section 125 (d) of the term "bond" did not
exclude such short-term munlipal bond,
(2) Definitions. ,ror the purposes of paiagraph (1)(A) The term "short-term municipal
bond" means any obligation Issued by a
government or political subdivision thereof
if the interest on such obligation is excludible
from gross income: but such term does not
'include such an obligation if (1) It Is sold
or otherwise disposed of by the taxpayer
within thirty days after the date o Itu acquisition by him, or (11)Its earliest maturity
or call date is a date more than five years
from the date on which it was acquired by
the taxpayer.
(B) The term -"cost of securities sold"
means the amount ascertained by subtractIng the inventory value of the closing In-ventory of a taxable year from the sum of
(1) the Inventory value of the opening In-ventory for such year and (it) the cost of
securities and other property purchased
during such year which would properly be
-included in the inventory of the taxpayer If
on hand at the close of the taxable year.
[Sec. 22 (o) as added by sec. 203 (a), Rev.
Act 1950]
§ 39.22 (o)-1

Treatment of b o itd

premiums in case of dealers in taxexempt securities-(a) In general, (1)
Section 22 (o)requires certain adjustments to be made by dealers in sceurlties with respect to premiums paid on
short-term municipal bonds which are
held for sale to customers in the ordinary course of the trade or business.
The adjustments depend upon the
method of accounting used by the taxpayer in computing the gross income
from the trade or business. See paragraphs (b) and (c) of this section,

(2) The term "short-term municipal
-bond" under section 22 (o) means any
,obligation issued by a government or political subdivision thereof If the Interest
on the obligation is excludable from gross
income under section 22 (b) (4)
Such

term, however, does not Include an obligation the maturity or earliest call date
of which is a date more than five years

from the date of acquisition by the tax-

income; dealers in short-term municipal payer, or an obligation sold or otherwise
bonds.

disposed of by the taxpayer within 30

SEC. 22. Gross income.
* *
(o) Dealers in tax-exempt securities-(1)
Adjustment for bona premium. In computthe gross income of a taxpayer who holdsduring th'taxable year a short-term municipal bond (as defined in paragraph (2) (A))
primarily for sale to customers in the ordinary course of his trade or business(A) If the gross income of the taxpayer
from such trade or business is computed by
the Use Of inventories and his Inventories are

§ 39.22 n}-1

HeinOnline -- 18 Fed. Reg. 5818 1953

days after the date of acquisition

him.

by

A bond which is otherwise within

the definition of "short-term municipal
bond" is subject to the provisions of section 22 (o) If held by the taxpayer for

a period of more than 30 days, whether
or not such period is entirely within one
taxable year.

(b) Inventories not valued at cost, (1)
In the case of a dealer in securities who


computes gross income from his trade or business by the use of inventories and values such inventories on any basis other than cost, the adjustment required by section 22 (o) is the reduction of “cost of securities sold” by the amount equal to the amortizable bond premium which would be disallowed as a deduction under section 125 (a) (2) if the dealer were an ordinary investor holding such bond. Such amortizable bond premium is computed under section 125 (b) by reference to the cost or other original basis of the bond on the date of acquisition (determined without regard to section 113 (a) (1) relating to inventory value on a subsequent date) if the date of acquisition precedes July 1, 1950, and in computing such bond premium under section 125 (b) the amount of such amortizable bond premium, there shall be made adjustments to bond premium proper to reflect unamortized bond premium on such bond for the period including the holding period (as determined under section 117 (b)) prior to the date as of which section 22 (o) first becomes applicable to the bond in the hands of the taxpayer. See § 39.125 (b)–1.

(2) Subparagraph (1) may be illustrated by the following example:

Example. X, a dealer in securities who values his inventories at cost rather than tax basis, makes his income tax returns on the calendar year basis. On January 1, 1950, he bought, for $1,018 each, three short-term municipal bonds (A, B, and C) having a face obligation of $1,000, and maturing on January 1, 1954. On July 1, 1952, he buys, for $1,018 each, three more bonds (X, Y, and Z) of the same issue. Bonds A and X are sold on December 31, 1952. Bonds B and Y are sold on January 1, 1953. Bonds C and Z are sold on December 31, 1953. The adjustment for the years 1952 and 1953 is as follows:

<table>
<thead>
<tr>
<th>Bond</th>
<th>Date acquired</th>
<th>Date sold</th>
<th>Adjustment for—</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Jan. 1, 1949</td>
<td>Dec. 31, 1952</td>
<td>$12.00</td>
</tr>
<tr>
<td>B</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>C</td>
<td>July 1, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>X</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>Y</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>Z</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>51.60</td>
</tr>
</tbody>
</table>

For the purpose of determining such adjustment, the amortizable bond premium is computed under section 125 (b) as follows:

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<th>Bond</th>
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<td>July 1, 1952</td>
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<td>12.00</td>
</tr>
<tr>
<td>X</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
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<td>Dec. 31, 1952</td>
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</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>51.60</td>
</tr>
</tbody>
</table>

For the purpose of determining such adjustment, the amortizable bond premium is computed under section 125 (b) as follows:

(3) The term “cost of securities sold” means the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum of the inventory value of the opening inventory for such year and the cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(c) Inventories not used or inventories valued at cost. (1) In the case of a dealer in securities who computes gross income from his trade or business without the use of inventories or by use of inventories valued at cost, the adjustment required by section 22 (o) is a reduction of the amount of each short-term municipal bond sold or otherwise disposed of during the taxable year. The amount of such reduction is the amount by which the adjusted basis of such bond would be required to be reduced under section 113 (b) (1) (H) if the bond were subject to the amortizable bond premium provisions of section 125, that is, the amortizable bond premium which would be disallowed as a deduction under section 125 (a) (2) if the taxpayer were an ordinary investor.

(2) If the bond was acquired before July 1, 1950, the amount of the reduction shall not include the amount of such amortizable bond premium which would be disallowed as a deduction under section 125 (a) (2) if the taxpayer were an ordinary investor, for any taxable year beginning before July 1, 1950. In the case of such bond, the amortizable bond premium which would be disallowed as a deduction under section 125 (a) (2) is determined after making adjustments to bond premium proper to reflect unamortized bond premium on such bond for the period including the holding period (as determined under section 117 (b)) prior to the date as of which section 22 (o) first becomes applicable to the bond in the hands of the taxpayer. See § 39.125 (b)–1.

(3) The application of subparagraph (1) may be illustrated by the following example:

Example. Y, a dealer in securities who values his inventories at cost rather than tax basis, makes his income tax returns on the calendar year basis. On January 1, 1950, he bought, for $1,018 each, three short-term municipal bonds (D, E, and F) having a face obligation of $1,000, and maturing on January 1, 1954. On July 1, 1952, he buys, for $1,018 each, three more bonds (G, H, and I) of the same issue. Bonds D, E, and F are sold on December 31, 1952. Bonds G and H are sold on January 1, 1953. Bonds I are sold on June 30, 1953. Bonds I are sold on December 31, 1953. The adjustment for the years 1952 and 1953 is as follows:

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<tr>
<th>Bond</th>
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<th>Adjustment for—</th>
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</thead>
<tbody>
<tr>
<td>D</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>$12.00</td>
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<tr>
<td>E</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>F</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>G</td>
<td>Jan. 1, 1953</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>H</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>I</td>
<td>June 30, 1953</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>51.60</td>
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</table>

For the purpose of determining such adjustment, the amortizable bond premium is computed under section 125 (b) as follows:

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<td>D</td>
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<td>12.00</td>
</tr>
<tr>
<td>F</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>G</td>
<td>Jan. 1, 1953</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>H</td>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>12.00</td>
</tr>
<tr>
<td>I</td>
<td>June 30, 1953</td>
<td>Dec. 31, 1953</td>
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</tr>
<tr>
<td>Total</td>
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For the purpose of determining such adjustment, the amortizable bond premium is computed under section 125 (b) as follows:

(1) Any trade or business expense, (1) Trade or business expenses.—(A) General. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including amount expended for meals and lodging) while away from home in the pursuit of a trade or business, or which the taxpayer has not taken or is not taking title to or in which he has no equity. In the case of any corporation engaged in the business of dealing in securities, exchanges described in section 22 (b) (15) (B) shall be allowable under this subparagraph only to the extent that such expenses exceed the amount excluded from gross income by section 22 (b) (15). (B) Corporate charitable contributions. No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per cent limitation thereon contained and for the requirement therein that payment must be made within the taxable year.

(2) Expenditures for advertising and good will. If a corporation has, for the purpose of computing its excess profits credit under section 21, or excess profits tax under section 24, as amended by section 20 of this chapter, the net income therefrom; expenses from gross income; expenses, corporation charitable contributions. In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, collection, or maintenance of property held for the production of income.

(3) ‘‘Cost of securities sold’’ means the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum of the inventory value of the opening inventory for such year and the cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

No. 189—Pt. II—Sec. 1—7

§ 39.23 (a)
RULES AND REGULATIONS

§ 39.23 (a)-1 Business expenses. Business expenses deductible from gross income include the ordinary and necessary expenses paid or incurred in carrying on a trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than subsection (a)-6 of this section and its practical application may be further stated and illustrated as follows:

(a) Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for the purpose of business purposes, the railroad fares are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including railroad fares, meals, and lodging, are business expenses.

(b) If, then, an individual, whose business required him to travel, received a salary as full compensation for his services, without reimbursement for traveling expenses, or was employed on a commission basis with no expense allowance, his traveling expenses, including the entire amount expended for meals and lodging, are deductible from gross income.

(c) If an individual receives a salary and is also paid his actual traveling expenses, he shall include in gross income the amount so repaid and may deduct such expenses.

(d) If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, the amount of the allowance should be included in gross income and the cost of such meals and lodging may be deducted therefrom.

(e) A payment for the use of a sample room at a hotel for the display of goods is a business expense.

(f) Only such expenses as are reasonable and necessary in the conduct of the business and directly attributable to it may be deducted.

(g) A taxpayer claiming the benefit of the deductions referred to in this section must attach to his return a statement showing (1) the nature of the business in which engaged; (2) the number of days away from home during the taxable year on account of business; (3) the total amount of expenses incident to meals and lodging while absent from home on business during the taxable year; and (4) the total amount of other expenses incident to travel and claimed as a deduction.

(h) Claim for the deductions referred to in this section must be substantiated, when required by the Commissioner, by evidence showing in detail the amount and nature of the expenses incurred.

(i) Commuters' fares are not considered as business expenses and are not deductible.

§ 39.23 (a)-3 Cost of materials. Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the amount that they are actually expended during the taxation year for which the return is made, provided that the cost of such materials and supplies has not been deducted in determining the net income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method.

§ 39.23 (a)-4 Repairs. The cost of material repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as an expense. If repair work is done during the year for which the return is made, the cost of the repair may be deducted, provided the depreciation or the gain or loss basis of the taxpayer's plant, equipment, or other property, as the case may be, is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept.

§ 39.23 (a)-5 Professional expenses. A professional man may claim as deductions the cost of supplies used by him in the diagnosis of disease or injury. Expenditures paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently expended for books of a corporation having few instruments and equipment, the useful life of which is short, may be deducted.

§ 39.23 (a)-6 Compensation for personal services. (a) There may be included among the ordinary and necessary expenses paid or incurred by an individual in his capacity as a taxpayer, salaries paid to officers or employees, the rent paid for office rooms, and the cost of advertising and other selling expenses.

(b) The test set forth in paragraph (a) of this section and practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few 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 stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments correspond to a distribution of earnings upon the stock. An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries are not merely for services, but in part constitute payment for the transfer of their business.

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

(3) 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 the reason the compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to salaries or other compensation for personal services will be included in gross income of the recipient and subjected to both normal tax and surtax.

§ 39.23 (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 depend upon the circumstances. 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 a distribution of earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated as a capital expenditure and as such payments constitute payment for services actually rendered by the payor, as a capital expenditure and as a dividend. If the corporation pays such bonuses in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings a deduction for this purpose, in the case of the landlord, the amount of the tax bearing portion of 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 for determining 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.

§ 39.23 (a)-8 Bonuses to employees. Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when aggregated with all other similar payments, 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 the services rendered, are not deductible from gross income. § 39.23 (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 not compensated for by insurance 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).

§ 39.23 (a)-10 Rentals. (a) If a leasehold is acquired for business purposes for a specified sum, the purchase may take as a deduction in his return an equivalent 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.

(b) The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment in the real property, the deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of his 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 a deduction for this purpose, in the case of the landlord, the amount of the tax bearing portion of 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 for determining 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.

§ 39.23 (a)-12 Depositors’ guaranty fund. Banking corporations which pursuant to the laws of the States in which they are doing business are required to set apart, keep, and maintain in their books a fund, the amounts to the tax liabilities of their depositors, which amounts are paid or accrued as compensation for injuries, and held to be a capital investment, and are not deductible as such by the payor, will be deductible in his return, as an expense deduction, in so far as such cost represents actual outlays for the improvement of the property, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated as a capital expenditure and as such payments constitute payment for services actually rendered by the payor, as a capital expenditure and as a dividend. If the corporation pays such bonuses in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings a deduction for this purpose, in the case of the landlord, the amount of the tax bearing portion of 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 for determining 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.

§ 39.23 (a)-13 Corporate contributions. (a) No deduction is allowable 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 $8,000, only $4,000 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 remaining $1,000.  
(b) 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(c) (1). For example, payments by a street railway corporation to a local hospital which is a charitable organization within the meaning of section 23(c) (1) is 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) if the requirements 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 made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization described in section 23(q) not intended 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.

§ 39.23(a)–14 Expenditures for advertising or promotion of good will. A corporation which has, for the purpose of computing its excess profits credit, elected under subsection (f) (applicable to the excess profits tax imposed by subchapter D of chapter 1) to charge to capital account for taxable years in its base period expenditures for advertising or the promotion of good will which may be regarded as capital investments 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 good will which it seeks to deduct for such later taxable years may not be regarded as capital investments under the provisions of the regulations under section 451. 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 furnished with respect to such expenditures, see § 40.451-2 of Regulations 130 (Part 40 of this chapter) (applicable to the excess profits tax imposed under subchapter D of chapter 1).

§ 39.23(a)–15 Nontrade or nonbusiness expenses. (a) Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (2) for the management, conservation, or maintenance of property held for the production of such income; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in subparagraph (1) of this paragraph.

(b) The term "income" for the purposes of this section means not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is determined in a manner but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing a capital gain on their resale, even though there is no current yield thereon it is anticipated that dividends and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation, or maintenance of a building devoted to rental purposes are deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely in anticipation of a loss with respect thereto. Such expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not deductible under section 23(a) (2). The expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision although the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely in anticipation of a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not deductible under section 23(a) (2).

(c) Expenses, to be deductible under section 23(a) (2) must be "ordinary and necessary" within the meaning of that section. The expenses which are disallowed under section 23(a) (2) disallow any expenses which are disallowed under any of the provisions of chapter 1.

(d) Capital expenditures, and expenses of carrying on transactions which are neither trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income, or for the management, conservation, or maintenance of property held for any other reason, is to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the results, the reason for the transaction, the prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

(e) Among expenditures not allowable under section 23(a) (2) are the following:  (1) Commuter's expenses; expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

(f) Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23(a) (2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income, and (2) they are necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

(g) Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible.
even though such property was formerly held by the taxpayer for use as a home. (1) Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of income, or where it was properly so treated under section 262 (b) in computing the net estate subject to the estate tax.

(2) 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 accruing to the ward or minor, are deductible.

(3) Reasonable amounts paid or incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if received, would have been included in income) or in developing or improving property, held for the production of income, belonging to the ward or minor, are deductible.

(4) Expenses incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if received, would have been included in income) or in developing or improving property, held for the production of income, belonging to the ward or minor, are deductible.

(1) 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 section 511 (a) (3) with respect to the tax on capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7).) Where, however, the item may properly be treated only with respect to 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.

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

§ 39.23 (b) Statutory provisions; deductions from gross income. In computing net income there shall be allowed as deductions:

(a) Interest

(b) Interest. All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations, (other than obligations of the United States or of any State), is deductible. Amounts deducted under section 23 (b) (1) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other section of the Internal Revenue Code or the regulations applicable thereunder, which are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof.

§ 39.23 (c) Deductions from gross income. In computing net income there shall be allowed as deductions:

(1) Federal income taxes;

(2) War-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, or section 923 of the Revenue Act of 1932, or by any such provisions as amended or supplemented;

(3) Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefit of section 151;

(4) Estate, inheritance, legacy, succession, and gift taxes;

(5) Federal import duties, and Federal excise and stamp taxes (not described in subparagraphs (A), (B), (D), (E), or (F)), but this subsection shall not prevent such duties and taxes from being deducted under subsection (a).

§ 39.23 (c) (2) (Repealed by sec. 105 (e) (2), Rev. Act 1942.)

(3) Gasoline and retail sales taxes. In the case of a tax imposed by any State, Territory, District, or possession of the United States, or any political subdivision thereof, on persons selling gasoline or motor vehicle fuel, or other motor vehicle fuel, or upon persons using, as personal property at retail, or upon persons selling gasoline or other motor vehicle fuel, or other motor vehicle fuel, or upon persons using, as personal property at retail, or upon persons selling gasoline or other motor vehicle fuel, or other motor vehicle fuel, or upon persons using, as personal property at retail, the amount of such tax shall be allowed as a deduction in computing the net income of such consumer as if such amount constituted a

§ 39.23 (c)
RUL ES AND REGULATIONS

§ 39.23 (c)–1 Taxes—(a) In general. Subject to the exceptions stated in this section and §§ 39.23 (c)–2 and 39.23 (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 43) Estate, inheritance, legacy, succession, and gift taxes, the employment taxes imposed by sections 1401, 1501, and 1516, and Federal income taxes (including the tax withheld at source under section 1622) are not deductible from gross income. The Federal war-profits and excess-profits taxes imposed by the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 701 of the Revenue Act of 1934, and subchapter E of chapter 2 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 any extent for the taxable year the benefits of section 111, as amended, of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 701 of the Revenue Act of 1934, and subchapter E of chapter 2 are not deductible from gross income. See the last sentence of section 131 (a).

(b) State and local sales and gasoline taxes. (1) Amounts representing sales or gasoline taxes paid by a consumer of services or tangible personal property are deductible by such consumer as taxes, provided they are not paid in connection with his trade or business. The fact that, under the law imposing it, the incidence of the sales or gasoline tax does not fall on the consumer is immaterial. The requirement of section 23 (c) (3) that the amount of the tax must be separately stated will be deemed complied with where it clearly appears that, at the time of sale to the consumer, the tax was added to the sales price and collected or charged as a separate item. It is not necessary, for the purposes of this section, that the consumer be furnished with a sales slip, bill, invoice, or other statement on which the tax is separately stated. Where the law imposing the sales or gasoline tax for which the taxpayer seeks deduction contains a provision against the seller absorbing the tax, or a provision requiring a posted notice stating that the tax will be added to the quoted price, or a requirement that the tax be separately shown in advertisements or separately stated on all bills and invoices, it is presumed that the amount of the sales or gasoline tax was separately paid by the consumer; except that such presumption shall have no application to a gasoline tax imposed upon a wholesaler unless it applies with respect to both the sale at wholesale and the sale at retail.

(2) 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. The term also includes a tax imposed by such authorities upon persons engaged in furnishing services at retail, which is measured by the gross receipts for furnishing such services.

(3) The term “gasoline tax” means, for the purpose of paragraph (2) above, a tax imposed by such authorities upon persons selling gasoline or other motor vehicle fuels either at wholesale or 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 the gasoline or fuel sold.

(4) In general, the term “consumer” means the ultimate user or purchaser; it does not include a person who acquires the property for resale, such as a retailer.

§ 39.23 (c)–2 Federal duties and excise taxes. Federal import or tariff duties, business, license, privilege, excess, and stamp taxes (not described in subparagraph (A) (B) (D) or (E) of section 23 (c) (1)) paid or accrued within the taxable year are not deductible as taxes. The fact that any such tax is not connected with the production of income with respect to which such tax is paid or incurred does not prevent (a) a deduction therefor under section 23 (a) provided it represents an ordinary and necessary expense paid or incurred during the taxable year by a corporation in the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income, or (b) the inclusion of such tax paid or incurred during the taxable year by a corporation or an individual as a part of the cost of acquisition or production in the trade or business, or, in the case of an individual, for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income, or (b) the inclusion of such tax paid or incurred during the taxable year by a corporation or an individual as a part of the cost of production of income with respect to which such tax is paid or incurred.

§ 39.23 (c)–3 Taxes for local benefits. So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property or its owner, if the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The 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. As a general rule, assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and in such cases the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made, none of the amounts so paid is deductible.

§ 39.23 (d) Statutory provisions: deductions from gross income, taxes of shareholder paid by corporation.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

(d) Taxes of shareholder paid by corporation. The deduction for taxes allowed by subsection (c) (1) of this section is subject to the condition that the corporation in the case of taxes imposed upon a shareholder of the corporation upon the interest of such shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

§ 39.23 (d)–1 Tax on bank or other stocks. Banks or other corporations paying taxes assessed against their shareholders on account of their ownership of the shares of stock issued by such corporations without reimbursement from such shareholders may deduct the amount of taxes so paid. The Internal Revenue Code specifically provides, however, that in such cases the shareholders may not deduct the amount of the taxes. The amount so paid should not be included in the income of the shareholder.

§ 39.23 (e) Statutory provisions; deductions from gross income, losses by individuals.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

2) If incurred in any transaction entered into for profit, though not connected with the trade or business; or

3) Of property not connected with the trade or business, if the loss arises from fires, storms, or other unfortunate events beyond the control of the owner, and the owner at the time of the occurrence of such loss has been, and continues to be, in the business of the kind from which such loss has been, and continues to be, exempted, the interest of the owner in the business is so large as to render the loss to him a part of the ordinary and usual losses of the business. No loss shall be allowed as a deduction under this paragraph if at the time of the occurrence of such loss the owner shall have ceased to conduct business. No deduction shall be allowed for such loss as a deduction from the estate tax on the estate tax return.

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§ 39.23 (e)–1 Losses by individuals. (a) Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (1) incurred in the ordinary course of an individual's trade or business, or (2) incurred in any transaction entered into for profit, or (3) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has been claimed on the return. The amount of the loss may be determined by subtracting the fair market value of the property at the time of the casualty from its basis. The amount of the loss so determined is the amount of the loss, except as limited by section 117, is $7,200, as computed in the following manner:

<table>
<thead>
<tr>
<th>Cost of property</th>
<th>$52,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less depreciation (not less than amount allowable) in respect of the building (depreciation for 3 years at 5 percent based on $10,000, value of building when converted to business use)</td>
<td>$1,800</td>
</tr>
<tr>
<td>Loss computed as provided in section 111</td>
<td>$20,200</td>
</tr>
</tbody>
</table>

(b) In general losses for which an amount may be deducted from gross income must be determined by closed completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere possibility of events, bona fide and actually sustained in determining the amount of losses actually sustained. See section 113 (b) for special provisions with respect to capital losses, see section 127.

(c) A loss occasioned by damage to an automobile maintained for pleasure, where such damage results from the fault driving the taxpayer or other person operating the automobile, but is not due to the willful act or negligence of the lossworthy of ascertaining any actual loss.

(d) No loss is realized by the transfer of property by gift or by death. But see section 4(d) (d).

(e) 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. If, however, property so purchased or constructed is prior to its sale rented or otherwise appropriated to income-producing purposes up to the time of the sale, a loss from the sale of the property, computed as provided in section 111, is subject to the limitations provided in section 117, allowances for depreciation, and not to exceed the excess of the value of the property at the time it was appropriated 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 1940 for use as his personal residence and so used by him up to January 1, 1952, when the property was sold, it was rented by the taxpayer. The fair market value of the property at the time it was rented was $12,000, of which $12,000 was allocable to the building. The building had an estimated life of 20 years on January 1, 1940. The property was sold on January 1, 1952, for $16,000. The loss from the sale allowable as a deduction, except as limited by section 117, is $4,200, as computed as follows:

<table>
<thead>
<tr>
<th>Cost of property</th>
<th>$12,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss computed as provided in section 111</td>
<td>$20,200</td>
</tr>
</tbody>
</table>

(f) Loss of use value. (a) When, through some change in business conditions, the usefulness in the business of some or all of the assets is suddenly terminated, so that the taxpayer is unable to use such assets for productive purposes, or such assets permanently from use in such business, he may claim as a loss for the year in which he takes such section 127, the difference between the basis of the property adjusted as provided in section 113 (b) and section 113 (a) (14)–1 and 39.113 (b) (1)–1 to 39.113 (b) (14)–1, inclusive) and the salvage value of the property. This exception to the rule requires that any other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been permanently discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when it is no longer permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income. The limitations provided in section 117 with respect to the sale or exchange of capital assets have no application to losses due to the discarding of capital assets.

(g) If the depreciable assets of a taxpayer consist of more than one item and depreciation, whether in respect of items or groups of items, is based upon the average lives of such assets, losses claimed on the normal retirement of such assets are not allowed as a deduction, as the use of an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired. In order to account properly for such retirement the entire cost or other basis of assets retired, adjusted for salvage, will be charged to the depreciable reserve account, which will enable the full cost or other basis of the property to be recovered.

(h) In cases in which depreciable property is disposed of due to causes other than exhaustion, wear and tear, and normal obsolescence other than normal, or sale, a deduction for the difference between the basis of the property (adjusted as provided in section 127) and 39.113 (b) (14)–1 and 39.113 (b) (14)–1, inclusive and its salvage value and/or amount realized upon its
RULES AND REGULATIONS

§ 39.23 (e)–4 Shrinkage in value of stocks. A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a deduction merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases to employers 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 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 requirement is the worthlessness of the stock, such charging off or writing down will, 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 may be permitted or charged off or written down in any other case.

For dealers in securities, see § 39.23 (e)–5. For limitations on deductions for losses from sales or exchanges of capital assets generally including stocks and bonds, see section 117.

§ 39.23 (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 favorable markets, no deduction will be allowed unless the income of the taxpayer is reduced. If livestock has been used. If livestock has been injured or killed by order of the authorities of a State or of the United States, may in manner be claimed as a loss. If reimbursement is made by a State or the United States in whole or in part on account 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, pasture, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the year. If an individual owner and operator of a farm, in addition to being engaged in another trade, business, or calling, and sustaining a loss from such operation of the farm, the loss amount of which sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. As to losses claimed as deductions for estate tax purposes, see § 39.23 (e)–1. See also §§ 39.23 (a)–7, 39.23 (a)–11, and 39.23 (d)–10.

§ 39.23 (f) Statutory provisions; deductions from gross income; losses by corporations.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions: * * *

(f) Losses by corporations. In the case of a corporation losses sustained during the taxable year and not compensated for by insurance or otherwise.

§ 39.23 (g) Capital losses—(1) Limitation. Losses 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 and are capital assets, the taxpayer shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) Definition of securities. As used in this paragraph (2) of this subsection the term "securities" means shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

(4) Stock in affiliated corporation. For the purposes of paragraphs (2) and (3) of this section, the term "securities" means shares of stock in a domestic or foreign corporation affiliated with the taxpayer, and (B) rights to subscribe for or to receive such shares.

(5) Stock in affiliated corporation. For the purposes of paragraph (2) of this section, the term "securities" means shares of stock in a domestic or foreign corporation affiliated with the taxpayer, and (B) rights to subscribe for or to receive such shares.

(6) Losses sustained by foreign corporations. For purposes of computing the net income of any taxpayer, such losses are to be considered as losses sustained from the sale of the securities in 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 are deemed destroyed or seized under section 127, relating to war losses.

(b) 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 receive such shares.

§ 39.23 (g)–2 Loss on stock of affiliated corporation. (a) If a taxpayer is a domestic corporation and is affiliated, within the definition in section 23 (g) (4), with another corporation, the stock in such affiliated corporation owned by the taxpayer is not considered to be a "capital asset" of the taxpayer for the purpose of determining the loss from the worthlessness of such stock within the provisions of section 23 (g) (2) and § 39.23.
§ 39.23 (h) 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 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.

§ 39.23 (i) Statutory provisions; deductions from gross income; cross reference; capital debts.

Sec. 22. Deductions from gross income. In computing net income there shall be allowed as deductions:

(i) Basis for determining loss. The basis for determining the amount of the deduction for losses sustained, to be allowed under subsection (a) or (b), and for bad debts, to be allowed under subsection (b), shall be the adjusted basis provided in section 112 (b) for determining the basis for the sale or other disposition of property.

§ 39.23 (j) Basis for determining loss. The basis for determining the amount of the deduction allowed for losses sustained, to be allowed under section 23 (a), and to corporations under section 23 (f) or (g), or of the amount of the deduction for bad debts on the current adjusted basis provided in section 112 (b) for determining the basis for the sale or other disposition of property. Proper adjustment must be made in each case for any expenditure, receipt, loan, or other transaction or event relating to capital account, for depreciation, obsolescence, amortization, or depletion.

§ 39.23 (k) Statutory provisions; deductions from gross income; cross reference; capital debts.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

(b) Wagering losses. Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.
§ 39.23 (k)–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, but only if that part of the debt be charged off during the taxable year.

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

(b) 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 ascertainment of worthlessness and charge-off during the taxable year (which were prerequisite to deduction of a bad debt under the law at that time) are no longer required for the allowance of a debt which becomes wholly worthless, the method used in the return for 1921 must be followed for subsequent years unless permission is granted by the Commissioner to change to the other method. A taxpayer filing a first return of income may select either of the two methods subject to approval by the Commissioner upon examination of the return. If the method selected is approved, it must be followed in returns for subsequent years, except as permission may be granted by the Commissioner to change to another method. Application 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 § 39.23 (k)–5.)

(c) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless, to the extent charged off during the taxable year, shall be allowed as a deduction in computing net income. If a taxpayer claims a deduction for a part of a debt for the taxable year within 30 days after the charge-off, such charge-off shall be disallowed. In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

(d) Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an event of the work which is at least a part of an unsecured and unpreferred debt. In bankruptcy cases a debt may become worthless before settlement in some instances, and only when a settlement in bankruptcy shall have been had. In either case the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deductions to such later year. If a taxpayer computes his income upon the basis of valuing his property at market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

(e) 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 charge-off takes place, be conclusively presumed to be worthless or worthless only in part during the taxable year, as the case may be. But no such debt shall be so conclusively presumed to be worthless or worthless only in part as to affect the amount of taxable income will not be allowed as a deduction unless the income such items represent has been allowed as a deduction 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 the settlement and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which becomes worthless is entitled to deduct the amount of deduction to be based upon the price he paid for them and not upon its face value.

§ 39.23 (k)–3 Uncollectible defalcation upon sale of mortgaged or pledged property. (a) 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 obligation remaining unsatisfied 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 the Income from which does not apply) as a bad debt for the taxable year in which the sale is made. (b) If the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are assumed by the purchaser of the property (to the extent that such obligations constitute capital or represent an item the Income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the amount of the property at the date of acquisition.

§ 39.23 (k)–1
§ 39.23 (k)-4 Worthless bonds and similar obligations. (a) Except as otherwise provided in section 23 (k) (5) of the Code and of regulations thereunder, a deduction under section 23 (k) (1) to any taxpayer (other than a bank as defined in section 104) with respect to a debt evidenced by a security which has become worthless in whole or in part. If a security is a capital asset and becomes worthless during the taxable year, a deduction for the loss resulting therefrom is allowable under section 23 (k) (2) to a taxpayer other than a bank. Such a loss, however, is made subject to the limitations provided in section 117 with respect to sales or exchanges. For the purposes of computing the net income of any taxpayer, other than a bank as defined in section 104, such a loss is to be considered as being sustained from the sale or exchange of the security on the last day of the taxable year, irrespective of when during the taxable year such security actually became worthless. Except in the case of a bank as defined in section 104, no deduction is allowable under section 23 (k) (3) with respect to a debt evidenced by a security, as defined 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 127, relating to war losses.

(b) As used in section 23 (k) (2) the term "security" means a bond, debenture, note, 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 any governmental or political subdivision thereof) either in registered form or accompanied by interest coupons.

(c) 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 on non-reforeclosed real estate to which 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.

(d) A taxpayer (other than a dealer in bonds or other similar obligations) possessing debts evidenced by bonds or other similar 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 fluctuation, 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) he has demonstrated to the satisfaction of the Commissioner, and if he has made a proper charge-off with respect to the debt partible, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations. A bank as defined in section 104 may deduct such uncollectible part of the debt even though the evidence of the debt is a security as defined in this section.

§ 39.23 (k)-5 Reserve for bad debts—(a) Taxpayer other than mutual savings banks, building and loan associations, and cooperative banks—(1) General. A mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit may, as an alternative to deduction from gross income of all debts which become worthless in whole or in part, deduct amounts credited to a reserve for bad debts in the manner and under the circumstances prescribed in this section. In the case of such an institution the selection of either of the alternative methods for treating bad debts may be made by the taxpayer in the return for its first taxable year beginning after December 31, 1951. The method selected shall be subject to the approval of the Commissioner upon examination of the claims and in the event of exchange in the method so selected and approved may be made only if permission is granted as provided in § 39.23 (k)-1 (b).

(2) Definitions. When used in this paragraph—

(i) The term "institution" means either a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, such a bank as defined in section 3797 (a) (19) or a cooperative bank without capital stock organized and operated for mutual purposes and without profit.

(ii) "Surplus, undivided profits, and reserves" means the amount by which the total assets of an institution exceed the amount of the total liabilities of such an institution. For this purpose the term "total assets" means the sum of the money, plus the aggregate of the adjusted basis of the property other than money held by an institution, any adjusted basis for any asset is its adjusted basis for determining gain upon sale or exchange for Federal income tax purposes. (See, in general, section 115 and the regulations promulgated thereunder.) For special rules with respect to adjustments to basis for prior taxable years during which the institution was exempt from tax, see § 39.113 (b) (1)-4. The determination of the total assets of any taxpayer shall conform to the method of accounting employed by such taxpayer in determining net income and to the rules applicable in determining its earnings and profits. The term "total liabilities" means all liabilities of the taxpayer, which are fixed and determined, absolute and not contingent, and includes those items which constitute liabilities in the sense of debts or obligations. The total deposits or withdrawable accounts, as defined in subdivision (iv) of this subparagraph, shall be considered a liability. The term includes a building and loan association having permanent nonwithdrawable capital stock represented by shares, the paid-in amount of such stock shall also be considered a liability. Reserves for con—
'tingencies and other reserves, however, which are mere manifestations of surplus are not liabilities.

(iii) The term "surplus or bad debt" reserves existing at the close of December 31, 1951" means the amount of surplus, undivided profits, and reserves, or other amounts credited to these reserves accumulated by the institution prior to January 1, 1952, and in existence at the close of December 31, 1951.

The term "total deposits or withdrawable accounts" means the aggregate of the amounts placed with an institution for deposit or investment and any interest or other earnings outstanding on the books of account of the institution at the close of the taxable year.

(iv) The term "surplus, reserves, and undivided profits in an amount less than 12 percent of the total deposits or withdrawable accounts" means the aggregate of amounts assigned to or committed for the purpose of absorbing losses.

Where 12 percent of the total deposits or withdrawable accounts of an institution at the close of the taxable year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year, there is allowable as a deduction from gross income as an addition to a reserve for bad debts any amount determined by the taxpayer not exceeding the lesser of:

(i) The amount of the net income of the institution for the taxable year computed without regard to section 23 (k) (1), or

(ii) The amount by which 12 percent of the total deposits or withdrawable accounts at the close of the taxable year exceeds the sum of the institution's surplus, undivided profits, and reserves at the beginning of the taxable year.

Bad debt losses sustained during the taxable year shall be charged against the bad debt reserve. Such losses shall be charged against the bad debt reserve during a prior taxable year in which the institution was subject to tax under this chapter shall be charged against the book of the bad debt reserve. The establishment of such reserve and all adjustments made thereto must be reflected on the regular books of account of the institution at the close of the taxable year, or as soon as practicable thereafter. For the purpose of this paragraph minimum amounts credited in compliance with Federal or State statutes, regulations, or supervisory orders, to reserve or similar accounts, or additional amounts credited to such reserve or similar accounts and permissible under such statutes, regulations, or orders, and any charges which may be made for the purpose of absorbing losses sustained by an institution will be deemed to have been credited to the bad debt reserve authorized under this paragraph.

Example (1). On January 1, 1953, and on December 31, 1952, Institution A, which keeps its books on the basis of the calendar year, has total deposits or withdrawable accounts of $800,000. Institution A is insured by an agency of the Federal government.

Example (2). The net income of Institution B, for the taxable year 1952, computed under chapter 1 after all deductions including the deduction for dividends, is $275,000. Such $275,000 is credited by Institution B to the Federal insurance reserve, and the deduction provided in section 23 (k) (1), is determined to be $250,000. Such $250,000 is credited by Institution B to the Federal insurance reserve in section 23 (k) (1), and $30,200 is credited under section 39.23 (k) (5) (b) (3). The amount by which 12 percent of the total deposits or withdrawable accounts of Institution B at the close of the taxable year exceeds the sum of such institution's surplus, undivided profits and reserves at the beginning of the taxable year is $500,000.

During 1954, upon examination of the returns filed by Institutions A and B for 1952, it is determined that the net income of such institution, properly computed, without regard to section 23 (k) (1), is $276,000.

Example (3). Institution C, for example, which is an institution subject to the Federal insurance agency and which has a taxable year ending December 31, 1951, has a surplus of $100,000. A nonbusiness bad debt deduction is allowable as a deduction from gross income as a reasonable addition to the reserve for bad debts determined under the general provisions of paragraph (a) of this section. In making such determination there will be taken into account the surplus, undivided profits, and reserves of the institution from December 31, 1951, until the beginning of the taxable year. Deductions for additions to the reserve for bad debts, in addition to the deductions allowed, if any, under subparagraph (3) of this paragraph, will be authorized in these cases where the institution proves to the satisfaction of the Commissioner that the nonbusiness bad debt experience of the institution warrants the maintenance of a bad debt reserve in excess of that provided in subparagraph (3) of this paragraph.

§ 39.23 (k) (6) Nonbusiness bad debts. (a) In the case of a nonbusiness bad debt, other than a corporation, if a nonbusiness bad debt becomes entirely worthless within the taxable year, the loss resulting therefrom shall be treated as a loss from the sale or exchange of a capital asset held for not more than six months. Such a loss is subject to the limitations provided in section 117 with respect to gains and losses from the sale or exchange of capital assets. A loss with respect to such a debt will be treated as sustained only if and when the debt has become totally worthless, and no deduction shall be allowed for a nonbusiness bad debt which is recoverable in part during the taxable year. Nor are the provisions of this section applicable in the case of a loss resulting from a security as defined in section 23 (k) (3). A nonbusiness bad debt is a debt, other than a debt which is worthless which is incurred in the taxpayer's trade or business.
and other than a debt evidenced by a security as that term is defined in section 23 (k). (3) The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the same as which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23 (e) is "incurred in trade or business" under section 23 (e).

(1) The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the way or for which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. (2) That relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a nonbusiness debt for this section.

(2) To illustrate: A, an individual engaged in the grocery business and who makes his income tax returns on the calendar year basis, extends credit on the 23rd of January, 1951.

(1) In 1952 A sells the business but retains the claim against B. The claim becomes worthless in A's hands in 1953. A's loss is not controlled by the nonbusiness debt provisions, even though the original consideration was advanced by A in his trade or business, since it was not sustained as a proximate incident to the conduct of any trade or business in which he was engaged at the time the claim became worthless.

(2) In 1953 A sells the business to C but sells the claim against B to the taxpayer, D. If C's claim becomes worthless in D's hands in 1953, at a time when D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a business loss, D's loss is controlled by the nonbusiness debt provisions, even though the original consideration was advanced by A in his trade or business.

(3) In 1955 A dies, leaving the business, including the accounts receivable, to his son, C, the taxpayer. The claim against B becomes worthless in C's hands in 1953. C's loss is not controlled by the nonbusiness debt provisions, even though C did not advance any consideration for the claim or acquire it in carrying on his trade or business, since it was sustained as a proximate one in the conduct of the trade or business in which he was engaged at the time the debt became worthless.

(4) In 1952 A dies, leaving the business to his son, C, but the claim against B to his son, D, the taxpayer. The claim against B becomes worthless in D's hands in 1953, at a time when D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a proximate result. D's loss is controlled by the nonbusiness debt provisions, even though the original consideration was advanced by A in his trade or business.

(5) In 1952 A dies and while his executor, C, is carrying on the business, the claim against B becomes worthless. In 1953, the loss sustained by A's estate is not controlled by the nonbusiness debt provisions. While C did not advance any consideration for the claim after the one-half of the estate or acquire it in carrying on a trade or business in which the estate was engaged, the loss was sustained as a proximate incident to the conduct of which the estate was engaged at the time the debt became worthless.

(6) In 1952, A, in liquidating the business, attempts to collect the claim against B but sells the claim to the taxpayer, C, for less than the salvage value. The claim against B becomes worthless in A's hands in 1953, at a time when A was engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a proximate result. A's loss is not controlled by the nonbusiness debt provisions, since A did not advance any consideration for the claim or acquire it in carrying on his trade or business, but sells the claim against B to the taxpayer, C, for less than the salvage value. While C did not advance any consideration for the claim after the estate acquired it or acquire it in carrying on a trade or business in which the estate was engaged, the loss was sustained as a proximate incident to the conduct of which the estate was engaged at the time the claim against B became worthless.

§ 39.23 (d) Statutory provisions; deductions from gross income; depreciation.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

(1) Depreciation. A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence).

(2) Of property used in the trade or business, or

(3) Of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed on the basis of the trust income allocable to each.

[See, 23 (1) as amended by sec. 121 (e). Rev. Act 1942]

§ 39.23 (d)–1 Depreciation. A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or held 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 proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily a uniform rate), whereby the aggregate of 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 depreciable 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 for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter, up to the end of the term for which he was entitled. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the remaindermen, in accordance with the provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustor and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust is to be paid to the trustor and the beneficiaries, respectively, and the trust corpus is liquidated, the income beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee is to determine the distribution of the trust corpus to the beneficiaries, the trustor and the beneficiaries shall be entitled to the depreciation allowance in the ratio of their respective interests in the trust corpus.

§ 39.23 (d)–2 Depreciable property. The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under § 39.23 (a)–15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinary or other property is used in determining the distributable income of a trust, or, in the case of property held for the production of income, in determining the allowable deduction shall be apportioned between the income beneficiaries and the remaindermen, or, in the case of property held for the production of income, in determining the allowable deduction shall be apportioned between the beneficiaries and the remaindermen.

§ 39.23 (d)–3 Depreciation of intangible property. Intangibles, 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 business or trade or 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 be of value in the business or in the production of income for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. No deduction for depreciation, including obsolescence, is allowable in respect of good will.

§ 39.23 (1)-4 Capital sum recoverable through depreciation allowances. The capital sum to be replaced by depreciation allowance in respect of the property in respect of which the allowance is made. (See sections (a) and (14.) To this amount should be added any reasonable amount for improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section (a) and (b)). In this connection, the amortization shall be recorded on the taxpayer's books, the amount measuring a reasonable deduction shall be taken. When the amortization 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. (b) 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 and establishing adequate reserves understated the known facts in prior years. This provision may be illustrated by the following example:

Example. An asset was purchased Jan.

1947, at a cost of $900. The useful life of the asset is 10 years. It has no salvage value. Depreciation was deducted and allowed for 1947 to 1951 as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>$500</td>
</tr>
<tr>
<td>1948</td>
<td>$1,000</td>
</tr>
<tr>
<td>1949</td>
<td>$1,000</td>
</tr>
<tr>
<td>1950</td>
<td>$1,000</td>
</tr>
<tr>
<td>1951</td>
<td>$1,000</td>
</tr>
<tr>
<td>Total amount allowed</td>
<td>$3,500</td>
</tr>
</tbody>
</table>

The correct reserve as of December 31, 1951, is computed as follows:

Dec. 31:

1947 ($900.00 - 10) $1,000
1948 ($900.00 - 9) 1,000
1949 ($900.00 - 8) 1,000
1950 ($900.00 - 7) 1,000
1951 ($900.00 - 6) 1,000

Reserve Dec. 31, 1951 5,000

Depreciation for 1952 is computed as follows:

Cost $10,000

Reserve as of December 31, 1951 5,000

Uncovered cost 5,000

Depreciation allowable for 1952 ($5,000 - 5) 1,000

§ 39.23 (1)-6 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 the cost or other basis thereof. If the property has been the subject of deductions for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and cannot be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

§ 39.23 (1)-7 Depreciation of patent or copyright. In computing a depreciation allowance in respect of a patent or copyright, the capital sum to be replaced is the cost or other basis of the patent or copyright. The allowance should be computed by an appropriate fraction of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental fees, etc., actually paid. Depreciation of a copyright can be taken on the basis of the fair market value of the copyright as of March 1, 1913, as affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent be not obsolete prior to its expiration, such a proportion of the amount on which its depreciation may be based as the number of years of its remaining life divided by the whole number of years intervening between the basis date and the date when it legally expires may be deducted. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

§ 39.23 (1)-8 Depreciation of drawings and models. If a taxpayer has incurred expenditures in his business for design, drawings, prototyping models, or work of an experimental nature calculated to result in improvement of his facilities or his product, and if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness. The facts must be fully shown in the return or prior thereto to the satisfaction of the Commissioner. Except for such depreciation allowances no deduction shall be made by the taxpayer against any sum so set up as an asset except on the sale or other disposition of such asset at a loss or on proof of a total loss thereof.

§ 39.23 (1)-9 Records of depreciable property. In order that the verification of depreciation allowances claimed by the taxpayer may be facilitated, depreciation shall be recorded on the taxpayer's books, the amount measuring a reasonable allowance for depreciation either being deducted directly from the book value of the assets or preferably being credited to a depreciation reserve ac-
§ 39.23 (m)-1 Depletion of mines, oil and gas wells, other natural deposits, and timber—Depreciation of improvements.

(a) 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 reimbursement for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depletion and depreciation are to be allowed.

(b) Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. However, no depletion allowance is allowed the owner with respect to any timber or coal which such owner has disposed of under any form of contract by virtue of which he retains an interest in such timber or coal, if such disposal is considered a sale of timber or coal under section 117.

(c) The adjusted basis of depreciable property is returnable through annual depreciation deductions. Depreciation and depletion deductions on the property of a co-ex extrator, the corporation and not to its shareholders. The principles governing the apportionment of depletion in the case of property held by one person for life with remainder to another person in the case of property held in trust are also applicable to depletion. (See § 39.23 (d)–1).

(d) When used in §§ 39.22 (m)–1 to 39.23 (m)–19, inclusive—

(1) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(2) 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 necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.
a statement setting forth in detail such facts concerning the physical and other requirements for the operation of a treatment plant at a place nearer to the point of extraction from the ground as are sufficient to apprise the Commissioner of the exact basis of the application. If the application is approved by the Commissioner, there is a material change in any of the facts relied upon in such application, a new application must be submitted by the taxpayer.

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale.

"Ordinary treatment processes" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade which is beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining).

If there is no such representative market or field price (as of the date of sale) then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from (a) processes which are not included in the term "ordinary treatment processes," (b) the processes beyond the ordinary treatment processes, if the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property and (c) costs and grade as beneficiated. The processes included in the term "ordinary treatment processes" unless otherwise provided for in subdivisions (i), (ii), (iii), and (iv) of subparagraph (d) of this paragraph, are as follows:

(i) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(ii) In the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment;

(iii) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—crushing, grinding, and beneficia-

tion by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic) cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the mineral.

(iv) The furnacing of quicksilver ores is included in the term "ordinary treatment processes." Electrolytic deposition, roasting, thermal or osmotic smelting, refining, or substantially equivalent processes are not included in the term "ordinary treatment processes."

(2) In addition, a treatment effecting a chemical change, the blending with other material, a thermal action, and the fine pulverization, pressing into shape or molding, are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in subdivisions (i), (ii), (iii), and (iv) of subparagraph (d) of this paragraph, (ii) necessary or incidental to the processes provided for in subdivisions (i), (ii), (iii), and (iv) of subparagraph (d) of this paragraph, (iii) necessary to bring the ores or minerals into condition or form suitable for ship-

ment (for example, the agglomeration of concentrates)

(3) For the purposes of subdivisions (i), (ii), and (iii), the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

"Cost of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2) (3) and (4) and §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, means the "gross income from the property," as defined in paragraph (c) of this section, less the allowable deductions attributable to the processes listed in paragraph (f) of this section in so far as they relate to the purchase of such property, including overhead and operating expenses, interest, general and administrative expenses, and depletion costs properly charged to expense or allowable as deductions under section 23 (cc) depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated.

To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (f) of this

§ 39.23 (m)-1
section, deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (f) of this section and (2) 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) of this section 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) of this section shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

(h) As used in paragraphs (e) and (f) of this section, the term “crude mineral product” means the product as extracted, in which it emerges from the mine or well.

(i) “The property,” as used in section 113 (b), as provided for in § 39.23 (m)-1 to 39.23 (m)-19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer’s interest in each separate mineral property 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” for such treatment is consistently followed.

§ 39.23 (m)-2 Computation of depletion of mines, oil and gas wells, and other natural deposits without reference to discovery value or percentage depletion.

(a) The basis on which depletion, other than discovery depletion or percentage depletion, is to be allowed in respect of any property is the basis provided for in paragraph (a) as provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except that the amount of expenditures treated as discovered depletion under paragraphs 23 (cc) (2) and 23 (ff) shall be disregarded in determining such adjusted basis (see §§ 39.113 (a)–1 to 39.114–1, inclusive, and §§ 39.23 (cc)–1 and 39.23 (ff)–1) and if the amount of the basis as adjusted applicable to the mineral deposit has been determined for the taxable year, the depletion for that year shall be computed by dividing the amount by the number of units of mineral remaining as of the taxable year, and by multiplying the depletion unit, so determined, by the number of units of mineral remaining at the end of the taxable year to be recovered from the property (including units recovered but not sold) plus the “number of units sold within the taxable year” as defined in this section.

(b) The depletion allowance based on discovery value under this section shall not exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance exceed the residual value of other property at the end of operations, but there shall be included, in the case of oil and gas wells, there, the amount of any depletion in the taxable year although produced and sold prior to the taxable year, and excluded units sold reported in the case of a taxpayer after February 28, 1913, is the market or discovery value of the property at the date of discovery or within 30 days thereafter, if such mines or deposits were not acquired as the result of purchase of a proven tract or lease, and if the market value of the property is materially disproportionate to cost. Such basis may not be used in the case of the mines or deposits listed under § 39.23 (m)-5 for any period in respect to which depletion on the basis of percentage of income is allowable.

§ 39.23 (m)-3 Computation of depletion of mines and other natural deposits (other than those in respect of which percentage depletion is allowable) on basis of discovery value.

(a) The basis on which depletion is to be computed in the case of mines and other natural deposits (other than those in respect of which depletion is allowed on the basis of percentage of income under § 39.23 (m)-5) discovered by the taxpayer after February 28, 1913, is the market or discovery value of the property at the date of discovery or within 30 days thereafter, if such mines or deposits were not acquired as the result of purchase of a proven tract or lease, and if the market value of the property is materially disproportionate to cost. Such basis may not be used in the case of the mines or deposits listed under § 39.23 (m)-5 for any period in respect to which depletion on the basis of percentage of income is allowable. The value must be equitably apportioned between the owners of the economic interests therein. For the method of determining whether a discovery has been made, see § 39.23 (m)-14.

For the method of determining the fair market value, see § 39.23 (m)-7.

(b) With respect to any property for which discovery value is the taxpayer’s basis for depletion, the depletion for any taxable year, in addition to the discovery value of the mineral deposit in the property any subsequent allowable capital additions made to the property, shall be determined by subtracting the aggregate of depletion deductions with respect to the property which would previously have been allowable to the taxpayer without the application of any net income limitation, (c) dividing the remaining net income by the number of units of mineral remaining as of the taxable year, and (d) multiplying the depletion unit, thus determined, by the number of units of mineral sold within the taxable year.

§ 39.23 (m)-4 Computation of depletion based on a percentage of income in case of oil and gas wells. Under section 114 (b) (3) in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ 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 § 39.23 (m)-1 and 39.23 (m)-4. In no case shall the depletion 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.

§ 39.23 (m)-5 Computation of depletion based on percentage of income in case of oil and gas wells.
case of certain mines or other natural deposits. (a) In the case of the mines or other natural deposits listed hereinafter, a taxpayer may deduct for depletion under section 114 (b) (A) amounts equal to the following percentages of the gross income from the property:

<table>
<thead>
<tr>
<th>Mine or deposit:</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aplite</td>
<td>15</td>
</tr>
<tr>
<td>Asbestos</td>
<td>10</td>
</tr>
<tr>
<td>Barite</td>
<td>15</td>
</tr>
<tr>
<td>Bauxite</td>
<td>15</td>
</tr>
<tr>
<td>Bentonite</td>
<td>15</td>
</tr>
<tr>
<td>Beryl</td>
<td>15</td>
</tr>
<tr>
<td>Borax</td>
<td>10</td>
</tr>
<tr>
<td>Brromine</td>
<td>5</td>
</tr>
<tr>
<td>Brucite</td>
<td>10</td>
</tr>
<tr>
<td>Calcium carbonates</td>
<td>10</td>
</tr>
<tr>
<td>Calcium chloride</td>
<td>5</td>
</tr>
<tr>
<td>Clay</td>
<td>5</td>
</tr>
<tr>
<td>Clay                     (b)</td>
<td></td>
</tr>
<tr>
<td>Ball</td>
<td>15</td>
</tr>
<tr>
<td>Brick and tile</td>
<td>15</td>
</tr>
<tr>
<td>China</td>
<td>15</td>
</tr>
<tr>
<td>Refractory and fire</td>
<td>15</td>
</tr>
<tr>
<td>Sagger</td>
<td>5</td>
</tr>
<tr>
<td>Coal</td>
<td>10</td>
</tr>
<tr>
<td>Distomaceous earth</td>
<td>15</td>
</tr>
<tr>
<td>Dolomite</td>
<td>10</td>
</tr>
<tr>
<td>Feldspar</td>
<td>15</td>
</tr>
<tr>
<td>Fluorspar</td>
<td>15</td>
</tr>
<tr>
<td>Fuller earth</td>
<td>15</td>
</tr>
<tr>
<td>Garnet</td>
<td>15</td>
</tr>
<tr>
<td>Gismonite</td>
<td>5</td>
</tr>
<tr>
<td>Granite</td>
<td>5</td>
</tr>
<tr>
<td>Graphite, flake</td>
<td>15</td>
</tr>
<tr>
<td>Gravel</td>
<td>5</td>
</tr>
<tr>
<td>Lapisite</td>
<td>15</td>
</tr>
<tr>
<td>Limestone, chemical grade</td>
<td>10</td>
</tr>
<tr>
<td>Metallurgical grade</td>
<td>10</td>
</tr>
<tr>
<td>Magnesium</td>
<td>10</td>
</tr>
<tr>
<td>Magnesium carbonates</td>
<td>10</td>
</tr>
<tr>
<td>Magnesium chloride</td>
<td>5</td>
</tr>
<tr>
<td>Marble</td>
<td>5</td>
</tr>
<tr>
<td>Metal mines</td>
<td>10</td>
</tr>
<tr>
<td>Mica</td>
<td>5</td>
</tr>
<tr>
<td>Oyster shells</td>
<td>10</td>
</tr>
<tr>
<td>Phosphate rock</td>
<td>15</td>
</tr>
<tr>
<td>Potash</td>
<td>15</td>
</tr>
<tr>
<td>Pumice</td>
<td>5</td>
</tr>
<tr>
<td>Pyrophyllite</td>
<td>15</td>
</tr>
<tr>
<td>Quartzite</td>
<td>5</td>
</tr>
<tr>
<td>Rock ash</td>
<td>15</td>
</tr>
<tr>
<td>Sand</td>
<td>5</td>
</tr>
<tr>
<td>Scoria</td>
<td>5</td>
</tr>
<tr>
<td>Slate</td>
<td>5</td>
</tr>
<tr>
<td>Soda</td>
<td>5</td>
</tr>
<tr>
<td>Sodium chloride</td>
<td>5</td>
</tr>
<tr>
<td>Spodumene</td>
<td>10</td>
</tr>
<tr>
<td>Stone</td>
<td>15</td>
</tr>
<tr>
<td>Sulfur</td>
<td>25</td>
</tr>
<tr>
<td>Talc</td>
<td>15</td>
</tr>
<tr>
<td>Thenardite</td>
<td>10</td>
</tr>
<tr>
<td>Trigo</td>
<td>15</td>
</tr>
<tr>
<td>Trona</td>
<td>15</td>
</tr>
<tr>
<td>Vermiculite</td>
<td>10</td>
</tr>
<tr>
<td>Wollastonite</td>
<td>10</td>
</tr>
</tbody>
</table>

Such deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowances 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 §39.23 (m) - (a) 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.

(b) For purposes of this section, the minerals indicated below shall have the following meanings:

- **Borax**
- **Bromine**
- **Carbonates**

Any boron material including that contained in brines, bromine if obtained from brine wells.

Miscellaneous limestones and other calcium carbonate rocks (not specifically provided for at 6 or 15 percent rate of percentage allowance) such as cement rock and limestone used or sold for use in soil treatment. This classification does not include rock or minerals used or sold for use as ballast, road making, concrete aggregate, or in which chemical composition is not a major requirement. Calcium carbonate if produced from brine wells.

## RULES AND REGULATIONS

### §39.23 (m) - 6 Determination of cost of deposits

In any case in which a depletion or depreciation deduction is computed on the basis of the cost or price at which any interest in any mineral property was acquired, the taxpayer will be required to show that the cost or price at which such interest was bought was fixed for the purpose of a bona fide purchase and sale, by which the interest was transferred to an owner other than the vendor. No fictitious or inflated cost or price will be permitted to form the basis of calculation of a depletion or depreciation deduction, and in determining whether the price or cost at which any purchase or sale was made represented the actual market value of the interest sold, due weight will be given to the relationship or connection existing between the person selling the interest and the buyer thereof.

### §39.23 (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 a specified date is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer of as of that particular date. The Commissioner will give due weight and consideration to any and all factors and evidence bearing on the market value, such as cost, actual sales and transfers of similar properties, markups of value or stock or shares, royalties and rentals, and value fixed by the owner for purpose of a capital stock tax, valuation for local or State taxation, partnership agreements, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, and, in the absence of better evidence, disinterested appraisals approved by approved methods. Valuations by analytic appraisal methods, such as the present value method, are not entitled to great weight, (1) if the value of a mineral deposit can be determined upon the basis of (1) the cost, (2) if the knowledge of the presence of the mineral has not greatly enhanced the value of the mineral property, (3) if the removal of the mineral does not materially reduce the value of the property from which it is taken, or (4) if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer or to extrinsic causes other than the possession of the mineral itself. If the fair market value must be ascertained as of a certain date, analytic appraisal methods will not be used if the fair market value can reasonably be determined by any other method.

(b) To determine the fair market value of a mineral property by the present value method, the essential factors must be determined for each deposit included in the property. The factors essential in the case of all mineral deposits are (1) the total expected profit, (2) the rate at which this profit will be obtained, and (3) the rate of interest. 

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**Note:** The text above contains a table with mineral names and their respective codes, along with instructions on how to determine the fair market value for depletion or depreciation purposes. The table includes specific percentages applicable to various minerals, and the text provides guidelines for valuing mineral properties.
In the case of oil and gas properties, the addition of factors is (f) the total quantity of oil and gas in terms of the principal or customary unit (or units) paid for in the product marketed, (g) the quantity of oil and gas expected to be recovered during the period for the preparation of the oil and gas for market, (h) the probable operating life of the deposit in years, (i) the development cost, and (j) the operating cost. In order to estimate the total expected profit from the operation of mines it is necessary to determine the quantity, quality, and recoverable mineral content of the developed, probable, and prospective ore reserves in all cases. For mines with a prior operating record the "spread of profit" per unit of recoverable mineral, or the percentage of net profit to gross process cost per unit or of the total cost of the production is the other factor required in estimates of the total expected profit. For mines with no prior operating record the future sales price and future production cost per unit or of the total cost of the production is estimated in order to determine the "spread of profit" per unit of recoverable mineral.

If the deposit has been sufficiently developed the valuation factors specified in paragraph (b) of this section may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the mineral, percentage of recovery, cost of development, production, interest rate, and selling price of the product marketed during the expected operating life of the mineral deposit. Mineral deposits for which these factors may not be determined with reasonable accuracy from past operating experience may also, with the approval of the Commissioner, be valued by the present value method; but the factors must be derived in accordance with the best evidence, such as the general type of the deposit, the characteristics of the district in which it occurs, the habit of the mineral deposition, the intensity of mineralization, the oil-gas ratio, the rate at which additional mineral has been disclosed by exploitation, the stage of the operating life of the property, and the history of the deposit, in order to establish a reasonable estimate of the required factors.

(d) Mineral deposits of different grades, locations, and areas of extraction in a mineral property should be valued separately. The mineral content of a deposit shall be determined in accordance with § 39.23 (m)-9. In estimating the average grade of the developed and prospective mineral, account should be taken of probable increases or decreases as indicated by the operating history. The rate of exhaustion of a mineral deposit should be determined with due regard to the production exposed by plant capacity, by the character of the deposit, by the ability to market, the mineral product, by labor and operating programs in force or reasonably to be expected for future operations. The operating life of a mineral deposit is that number of years necessary for the expected depletion of the and prospective mineral content at the rate determined as above. The operating life of oil and gas wells is influenced by the rate of discovery and development, and also by voluntary or enforced curtailment of production. The operating cost includes all current expense of producing, preparing, and marketing the mineral product sold (due consideration being given to taxes) exclusive of allowable capital additions, as defined in §§ 39.23 (m)-15 and 39.23 (m)-16, and deductions for depreciation and depletion, but including cost of repairs. For definitions of "development expenses" and "operating expenses" in the case of oil and gas wells, see § 39.23 (m)-16. The value of each mineral deposit is the present value of the estimated net profit to be derived from the deposit, if it is necessary to estimate the "spread of profit" per unit of recoverable mineral.

§ 39.23 (m)-9 Determination of mineral contents of mines and of oil and gas wells. (a) If it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units of oil, pounds, ounces, barrels, thousand cubic feet, or other measure) of mineral product reasonably known, or on good evidence believed, to have existed in the ground as of that date, the estimate or determination must be made. The value of each mineral deposit shall be the present value as of the date of the estimated net profit as determined by the operating life, and further reduced by the value at that date of the depreciable assets and of the capital additions, if any, necessary to realize the profit.

(e) The value of each mineral deposit is the present value of the estimated net profit to be derived from the deposit, if it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units of oil, pounds, ounces, barrels, thousand cubic feet, or other measure) of mineral product reasonably known, or on good evidence believed, to have existed in the ground as of that date, the estimate or determination must be made. The value of each mineral deposit shall be the present value as of the date of the estimated net profit as determined by the operating life, and further reduced by the value at that date of the depreciable assets and of the capital additions, if any, necessary to realize the profit.

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

§ 39.23 (m)-9 Resale of mineral deposits not allowed. No resale of a property whose value as of any specific date has been determined and approved will be made or allowed during the period for the determination of the basis for depletion, the values of the several interests in the property may be as determined separately, but, when determined as of the same date, shall together never exceed the value at that date of the mineral property in fee simple. For purposes of the present value method, 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 the case of a subsequent discovery of nonmetallic minerals in respect to which depletion is not allowed on the basis of percentage of income under § 39.23 (m)-4 or § 39.23 (m)-5, or of misrepresentation or fraud or gross error 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 number of recoverable units shall be corrected when a virtual change of ownership of part of the property results as the outcome of litigation. The value should be redistributed:

(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 § 39.23 (m)-9, and

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

§ 39.23 (m)-9 Determination of mineral contents of mines and of oil and gas wells. (a) If it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units of oil, pounds, ounces, barrels, thousand cubic feet, or other measure) of mineral product reasonably known, or on good evidence believed, to have existed in the ground as of that date, the estimate or determination must be made. The value of each mineral deposit shall be the present value as of the date of the estimated net profit as determined by the operating life, and further reduced by the value at that date of the depreciable assets and of the capital additions, if any, necessary to realize the profit.

(e) The value of each mineral deposit is the present value of the estimated net profit to be derived from the deposit, if it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units of oil, pounds, ounces, barrels, thousand cubic feet, or other measure) of mineral product reasonably known, or on good evidence believed, to have existed in the ground as of that date, the estimate or determination must be made. The value of each mineral deposit shall be the present value as of the date of the estimated net profit as determined by the operating life, and further reduced by the value at that date of the depreciable assets and of the capital additions, if any, necessary to realize the profit.

(f) If, for the purpose of the equitable apportionment of depletion among the several interests of economic interests, the value of any mineral property must be ascertained as of any specific date for the determination of the basis for depletion, the values of the several interests in the property may be as determined separately, but, when determined as of the same date, shall together never exceed the value at that date of the mineral property in fee simple. For purposes of the present value method, 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 the case of a subsequent discovery of nonmetallic minerals in respect to which depletion is not allowed on the basis of percentage of income under § 39.23 (m)-4 or § 39.23 (m)-5, or of misrepresentation or fraud or gross error 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 number of recoverable units shall be corrected when a virtual change of ownership of part of the property results as the outcome of litigation. The value should be redistributed:

(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 § 39.23 (m)-9, and

(b) In the case of the sale of a part of the property, between the part sold and the part retained.
prior estimate, then the estimate of the remaining recoverable units shall be revised and the next year's depletion allocations made 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 estimate is required and such revision is made within the year. Such revised estimate will not, however, affect the basis for depletion.

§ 39.23 (m)–10 Depletion, adjustments of accounts based on bonus or advanced royalty. (a) If a bonus in addition to the depletion allowance is granted in the property, there shall be allowed to the payee as a depletion deduction in respect of the bonus an amount equal to that proportion of the basis for depletion as provided in section 114 (b) (1) or (2), whichever is the smaller.

(b) If the owner of operating rights in mineral property for a term of years is required to extract and pay for, annually a specified number of tons, or other agreed units of measurement, of such mineral, or to pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the premises, the payee shall treat an amount equal to that part of the bonus for depletion allocable to the number of units so paid for in advance of extraction as an allowable deduction from the gross income of any year in which such payment was made or payments shall be made; and no deduction for depletion by such payee shall be claimed or allowed in any subsequent year on account of the extraction of the same mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any grant of mineral rights expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the grantor shall adjust his capital account by restoring therefrom the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which such expiration, termination, or abandonment occurs.

(d) In lieu of the treatment provided for in paragraphs (a) and (b) of this section, if the owner of an economic interest in minerals in respect of which depletion is allowed on the basis of percentage of income under § 39.23 (m)–4 or § 39.23 (m)–5 may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year or period for which such deduction is allowable under such section of the percentages applicable as indicated in such sections; but the deduction shall not in any case exceed 50 per cent of the cost of the depletion so computed as a result of such bonus deduction (without allowance for depletion) from the property

(e) If a lessee or other owner of operating rights in one or more mineral properties acquires quantities on a specific number of units of mineral annually, whether or not extracted within the year, and may apply any amounts paid on account of the units not extracted in the same year against the royalty on mineral thereafter extracted, 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 year the advanced royalties are paid or accrued;

2. As deductions from gross income for the year the depletion in respect of which the advanced royalties were paid or accrued.

The option contained in this paragraph shall apply only to advanced royalties paid or accrued in taxable years ending on or after December 31, 1938. Every taxpayer shall make an election as to the treatment of all such advanced royalties in his return for the first taxable year ending on or after December 31, 1938, in which such advanced royalties are paid or accrued. A taxpayer will be considered to have made an election in accordance with the manner in which such items are treated in the year in which such items for the year paid or accrued will constitute an election to have all such items treated in accordance with subparagraph (2) of this paragraph. Any election made under this section is binding for all subsequent years and the taxpayer must treat all advanced royalties paid or accrued in such subsequent taxable years in the same manner.

§ 39.23 (m)–11 Depletion and depreciation accounts on books. (a) Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be recorded the cost or other basis provided by section 113 (a) as 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 section 113 (b).

(b) 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 §§ 39.23 (m)–2, 39.23 (m)–3, 39.23 (m)–4, or 39.23 (m)–5; and 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 provided by section 113 (a) plus all subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed, except such depletion and depreciation as may be allowable under section 114 (b) (2) (3) or (4) and §§ 39.23 (m)–3, 39.23 (m)–4, or 39.23 (m)–5.

(c) The grantor to whom section 114 (b) (2) and § 39.23 (m)–3 are applicable shall keep similar accounts with respect to discovery value.

§ 39.23 (m)–12 Statement to be attached to return when valuation, depletion, or depreciation of mineral property is claimed. (a) Except as provided in § 39.23 (m)–13, there shall be attached to the return of every taxpayer asserting a value for any mineral property as of specific date or claiming a deduction for depletion or depreciation a statement setting forth with respect to each mineral property (including oil and gas properties):

1. The name, description, location, and identifying number, if any, of the property

2. The nature of the taxpayer's interest in the property, accompanied by a description of the instruments by which it was acquired;

3. The date of acquisition and, if under lease, the exact terms and date of expiration of the lease;

4. The amount paid for the property, stating the amount paid to each vendor, with his name and address;

5. The date as of which the property is valued, if a valuation is necessary to establish the basis as provided by section 113 (a);

6. The value of the property on that date with a statement of the procedure method by which it was determined;

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

8. The estimated number of units of each kind of mineral at the end of the taxable year, and also at the date of depletion, if any, or at the date at which any valuation is made, together with an explanation of the method used in the estimate, the name and address of the person making the estimate, and an average analysis which will indicate the quality of the mineral valued, including the grade or gravity in the case of oil;

9. 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 desirable that this information be furnished by month);

10. The gross amount received from the sale of mineral;

11. The amount of depreciation 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 and every prior year (1) were allowed, (2) were allowable, and (3) would have been allowable without reference to percentage depletion or discovery value allowances, or (ii) whether the lessor repossessed the property, and, in the case of a lessor, whether the lease involved was still in effect at the close of the taxable year, and, if not, when it was terminated and for what reason, and whether the lessor repossessed the property. Any taxpayer who is the assignor of a lease with respect to any property, or the holder of an interest, shall state the exact nature of the interest held and shall furnish a certified copy of the instrument or instruments by which it was acquired.

The information required by this section 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 properties, provided all additional information necessary for keeping the maps up to date is filed each year. This includes records of dry holes, as well as producing wells, together with logs, depth and thickness of sands, location of new wells, etc.

§ 39.23 (m)-12. The other information required by paragraphs (a) (1), (a) (2), and (b) of § 39.23 (m)-12 shall be furnished in a single statement, and shall be deemed to be a part of the income tax return to which it relates.

§ 39.23 (m)-14. Discovery of mines or other natural deposits (except those in respect of which percentage depletion is allowable under § 39.23 (m)-4 or § 39.23 (m)-5). The fair market value of the property will be deemed to have become disproportionate to 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, expansion, and marketing.

(b) A mine or minerals of a kind not excepted by this section may be discovered when (1) there is found a deposit of mineable quantity and quality, or (2) there is disclosed by drilling or exploration, conducted above or below ground, a mineral deposit not previously known to exist and the existence of which was impossible 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 has been made, the Commissioner will take into account the peculiar conditions of each case; but no discovery, for the purposes of depletion, can be allowed as to minerals which constitute merely unimportant extensions of continuous commercial veins or deposits, or deposits only known to exist, which have been or should have been included in "probable" or "prospective" mineral, or which were in any other way known or must be of sufficient value and quantity and character and extent of the discovered de-
Postposals of mineral have with reasonable certainty been established, determined, or proved.

§ 39.23 (m)–15 Allowable capital additions in case of mines—(a) General rules. (1) All expenditures in excess of net receipts shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a productive stage when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(2) 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 maintain output or to avoid losses because of the recession of the working faces of the mine, and which (i) do not increase the value of the mine, or (ii) do not decrease the cost of production of mineral units, or (iii) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses.

(b) Special rules. Sections 23 (cc) and 23 (ff) contain special provisions for treatment of expenditures for certain exploration and development costs (other than for acquisition or improvement of depreciable property) with respect to ores and minerals other than oil or gas.

See §§ 39.23 (cc)–1 and 39.23 (ff)–1.

§ 39.23 (m)–16 Charges to capital and to expense in case of oil and gas wells. (a) Items chargeable to capital or to expense at taxpayer's option:

(1) Option with respect to intangible drilling and development costs incurred by an 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 working or operating rights) in the development of oil and gas properties: All expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., 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 operator, be deducted from gross income as an expense or charged to capital account. Such expenditures have for consequence been termed intangible drilling and development costs. They include the cost to operators of any drilling or development work (excluding amounts payable only out of profits) and the costs proceeding from production, and amounts properly allocable to cost of depreciable property) done for them by contractors under any form of contract, including turnkey contracts. Examples of items to which this option applies are, all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, (i) in the drilling, shooting, and cleaning of wells; (ii) in such clearing of ground, draining, road making, surveying, and geological work as is necessary for the drilling of wells; and (iii) in the construction of such derricks, tanks, pipelines, 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 projects which in themselves do not have a salvage value.

For the purposes of this option, labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the development of additional ores for which they have a salvage value. Included in this option are all costs of drilling and development undertaken (directly or through a contract) by an operator of an ordinary loss provided a proper election is made in the returns for the first taxable year beginning after December 31, 1942, in which such a nonproductive well is completed. The election with respect to intangible drilling and development costs of nonproductive wells is a new election, and, when made, shall be binding for all subsequent years. Any taxpayer who incurs option drilling and development costs in drilling a nonproductive well must make a clear 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 clear indication in such return of an election to deduct as ordinary losses intangible drilling and development costs of nonproductive wells shall be deemed to be a clear indication to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property.

(2) Items returnable through depreciation: (a) Intangible drilling and development costs incurred under a contract, such costs shall be allocated between the forgoing classes of items for the purpose of determining the depletion and depreciation allowances.

(4) Option with respect to cost of nonproductive wells: If the operator has elected to capitalize intangible drilling and development costs, then an additional option is accorded with respect to intangible drilling and development costs incurred in drilling a nonproductive well. Such costs incurred in drilling a nonproductive well may be deducted by the taxpayer as an ordinary loss provided a proper election is made in the returns for the first taxable year beginning after December 31, 1942, in which such a nonproductive well is completed. The election with respect to intangible drilling and development costs of nonproductive wells is a new election and, when made, shall be binding for all subsequent years. Any taxpayer who incurs option drilling and development costs in drilling a nonproductive well must make a clear 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 clear indication in such return of an election to deduct as ordinary losses intangible drilling and development costs of nonproductive wells shall be deemed to be a clear indication to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property.

(b) Nonoptional items distinguished:

(1) Capital items: The option with respect to intangible drilling and development costs 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 the drilling tools, pipes, casing, tubing, tanks, engines, boilers, machinery, etc. The option does not apply to any expenditure 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 storing or treating oil or gas. These are capital items and are returnable through depreciation.

(2) Expense items: Expenditures which must be charged off as expense, regardless of the class of the items covered by 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.

(d) This section does not grant a new option or election. Any taxpayer who made an election under paragraph (b) of § 29.23 (m)-9, Regulations 111 (26 C.F.R., 1949 ed., Supps.), is, by such election, bound with respect to all optional expenditures (whether made before January 1, 1952, or after December 31, 1951) with oil and gas properties. Any taxpayer who has never made expenditures for the development of oil and gas properties prior to his first taxable year for property before January 1, 1952, must make an election with respect to intangible drilling and development costs in general for the first taxable year in which the taxpayer makes such expenditures.

§ 39.23 (m)-17 Depreciation in case of mines. (a) The Internal Revenue Code provides that deductions for depreciation of improvements on mining property may be taken “according to the peculiar conditions in each case.” This is deemed to include exhaustion and wear and tear of the property used in mining of deposits, including a reasonable allowance for obsolescence. (See §§ 39.23 (m)-1, 10, unreasonable, as to deduction for depreciation and obsolescence generally. See particularly § 39.23 (m)-5 with regard to information which must be furnished in substantiation of deductions claimed for depreciation and obsolescence.)

(b) It shall be optional with the taxpayer, subject to the approval of the Commissioner, whether the cost or other basis of the plant and equipment plus allowable capital additions but minus estimated salvage value shall be recovered (1) at a rate established by current exhaustion of mineral, or (2) by reasonable charges for depreciation (see § 39.23 (m)-1) at a rate determined by the physical life or the economic life of such plant and equipment, according to the peculiar conditions of the case, by a method satisfactory to the Commissioner.

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

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

(e) Any difference between the salvage value of plant and equipment and the basis provided in section 113 (a) adjusted as provided in section 113 (b) remaining at the termination of mining operations shall be returned as a profit or loss in the year in which it is realized.

(f) Nothing in this section shall be interpreted as meaning (1) that the cost or other basis of a mining plant and equipment may be reduced by depreciation on such property subsequent to the date on which the property shall have become obsolete or shall have been abandoned for the purpose of mining, or (2) that property which has been depredated shall be depreciated at a rate below its normal capacity. In estimating the salvage value of mining equipment at the end of its estimated economic life consideration may be given to its specialized character and the cost of dismantling and dismantling and transporting it to market.

(g) Nothing in §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, shall be interpreted to permit expenditures charged to expense in any taxable year or any part of the year to be recovered through depletion or depreciation.

(h) Sections 23 (cc) and 23 (ff) provide special rules for treatment of depreciation allowances with respect to the exploration and development of a mine or other natural deposit other than oil or gas. See §§ 39.23 (cc)-1 and 39.23 (ff)-1.

§ 39.23 (m)-18 Depreciation of improvements in case of oil and gas wells. Taxpayers operating oil or gas properties will, in addition to and apart from the deduction allowed as hereinafore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under § 39.23 (m)-16. The amount deductible on this account shall be such an amount based upon its cost or other reasonable and comparable basis of the value of land for purposes other than mining as will be sufficient to provide for the exploration and development of a mine or other natural deposit other than oil or gas. See §§ 39.23 (cc)-1 and 39.23 (ff)-1.

§ 39.23 (m)-19 Depletion and depreciation of oil and gas wells in years before 1916. In any taxable year beginning after January 1, 1916, and prior to 1916 in order to show separately in these years the portion of such deduction representing depletion and depreciation, such expenditures, as to deduction for depletion and obsolescence, shall not be made during periods when the mine is idle or is producing at a rate below its normal capacity. In estimating the salvage value of the equipment at the end of its estimated economic life consideration may be given to its specialized character and the cost of dismantling and dismantling and transporting it to market.

§ 39.23 (m)-20 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) reduced by the amount required to be made of the reserves for depletion at January 1, 1916, and proper allocation between depletion and deduction must be maintained thereafter.

§ 39.23 (m)-21 Computation of allowance for depletion of timber for given year. (a) The allowance for depletion of timber in any taxable year shall be based upon the number of units of timber felled during the year and the depletion unit of the timber in the timber account or accounts pertaining to the timber cut. The depletion unit of the timber for a given timber account in a given year shall be the quotient obtained by dividing (1) the basis provided by section 113 (a) and adjusted as provided by section 113 (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 (2) 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 for or deducted from 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 account shall be the product of the number of units of timber cut from the given account during the year multiplied by the depletion unit of the timber in the timber 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 in the year of depletion for a given month will be determined in the manner outlined above for a given year. The total amount of the deduction for depletion in any taxable year shall be the sum of the amounts deductible for the several timber accounts. For description of timber accounts, see §§ 39.23 (m)-27 and 39.23 (m)-28.
§ 39.23 (m)-22 Revaluation of timber not allowed. No revaluation of 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 facts known on the date as of which the valuation was made. No revaluation will account for misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The deprecation unit should be charged when a revision of the remaining number of units of recoverable timber in the property has been made in accordance with § 39.23 (m)-26.

§ 39.23 (m)-23 Depreciation of improvements in case of timber. (a) 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: (1) Whether the cost or other basis of the property subject to depreciation shall be recovered at a rate established by current conditions prevailing at the time the property was acquired, or (2) Whether the cost or other basis shall be recovered by appropriate charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner.

(b) In no case may charges for depreciation be based on a rate which will extinguish the cost or other basis of the property at the time of the termination of its useful life. Nothing in this section shall be interpreted to mean that the value of a timber plant 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 or shall have been abandoned, or that any part of the value of cut-over land may be recoverable through depreciation. (See §§ 39.23 (1)-1 to 39.23 (1)-10, inclusive, as to deductions for depreciation and obsolescence generally. See particularly § 39.23 (1)-5 with regard to information which must be furnished in substantiation of deductions claimed for depreciation and obsolescence.)

§ 39.23 (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 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 land sold; (b) Description of, cost of, and terms of purchase or lease of, timber and land acquired; (c) Proof of profit or loss from sale of capital assets; (d) Description of timber with respect to which claim for loss, if any, is made; (e) Record of timber cut; (f) Changes in each timber account as the result of purchase, sale, cutting, 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 inventoried; (i) Unit production costs; and (j) Any other data which will be helpful in determining the reasonableness of the depletion or depreciation deductions claimed in the return.

§ 39.23 (m)-25 Determination of fair market value of timber. (a) If the fair market value of the property at a specified date is the basis for depletion or depreciation deductions, such value shall be determined, subject to approval or revision by the Commissioner upon audit, by the owner of the property in the light of the most reliable and accurate information available with reference to the condition of the property as it existed at that date, regardless of all subsequent changes, such as changes in surrounding circumstances, changes in standards of utilization, in degree of utilization, etc. The value sought will be the selling price, assuming a transfer between a willing seller and a willing buyer, as of the particular date. Such factors as the following will be given due consideration: (1) Character and quality of the timber as determined by species, age, size, condition, etc. (2) The quantity of timber per acre, the total quantity under consideration, and the location of the timber in question with reference to other timber; (3) Accessibility of the location with reference to distance from a common carrier, the topography and other features of the ground upon which the timber stands and over which it must be transported, in methods of exploitation, the probable cost of exploitation, and the climate and the state of industrial development of the locality; and (4) The freight rates by common carrier to important markets.

(b) The timber in each particular case will be valued on its own merits and not on the basis of general averages for regions; however, the value placed upon it, taking into consideration such factors as those mentioned above, will be consistent with that of the other timber in the region. The Commissioner will give due weight and consideration to any other data in all cases, and the principles of determining the market value, such as cost, actual sales and transfers of similar properties, the margin between the cost of production and the selling price 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 depletion purposes the fair market value at a specified date shall not include any part of the value attributable to land.

(c) 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.

§ 39.23 (m)-26 Determination of quantity of timber. Each taxpayer claiming a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board measure, log scale, cords, or other units) of timber reasonably known, or on good evidence believed, to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. This estimate shall state as nearly as possible the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 percent of the quantity of timber which the area would have sustained as of that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time. If subsequently during the ownership of the taxpayer making the return, as the result of the growth of the timber, of changes in standards of utilization, of losses not otherwise accounted for, of abandonment of timber, or of operations or development work, it is ascertained either by the taxpayer or the Commissioner that there remain on the ground, available for utilization, more or less units of timber than remain in the timber account or accounts on the basis of the original estimate, then the original estimate (but not the basis for depletion) shall be revised and the annual depletion deduction claimed for subsequent taxable years shall be based upon the revised estimate.
§ 39.23 (m)–91 Aggregating timber and land for purposes of valuation and accounting. (a) With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts on the basis of which the 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 be removed by a single logging development. In exceptional cases, provided there are good and substantial reasons, and subject to approval or revision by the Commissioner on audit, the taxpayer may divide the timber in a given block into two or more accounts, provided that the characteristics of the timber, or scattered tracts may 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.

(b) The timber accounts mentioned in paragraph (a) of this section shall not include any part of the value or cost, as the case may be, of the land. In a manner similar to that prescribed in paragraph (a) of this section, the land in a given “block” may be carried in a single land account or may be divided into two or more accounts based on the character of the land, or scattered tracts may be included in separate accounts. 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.

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

(d) For substantial reasons satisfactory to the Commissioner, or as required by the Commissioner, the taxpayer may, under the circumstances of the individual accounts, by combining two or more accounts, or by dividing and recombining accounts.

§ 39.23 (m)–28 Timber depletion and depreciation accounts on books. (a) Every taxpayer claiming or expecting to claim a deduction for depletion or depreciation of timber or its accessibility, or any part of said timber, shall be required to keep a separate account showing the cost of the timber or its accessibility, or scattered tracts may be included in separate accounts, or special timber products may be carried in distinct accounts, or distinct tree species or groups of tree species may be carried in distinct accounts, or other resources, if any, and a proper part of the cost or value shall be allocated to each. (See § 39.23 (m)–27.) These accounts shall be credited with the amount of the depreciation and depletion deductions computed in accordance with § 39.23 (m)–20 each year, or the amount of the depreciation and depletion shall be credited to depreciation and depletion reserve accounts, to the end that when the sum of the credits, or the credits under the provisions of § 39.23 (m)–20, equals the cost or other basis of the property, plus subsequent allowable capital additions, no further deduction for depreciation and depletion will be allowed.

§ 39.23 (m)–(o) Statutory provisions; deductions from gross income; charitable and other contributions. Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions: * * *

(1) Basis for depreciation and depletion. The basis upon which depletion, exhaustion, or amortization of real property is allowed shall include the cost or other basis of the property, plus subsequent allowable capital additions.

(2) A corporation, trust or community chest, fund, or other organization shall be treated as a natural person for the purposes of section 170 of the Internal Revenue Code of 1954, for the purpose of determining the amount of contributions or gifts that may be deducted by any such organization from gross income for the taxable year of the corporation, trust or community chest, fund, or other organization.

(3) The special fund for vocational rehabilitation authorized by section 12 of the World War II Veterans’ Act of 1942, 53 Stat. 611 (U. S. C., Title 38, sec. 101), shall be treated as a natural person for the purpose of determining the amount of contributions or gifts that may be deducted by any such organization from gross income for the taxable year of the corporation, trust or community chest, fund, or other organization.

(4) Post offices of the United States, or any state or agency thereof, shall be treated as a natural person for the purpose of determining the amount of contributions or gifts that may be deducted by any such organization from gross income for the taxable year of the corporation, trust or community chest, fund, or other organization.

(5) The requirement of section 170, that contributions or gifts be used exclusively for religious, charitable, educational purposes, or the prevention of cruelty to children or animals, requires that the contributions or gifts be used exclusively for religious, charitable, educational purposes, or the prevention of cruelty to children or animals; or

(6) The United Nations. * * *[* Not applicable.]

Sec. 22. Contributions and gifts. Sec. 22 (c) as amended by secs. 221 (a), Rev. Act 1935; sec. 127 (a), Rev. Act 1932; sec. 6 (b), Individual Income Tax Act 1935; sec. 1, Pub. Law 7 (80th Cong.); sec. 222 (a) Rev. Act 1935; sec. 4 (a), Pub. Law 623 (62d Cong.)]

Sec. 11. Dental or Tax Deductions and Exemptions [Internal Security Act of 1958]. (b) Notwithstanding any other provision of law, no deduction for Federal income-tax purposes shall be allowed in the case of any contribution or gift for the use of any organization if at the time of the making of such contribution (1) such organization is registered under section 12 of the act, or (2) the organization is subject to a final order of the Board (the Subversive Activities Control Board) requiring such organization to register under section 7. * * *

Sec. 23. Deductions and Charitable Contributions. Sec. 23 (o)–1 Contributions or gifts by individuals. * * *

(d) Contributions or gifts allowable under section 23 (o) only with respect to contributions or gifts which are actually paid during the taxable year, regardless of when pledged and regardless of when paid with respect to the person or organization paying the contribution in keeping his books and records. A contribution or gift to an organization described in section 23 (o) is deductible even though some portion of the funds of such organization is or may be used in foreign countries for charitable and educational purposes. This section does not apply to contributions or gifts by estates and trusts (see section 162). For disallowance of certain charitable deductions otherwise allowable under section 23 (o) (2) see sections 3013 and 162 (c) (2) and regulations promulgated pursuant thereto.

(b) A contribution or gift to the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any possession of the United States, exclusively for public purposes, is deductible.

(c) No deduction is allowed in computing the net income of a common trust fund or a partnership for contributions or gifts made to organizations described in section 23 (o). See sections 169 and 183. However, a partnership’s share of contributions or gifts allowed to be paid by a partnership during its taxable year to such organizations may be allowed as a deduction in the individual personal return for his taxable year with or without 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 in the case of 20 percent of his adjusted gross income. In the case of a nonresident alien individual or a citizen of the United States entitled to the benefit of section 251, see sections 213 (c) 220, and 251.
For contributions or gifts by corporations, see § 39.23 (q).-1.

(d) In the case of husband and wife making a joint return, the deduction for contributions or gifts is the aggregate of such contributions or gifts made by the spouse and is limited to 20 percent of the aggregate adjusted gross income of the spouses.

(e) A donation made by an individual to an organization other than one referred to in § 39.23 (o) which reasonably 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.

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

(g) If the purpose of the contribution or gift is other than money and it is used to purchase or pay for property or services, the amount thereof shall be the fair market value of the property at the time of the contribution or gift.

(Deductions from gross income.)

Sec. 23. Deductions from gross income: contributions of an employer to an employee's trust or annuity plan and compensation under a deferred-payment plan.

For contributions or gifts by corporations, see § 39.23 (q).-1.

(1) General rule. Contributions to an employee's trust or annuity plan and compensation under a deferred-payment plan shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under subsection (b) of this subparagraph.

2.1 In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the employee, the contributions shall be deductible in the succeeding taxable year in the amount determined in accordance with section 165 (a), in an amount determined as follows:

(1) An amount not in excess of 5 per centum of the amount otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount shall be determined by the Commissioner upon periodic examinations at not less than five-year intervals to the extent necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

(2) An amount not in excess of 5 per centum of the amount otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount shall be determined by the Commissioner upon periodic examinations at not less than five-year intervals to the extent necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

3.1 The amount deductible under clause (i) necessary to provide with respect to all of the employees under the plan, the remaining unfunded cost of their past and current service credits determined as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, but such remaining unfunded cost, if any, attributable to such individuals shall be determined as the excess of the amount so deductible in such case over a period of at least 5 taxable years.

4.1 In lieu of the amounts allowable under (i) and (ii), above, an amount equal to the present value of the future compensation which bears the same present value relationship to the normal cost of the plan, as determined by the Commissioner, is paid or accrued during a taxable year of the trust for which the 20 per centum of the compensation otherwise paid or accrued during such taxable year is more than the amount reasonably necessary to provide the remaining unfunded cost of the plan.

(2) Contributions are a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Commissioner, and such contributions shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under subsection (b) of this subparagraph.

5.1 A contribution or gift in each case. Claims for deductions under section 165 (g) with respect to all of the employees under the plan, plus

(i) Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence, the excess, or if no amount unpaid at the time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 per centum of the compensation otherwise paid or accrued during such succeeding taxable year, and the term "stock bonus or profit-sharing trust" as used in this subparagraph shall not exceed 15 per centum of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan.

6.1 Any contributions or compensation having the effect of a stock bonus or profit-sharing trust shall be considered a single trust for the purposes of applying the limitation in this subparagraph.

7.1 If contributions are paid in two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

8.1 If contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

9.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the trusts or plans.

10.1 If contributions are paid in two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

11.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable years of the trusts or plans in which the contributions are made.

12.1 Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence is paid.

13.1 If contributions or compensation having the effect of a stock bonus or profit-sharing trust shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

14.1 If contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

15.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the trusts or plans.

16.1 Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence, the excess, or if no amount paid.

17.1 If contributions or compensation having the effect of a stock bonus or profit-sharing trust shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

18.1 If contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

19.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable years of the trusts or plans in which the contributions are made.

20.1 Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence is paid.

21.1 If contributions or compensation having the effect of a stock bonus or profit-sharing trust shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

22.1 If contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

23.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable years of the trusts or plans in which the contributions are made.

24.1 Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence is paid.

25.1 If contributions or compensation having the effect of a stock bonus or profit-sharing trust shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

26.1 If contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

27.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable years of the trusts or plans in which the contributions are made.

28.1 Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence is paid.

29.1 If contributions or compensation having the effect of a stock bonus or profit-sharing trust shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

30.1 If contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

31.1 If contributions are made to more than one trust, or if contributions are made to the same trust under more than one plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable years of the trusts or plans in which the contributions are made.

32.1 Any excess, if any, of the amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the first sentence of this subparagraph is less than the amount payable under the first sentence of this subparagraph, the excess, or if no amount otherwise paid or accrued during the taxable year of the trust for which the amount so deductible under the preceding sentence is paid.

(2) Deductions prior to income tax acts. * * * [Not applicable.]

[Sec. 23 as amended by sec. 102 (b), Rev. Act 1942; sec. 202, Pub. Law 291 (79th Cong.)].

§§ 39.23 (q) and 39.23 (q)-1. Contributions of an employer to an employee's trust or annuity plan and compensation under a deferred-payment plan.
payment plan; in general. (a) Section 23 (p) prescribes limitations upon deductions for amounts contributed by an employer under a pension, annuity, stock bonus, or profit-sharing plan, or under any plan of deferred compensation. It is immaterial whether the plan covers present employees only, or present and former employees, or only former employees.

As to inclusion of full-time life insurance salesmen within the class of persons considered to be employees, see section 3797 (a) (20) Section 23 (p) does not apply to a plan which does not defer the recognition of compensation for the services actually rendered. In no case is it necessary to determine whether the amounts thus deductible under section 23 (p) (1) are or are not subject to the conditions and limitations under section 23 (p) as well as those particularly provided in section 23 (p).

(b) In order to be deductible under section 23 (p) contributions must be expenses which would be deductible under section 23 (a) if they were not for the provision in section 23 (p) (1) that they are deductible, if at all, only under section 23 (p) (1).

Section 23 (p) Contributions may therefore be deductible under section 23 (p) (1) only to the extent that they are ordinary and necessary expenses during the taxable year in carrying on trade or business and are compensation for personal services actually rendered. In no case is a deduction allowable under section 23 (p) for the amount of any contribution for the benefit of an employee in excess of the amount which, together with other deductions allowed for compensation for such employee's services, constitutes a reasonable allowance determined on the accrual basis for the services actually rendered. What constitutes a reasonable allowance depends upon the facts in the particular case.

Among the elements to be considered in determining this is the personal services actually rendered in prior years as well as the current year and all compensation and contributions paid to or for such employee in prior years as well as in the current year. Thus, a contribution which is in the nature of additional compensation for services performed in prior years may be deductible, even if the total of such contributions and other compensation for the current year would in excess of reasonable compensation for services performed in the current year, provided that such total plus all contributions and other compensation paid to or for such employee in prior years represents a reasonable allowance for all services rendered by the employee by the end of the current year. A contribution under a plan which is primarily for the benefit of stockholders of the employer is not deductible. Such a contribution may constitute a dividend within the meaning of section 115 (a) (2). See also § 39.23 (p) (1).

In addition to the limitations referred to above, deductions under section 23 (p) are limited by the conditions and limitations particularly provided therein.

(c) Section 23 (p) is not confined to formal stock bonus, pension, profit-sharing, and annuity plans, or deferred compensation plans which provides any method of contributions or compensation having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or profit-sharing plan, whether or not the employee's rights in such contributions or compensation are conditioned by the employee, there is a method having the effect of a plan deferring the receipt of compensation for which deductions are governed by section 23 (p) if an employer under such an arrangement defers paying any compensation to an employee until a later year or years under an arrangement having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, he shall not be allowed a deduction until the year in which the compensation is paid. This provision is not limited to the case where 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 payable cannot be exactly determined until the later year.

(d) Deductions under section 23 (p) are generally limited to the year in which for which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his return on the accrual basis.

Exemptions are made in the case of overpaid contributions or of amendments thereto were made available to employees generally, the dates when comprehensive detailed description of the plans and of each amendment thereto were made available to employees generally, the dates when the plans and when the plan, and the plan and the dates when any amendments thereto were put into effect so that contributions thereunder were irrevocable and a summary of the provisions and rules relating to compliance with the requirements for participation in the plan.

(i) Employee contributions.

(ii) Employee contributions.

(iii) Employer contributions.

(iv) The medium of funding (e. g., self-insured, unit purchase group annuity contract, individual level annual premium retirement endowment insurance contracts, etc.) and, if not wholly insured, the medium of contributions and the kind of investments, and the discontinuance or modification of the plan and distributions or benefit payments upon liquidation or termination.

(3) A tabulation in columnar form showing the information specified below with respect to each of the 25 highest paid employees covered by the plan in the taxable year, listed in order of their nondeferred compensation (where there are several plans of deferred compensation, the information for each of the plans may be shown on a single tabulation without repetition of the information common to the several plans)

(i) Name.

(ii) Whether an officer.

(iii) Whether an officer.

(iv) Percentage of each class of stock owned directly or indirectly by the employee or members of his family.

(v) Whether the principal duties consist in supervising the work of other employees.

(vi) Year of birth.

(vii) Length of service for employer to the close of the year.

(viii) Total nondeferred compensation paid or accrued during the taxable year with a breakdown of such compensation into the following components:

Basic compensation and overtime pay.
(b) Other direct payments, such as bonuses and commissions.

(c) Compensation paid other than in cash, such as goods, services, insurance not directly related to the benefits provided from funds under the plan, etc.

(viii) Amount allocated during the year for the benefit of the employee or his beneficiary (including any insurance provided thereby or directly related thereto) less the employee's contributions during the year, under each other plan of deferred compensation.

(ix) Amount allocated during the year for the benefit of the employee or his beneficiary (including any insurance provided thereby or directly related thereto) less the employee's contributions during the year, under the plan.

If a profit-sharing or stock bonus plan, also a breakdown of such amounts into the following components:

(a) Amounts originally allocated in the year;

(b) Amounts reallocated in the year.

(x) Amounts of employee contributions during the year under the plan.

(xi) If a pension or annuity plan, the annual rate or amount of the retirement benefit, and if later) and retirement on such date and amount of each payment.

If it is claimed that the requirements of subparagraph (F) thereof before giving effect to the provisions of subparagraph (F) thereof.

(ii) Under section 23 (p) (1) for contributions paid in the taxable year beginning before January 1, 1942.

(b) If there is any change in the plan, instruments, method, factors, or assumptions upon which the data and information specified in subparagraph (1), (2) or (7) of paragraph (a) are based, a detailed statement explaining the change and its effect must be filed with the information otherwise required for the taxable year in which the change is put into effect and, insofar as there is no such change, after the data and information specified in subparagraph (4) thereof before giving effect to the provisions of subparagraph (F) thereof.

(xii) In case of a trust, a detailed balance sheet and a detailed statement of receipts and disbursements during the year, and a profit-sharing or stock bonus plan.

If it is claimed that the requirements of subparagraph (F) thereof before giving effect to the provisions of subparagraph (F) thereof.

A statement of the applicable limitations under section 23 (p) (1) (A) (B) (C) or (F) and an explanation of the method of determining such limitations and a summary of the data and computations necessary to determine the allowable deductions for the taxable year.

A statement of the contributions paid in the taxable year, showing the date and amount of each payment. Also a summary of the deductions claimed for the taxable year for the plan with a breakdown of the deductions claimed into the following components:

(iii) All employees ineligible for coverage under the plan because of requirements as to minimum age and not included in subdivision (i) or (ii) of this subparagraph.

(iv) All employees ineligible for coverage under the plan solely because of requirements as to minimum age and not included in subdivision (i) or (ii) of this subparagraph.

(v) All employees ineligible for coverage under the plan because of requirements as to minimum age and not included in subdivision (i) or (ii) or (iv) of this subparagraph, specifying the reasons applicable to the group.

(vi) All employees ineligible for coverage under the plan for any reasons, which should be the sum of subdivisions (i) to (v) inclusive, of this subparagraph.

(vii) All employees eligible for coverage but not covered under the plan.

(viii) All employees covered under the plan.

(c) The following totals:

(1) Total nondeferred compensation paid or accrued during the taxable year, for all employees covered under the plan, and also for all employees of the employer.

(2) Total amount allocated during the year for the benefit of employees, former or retired employees, or their beneficiaries (including any insurance provided thereby, or directly related thereto) less employee contributions during the year under the plan, and if a profit-sharing or stock bonus plan, also a breakdown of such total into the following components:

(a) Amounts originally allocated in the year, and

(b) Amount reallocated in the year.

(x) A schedule showing the total number of employees as of the close of the year for each of the following groups, based on reasonable estimates:

(i) All employees eligible for coverage under the plan because of requirements as to employment classification, specifying the reasons applicable to the group (as, for example, temporary, seasonal, part time, hourly pay basis, etc.)

(ii) All employees ineligible for coverage under the plan because of requirements as to length of service and not included in subdivision (i) of this subparagraph.

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the same rule is followed consistently so that there is no gap or overlap in the information furnished for each item. In any case the date or period to which each item of information furnished relates shall be clearly shown. All the information required by this section should be filed with the tax return for the taxable year in which the contributions were paid. If the employer files his tax returns and identifies for association with the appropriate returns and must be filed independently of any information and data otherwise submitted in subparagraphs (4) (I) and (9) of paragraph (A), all written and oral communications directly related to the retirement benefits under a pension or annuity plan are provided for the employees or their beneficiaries by contributions under the plan, deductions on account of such incidental benefits are also covered under section 23 (p) (1) (A) or (B). See §39.23 (p)-6 as to taxability to employees of costs of incidental insurance contracts without a trust. For the meaning of "pension plan" as used here, see §39.165-1 (a). Where disability, withdrawal, insurance, and other benefits are paid directly related to the retirement benefits under a pension or annuity plan are provided for the employees or their beneficiaries by contributions under the plan, the amounts thereof are deductible under section 23 (p) (1) (A) contributions to a pension trust must be paid in a taxable year of the employer which ends within a taxable year of the trust for which it is exempt under section 165 (a). In order that contributions carried over may be deducted in a succeeding taxable year of the employer which does not end within a taxable year of the trust for which the contributions were paid before September 1, 1942, under the provisions of section 23 (p) (1) (A), (iv), the succeeding year also must end with or within a taxable year of the trust for which it is exempt under section 165 (a). See §39.23 (p)-5 as to carrying over of contributions under section 23 (p) (1) (B) in the case of an annuity plan. In either case, the deductions are also subject to further limitations provided in section 23 (p) (1) (A). The limitations provided in section 23 (p) (1) (A) with an exception provided for certain years under clause (i) thereof (see §39.23 (p)-5) are based on the actuarial cost of the plan. In order to be deductible under section 23 (p) (1) (A) requires that the costs and the limitations based on costs under that section shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary (or, in certain cases under sections 23 (p) (1) (A) (I) in accordance with the finding of the Commissioner). (b) In determining for the purpose of limitations under section 23 (p) (1) (A), the effects of expected mortality and interest must be discounted and the effects of expected withdrawals, changes in compensation, retirements at various ages, and other pertinent factors may be discounted or otherwise reasonably recognized. A properly weighted retirement age based on analyses of representative experience may be used as an assumed retirement age. Different basic assumptions or rates may be used for different classes of risks or different groups where justified by conditions or required by contract. In no event shall costs for the purposes of section 23 (p) (1) (A) exceed costs based on assumptions and methods all of which have reasonable relationship to the provisions and coverage of the plan, funding medium, reasonable expectations as to the effects of mortality and interest, reasonable and adequate regard for other factors such as withdrawal and deferred retirement, whether or not discounted, which can be expected to reduce costs materially, reasonable expenses of operation, and all other relevant conditions and circumstances. In any case, in determining the costs and limitations, an adjustment shall be made on account of any experience more favorable than that assumed in the basis of limitations in prior years, and, unless such adjustments are consistently made every year by reducing the limitations otherwise determined by any decrease in liability or cost projections for the succeeding year, the deduction taxable year more favorable than the assumed experience on which the costs and limitations were based, the adjustment shall be made by some other method approved by the Commissioner. (c) Any expenses incurred by the employer in connection with the plan, such as trustee's and actuary's fees, which are not provided for by contributions under section 23 (p) (1) (A) or (B) are deductible under section 23 (p) (1) (A) to the extent that they are ordinary and necessary. (d) In case deductions are allowable under section 23 (p) (1) (C) as well as under section 23 (p) (1) (A) or (B) the limitations under section 23 (p) (1) (A) and (C) are determined and applied under section 23 (p) (1) (C) if the further conditions provided in section 23 (p) (1) (C) but the amounts allowable as deductions are subject to the further limitations provided in section 23 (p) (1) (F). See §39.23 (p)-12. §39.23 (p)-5 Pension and annuity plans; limitations under section 23 (p) (1) (A) (i) (a) Subject to the applicable general conditions and limitations (see §39.23 (p)-4) the initial limitation under section 23 (p) (1) (A) (i) (a) is 5 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the pension or annuity plan. This initial 5 percent limitation applies to all contributions made for the taxable year with a statement explaining all the methods, factors, and assumptions used in determining the amount. This amount may be determined as the sum of (1) the unfunded past service cost as of the beginning of the year, and (2) the normal cost for the year, all determined:

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by methods, factors, and assumptions appropriate as a basis of limitations under section 23 (p) (1) (A) (iii). Whenever requested by the Commissioner, a similar certification and statement shall be submitted for the year or years specified in such request. The Commissioner will make periodical examinations of such data and at any time reduce the assumed values and will reduce the limitation under section 23 (p) (1) (A) (i) below the 5-percent limitation for the years with respect to which the 5-percent limitation exceeds the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan. Where the limitation is so reduced, the reduced limitation shall apply until the Commissioner finds that a subsequent actuarial valuation shows a change to be necessary. Such subsequent valuation may be made by the taxpayer at any time and submitted to the Commissioner with a request, for a change in the limitation.

For the purposes of all limitations under section 23 (p) (1) (A) (i) “compensation otherwise paid or accrued” means all of the compensation paid or accrued except that compensation is allowable under a plan that qualifies under section 165 (a) including a plan that qualifies under section 23 (p) (1) (B). Where two or more pension or annuity plans cover the same employee, the applicable limitations under section 23 (p) (1) (A) (i) the deductions with respect to each such plan are subject to the limitations applicable to the particular plan and the total deductions for all such plans are also subject to the limitations which would be applicable thereto if they constituted a single plan. Where, because of the particular provisions applicable to a large class of employees under a plan, the costs with respect to such employees are normal in comparison with their compensation, after the first year in which the initial 5-percent limitation applies, deductions under section 23 (p) (1) (A) (i) are subject to limitations determined by considering the plan applicable to such class as if it were a separate plan. Deductions under section 23 (p) (1) (A) (i) even where these are greater than the applicable limitations under section 23 (p) (1) (A) (ii) or section 23 (p) (1) (A) (iii).

§ 39.23 (p)–6 Pension and annuity plans: limitations under section 23 (p) (1) (A) (i) (a) Subject to the applicable general conditions and limitations (see § 39.23 (p)–4) under section 23 (p) (1) (A) (ii) deductions may be allowed to the extent of limitations based on costs determined by distributing the remaining unfunded cost of all employees covered under the trust or plan as a level amount or level percentage of compensation with respect to such service of each such employee. If the Commissioner determines that, as to any three individuals with respect to whom more than 50 percent of such remaining unfunded cost is attributable, the remaining unfunded cost attributable to such individuals shall be distributed over a period of at least five taxable years.

(b) The determination of costs as a basis of limitations under section 23 (p) (1) (A) (ii) may be illustrated by a case where it is estimated actuarially as of the beginning of the year on the basis of appropriate assumptions and factors, that employer contributions of 4 percent of compensation of each covered employee during such remaining service will be sufficient to provide the current service credits of all employees under the plan and employer contributions of 3 percent of compensation of each covered employee during such remaining service will be sufficient to provide the past service credits of all employees under the plan, so that the estimated cost for the first year is 7 percent of compensation of covered employees.

(c) The statutory limitation for any taxable year under section 23 (p) (1) (A) (ii) is, any excess of the amount necessary for the year on the basis of the costs over the amount allowable as a deduction under section 23 (p) (1) (A) (i) all determined under regulations prescribed by the Commissioner with the approval of the Secretary.

(d) For each excess, adjusted for prior experience, may be computed for each year as follows: all determinations being made as of the beginning of the year:

(1) Determine the value of all benefits expected to be paid after the beginning of the year for all employees, any former employees, and any other beneficiaries then covered under the plan.

(2) If employees covered under the plan, determine the value of all contributions expected to be made after the beginning of the year by employees then covered under the plan.

(3) Determine the value of all funds of the plan as of the beginning of the year.

(4) Determine the amount remaining to be distributed as a level amount or as a level percentage of compensation over the remaining future service of each employee by subtracting from subparagraph (1) of this paragraph the sum of subparagraphs (2) and (3) of this paragraph.

(5) Determine the value of all compensation expected to be paid after the beginning of the year to all employees then covered under the plan.

(6) Determine an accrual rate for each employee by dividing subparagraph (5) of this paragraph into subparagraph (4) of this paragraph.

(7) Compute the excess under section 23 (p) (1) (A) (ii) for the year by multiplying the compensation paid to all employees covered under the plan during the year by any excess of subparagraph (6) of this paragraph over 5 percent. In general, where this method is used, the limitation under section 23 (p) (1) (A) (ii) with respect to each such plan is the excess so computed without further adjustment on account of prior favorable experience, provided all the factors and assumptions used are reasonable in view of all applicable considerations (see § 39.23 (p)–4) and provided subparagraph (g) of this paragraph is not less than five times the annual rate of compensation in effect at the beginning of the year.

(e) Instead of determining the excess deductible under section 23 (p) (1) (A) (ii) by the above method, such excess may be less than determined by the Commissioner by some other method which is reasonable and appropriate under the circumstances. Thus, such excess may be based on the amounts necessary with respect to each individual covered under the plan to provide the remaining unfunded cost of all his benefits under the plan distributed as a level amount over the period remaining until the normal commencement of his retirement benefits, in accordance with other generally accepted actuarial methods which are reasonable and appropriate in view of the provisions of the plan and the funding medium. In view of the relationship of section 23 (p) (1) (A) (ii) to sections 23 (p) (1) (A) (i) and 23 (p) (1) (A) (iii) however, if the excess is determined by a method other than the above method, the Commissioner, except where they do not exceed the limitations under section 23 (p) (1) (A) (iii) adjusted for prior favorable experience.

§ 39.23 (p)–7 Pension and annuity plans: limitations under section 23 (p) (1) (A) (iii) (a) Subject to the applicable general conditions and limitations (see § 39.23 (p)–4) under section 23 (p) (1) (A) (iii) in lieu of amounts deductible under the plan, the total limitations under sections 23 (p) (1) (A) (i) and section 23 (p) (1) (A) (ii) combined must be at least equal to the excess of any excess of subparagraph (1) of this paragraph over subparagraph (2) of this paragraph.

(b) The limitations under section 23 (p) (1) (A) (iii) for any taxable year is the sum of normal cost for the year plus an amount not in excess of one year's excess of the past service or supplementary cost as of the date the past service or supplementary credits are provided under the plan, all determined under regulations prescribed by the Commissioner with the approval of the Secretary. For this purpose the normal costs may be determined by any generally accepted actuarial method and may be expressed.
either as (1) the aggregate of level amounts with respect to each employee covered under the plan, (2) a level percentage of payroll with respect to each employee covered under the plan, or (3) the aggregate of the single premium or unit costs for the unit credits accruing during the year with respect to each employee covered under the plan, provided, in any case, that the method is reasonable in view of the provisions and coverage of the plan, funding medium, and other applicable considerations. The limitation may include one-tenth of the past service or supplementary cost as of the date the provisions resulting in such cost were put into effect, but is subject to adjustments for prior favorable experience. See § 39.23 (p)-4. In any case past service or supplementary costs shall not be included in the provision for any year when the amount required to fully fund or purchase such past service or supplementary credits has been deducted and no deduction is allowable for any amount (other than the normal cost) which is paid in after such credits are fully funded or purchased.

§ 39.23 (p)-8 Pension and annuity plans; contributions, the application of limitations under section 23 (p) (1) (A) application of section 23 (p) (1) (A) (i) Where contributions paid by an employer in a taxable year beginning after December 15, 1951, under an annuity or pension plan exceed the limitations applicable under section 23 (p) (1) (A) or (B) then in accordance with section 23 (p) (1) (A) (iv) the excess contributions are carried over and are deductible in succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the limitation applicable to such year under sections 23 (p) (1) (A) (i) (B) or (ii) or (iii) or (iv) provisions of section 23 (p) (1) (A) (iv) are to be applied before giving effect to the provisions of section 23 (p) (1) (F) for any year. The carry-over provisions of section 23 (p) (1) (A) (iv) means payments of this condition, "refunds of premiums" in the case of contributions paid before its discontinuance have been pur- chase. The arrangement of this condition, "refunds of premiums" under the plan. For the purpose of "annuity plan" as used here, see § 39.23 (p)-1, the contributions are deductible under section 23 (p) (1) (A) if the contributions are paid by an employer under an annuity plan for employees and the general conditions for deduction for such contributions are satisfied (see § 39.23 (p)-1), the contributions are deductible under section 23 (p) (1) (A) if the further conditions provided therein are satisfied. For the meaning of "annuity plan" as used here, see § 39.23 (p)-4. In order that contributions by the employer may be deducted under section 23 (p) (1) (B) all of the following conditions must be satisfied:

(1) The contributions must be paid toward the purchase of retirement annuities (or for disability, severance, insurance, or survivorship benefits incidental and directly related to such an- nuities) under an annuity plan for the exclusive benefit of the employer's employees and their beneficiaries. See § 39.165-1 (a).

(2) The contributions must be made in a taxable year of the employer which ends with or within a year of the plan for which the applicable requirements with respect to discrimination set out in section 165 (a) (3), (4), (5) and (6) in order that contributions carried over may be deducted in a succeeding taxable year of the employer in accordance with section 23 (p) (1) (iv), the succeeding year also must end with or within a taxable year of the plan for which the applicable requirements. See §§ 33.165-3 and 33.165-4. These requirements are considered to be satisfied for the period beginning with the date on which an annuity plan was put into effect and ending with the fifteenth day of the third month following the close of the taxable year of the employer in which the plan was put into effect, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period. See section 165 (d) (2) (B) and the Revenue Act of 1942 as amended by Public Law 511 (78th Cong.), approved December 20, 1942, as set forth preceding § 53.165-1, and § 29.165-8, respectively.

(2) There must be a definite written arrangement between the employer and the insurer that refunds of premiums, if any, shall be applied within the taxable year of the employer in which such premiums were paid or within the next succeeding taxable year toward the purchase of retirement annuities (or for disability, severance, survivorship insurance, or other benefits incidental and directly related to such an- nuities) under the plan. For the purpose of this condition, "refunds of premiums" means payments by the insurer on account of or paid in cash, or paid in certificates of credits, credited at the rate of interest,

In the case of contributions paid before September 1, 1942, which are carried over to taxable years beginning before December 31, 1951, the provisions of section 23 (p) (1) (A) (iv) are applied after giving effect to the special provision for alternative limitations in section 165 (d) (1) (C) of the Revenue Act of 1949 for the taxable year beginning in 1942 (see § 29.23 (p)-3 of Regulations 111 (26 CFR, 1949 ed., Supp.))

§ 39.23 (p)-9 Contributions of an employer under an employees' annuity plans which meets the requirements of section 165 (a) application of section 23 (p) (1) (B) (a) If contributions are paid by an employer under an annuity plan for employees and the general conditions are satisfied for deduction for such contributions are satisfied (see § 39.23 (p)-1), the contributions are deductible under section 23 (p) (1) (B) if the contributions are paid under section 23 (p) (1) (B) all of the following conditions must be satisfied:

(a) All contributions paid under section 23 (p) (1) (B) (i) and (B) (ii) or (B) (iii) or (B) (iv) are to be applied before giving effect to the provisions of section 23 (p) (1) (F) for any year. The carry-over provisions of section 23 (p) (1) (A) (iv) means payments of this condition, "refunds of premiums" in the case of contributions paid before its discontinuance have been pur- chase. The arrangement of this condition, "refunds of premiums" under the plan. For the purpose of "annuity plan" as used here, see § 39.23 (p)-1, the contributions are deductible under section 23 (p) (1) (A) if the contributions are paid by an employer under an annuity plan for employees and the general conditions for deduction for such contributions are satisfied (see § 39.23 (p)-1), the contributions are deductible under section 23 (p) (1) (A) if the further conditions provided therein are satisfied. For the meaning of "annuity plan" as used here, see § 39.23 (p)-4. In order that contributions by the employer may be deducted under section 23 (p) (1) (B) all of the following conditions must be satisfied:

(1) The contributions must be paid toward the purchase of retirement annuities (or for disability, severance, insurance, or survivorship benefits incidental and directly related to such an- nuities) under an annuity plan for the exclusive benefit of the employer's employees and their beneficiaries. See § 39.165-1 (a).

(2) The contributions must be made in a taxable year of the employer which ends with or within a year of the plan for which the applicable requirements with respect to discrimination set out in section 165 (a) (3), (4), (5) and (6) in order that contributions carried over may be deducted in a succeeding taxable year of the employer in accordance with section 23 (p) (1) (iv), the succeeding year also must end with or within a taxable year of the plan for which the applicable requirements. See §§ 33.165-3 and 33.165-4. These requirements are considered to be satisfied for the period beginning with the date on which an annuity plan was put into effect and ending with the fifteenth day of the third month following the close of the taxable year of the employer in which the plan was put into effect, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period. See section 165 (d) (2) (B) and the Revenue Act of 1942 as amended by Public Law 511 (78th Cong.), approved December 20, 1942, as set forth preceding § 53.165-1, and § 29.165-8, respectively.

(b) The contributions must be paid in a taxable year of the employer which ends with or within a year of the plan for which the applicable requirements with respect to discrimination set out in section 165 (a) (3), (4), (5) and (6) in order that contributions carried over may be deducted in a succeeding taxable year of the employer in accordance with section 23 (p) (1) (iv), the succeeding year also must end with or within a taxable year of the plan for which the applicable requirements. See §§ 33.165-3 and 33.165-4. These requirements are considered to be satisfied for the period beginning with the date on which an annuity plan was put into effect and ending with the fifteenth day of the third month following the close of the taxable year of the employer in which the plan was put into effect, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period. See section 165 (d) (2) (B) and the Revenue Act of 1942 as amended by Public Law 511 (78th Cong.), approved December 20, 1942, as set forth preceding § 53.165-1, and § 29.165-8, respectively.
year of the trust for which it is exempt under section 165 (a).

(b) The amount of deductions under section 23 (p) (1) (C) for any taxable year is subject to limitations based on the compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan. For this purpose “compensation otherwise paid or accrued” means all compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 165 (a) including a plan that qualifies under section 23 (p) (1) (B). The limitations under section 23 (p) (1) (C) apply to the total amount deductible for contributions to the trust regardless of the manner in which the funds of the trust are invested, applied, or distributed, and no other deduction is allowable on account of any benefits provided by contributions to the trust or by any plan, even if contributions are paid to two or more profit-sharing or stock bonus trusts satisfying the conditions for deduction under section 23 (p) (1) (C) such trusts are considered as a single trust in applying these limitations.

(c) The primary limitation on deductions for a taxable year is 15 percent of the compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan. So long as the contributions do not in any year exceed the primary limitation, this is the only limitation under section 23 (p) (1) (C) which has any effect.

(d) In order that the deductions may average 15 percent of compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan, the limitations under section 23 (p) (1) (C) for any year beginning after December 31, 1941, must not be exceeded in any year. The limitations under section 23 (p) (1) (C) for any prior years beginning after December 31, 1941, are based on the compensation otherwise paid or accrued during the taxable year and the excess contributions not deducted under the limitations of section 23 (p) (1) (C) for prior years beginning after December 31, 1941.

§ 39.23 (p)-11 Contributions of an employer under a plan that does not meet the requirements of section 165 (a) application of section 23 (p) (1) (D) Section 23 (p) (1) (D) covers all cases for which deductions are allowable under section 23 (p) (1) but not allowable under subparagraphs (A) (B) (C) or (E) of such section. A deduction is allowable under section 23 (p) (1) (D) for any contribution paid or accrued by an employer under a stock bonus plan, pension plan, profit-sharing or annuity plan, or a profit-sharing or stock bonus trust, or for any contribution paid or accrued by an employer on account of any employee under 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) (D). If payments are made under such a plan 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 the rights of individual employees to, or derived from, such employer’s contributions or such compensation are nonforfeitable at the time the contribution or compensation is paid. As to what constitutes nonforfeitable rights of an employer, see § 39.1565-7. If an amount is accrued but not paid during the taxable year, no deduction is allowable for such amount for such year. If an amount is paid during the taxable year but the rights of the employee therein are forfeitable at the time the lump sum is paid, no deduction is allowable for such amount for any taxable year.

§ 39.23 (p)-12 Contributions of an employer where deductions are allowable under section 23 (p) (1) (A) or (B) and also under section 23 (p) (1) (C), application of section 23 (p) (1) (F) (a) Where deductions are allowable under section 23 (p) (1) (A) or (B) on account of contributions under a pension or annuity plan and deductions are also allowable under section 23 (p) (1) (C) for the same taxable year, on account of contributions to a profit-sharing or stock bonus trust, the total deductions under these sections are subject to the provisions of sections 23 (p) (1) (F) (b) of Reg. 26 CFR, 1949 ed., Supp. 1, for prior years beginning after December 31, 1941. The provisions of section 23 (p) (1) (C), before giving effect to section 23 (p) (1) (F), may be illustrated as follows:

<table>
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<th>Year</th>
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<th>Contributions carried over</th>
<th>Total</th>
<th>Excess contributions carried over to succeeding years</th>
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<td>10</td>
</tr>
</tbody>
</table>

(d) In order that the deductions may average 15 percent of compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan, the limitations under section 23 (p) (1) (C) for any year beginning after December 31, 1941, must not be exceeded in any year. The limitations under section 23 (p) (1) (C) for any prior years beginning after December 31, 1941, are based on the compensation otherwise paid or accrued during the taxable year and the excess contributions not deducted under the limitations of section 23 (p) (1) (C) for prior years beginning after December 31, 1941.

§ 39.23 (p)-11 Contributions of an employer under a plan that does not meet the requirements of section 165 (a) application of section 23 (p) (1) (D) Section 23 (p) (1) (D) covers all cases for which deductions are allowable under section 23 (p) (1) but not allowable under subparagraphs (A) (B) (C) or (E) of such section. A deduction is allowable under section 23 (p) (1) (D) for any contribution paid or accrued by an employer under a stock bonus plan, pension plan, profit-sharing or annuity plan, or a profit-sharing or stock bonus trust, or for any contribution paid or accrued by an employer on account of any employee under 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) (D). If payments are made under such a plan 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 the rights of individual employees to, or derived from, such employer’s contributions or such compensation are nonforfeitable at the time the contribution or compensation is paid. As to what constitutes nonforfeitable rights of an employer, see § 39.1565-7. If an amount is accrued but not paid during the taxable year, no deduction is allowable for such amount for such year. If an amount is paid during the taxable year but the rights of the employee therein are forfeitable at the time the lump sum is paid, no deduction is allowable for such amount for any taxable year.

(d) In order that the deductions may average 15 percent of compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan, the limitations under section 23 (p) (1) (C) for any year beginning after December 31, 1941, must not be exceeded in any year. The limitations under section 23 (p) (1) (C) for any prior years beginning after December 31, 1941, are based on the compensation otherwise paid or accrued during the taxable year and the excess contributions not deducted under the limitations of section 23 (p) (1) (C) for prior years beginning after December 31, 1941.

§ 39.23 (p)-11 Contributions of an employer under a plan that does not meet the requirements of section 165 (a) application of section 23 (p) (1) (D) Section 23 (p) (1) (D) covers all cases for which deductions are allowable under section 23 (p) (1) but not allowable under subparagraphs (A) (B) (C) or (E) of such section. A deduction is allowable under section 23 (p) (1) (D) for any contribution paid or accrued by an employer under a stock bonus plan, pension plan, profit-sharing or annuity plan, or a profit-sharing or stock bonus trust, or for any contribution paid or accrued by an employer on account of any employee under 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) (D). If payments are made under such a plan 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 the rights of individual employees to, or derived from, such employer’s contributions or such compensation are nonforfeitable at the time the contribution or compensation is paid. As to what constitutes nonforfeitable rights of an employer, see § 39.1565-7. If an amount is accrued but not paid during the taxable year, no deduction is allowable for such amount for such year. If an amount is paid during the taxable year but the rights of the employee therein are forfeitable at the time the lump sum is paid, no deduction is allowable for such amount for any taxable year.

(d) In order that the deductions may average 15 percent of compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan, the limitations under section 23 (p) (1) (C) for any year beginning after December 31, 1941, must not be exceeded in any year. The limitations under section 23 (p) (1) (C) for any prior years beginning after December 31, 1941, are based on the compensation otherwise paid or accrued during the taxable year and the excess contributions not deducted under the limitations of section 23 (p) (1) (C) for prior years beginning after December 31, 1941.
23 (p) (1) (F) for any taxable year are based on the compensation otherwise paid or accrued during the year to all the employees who are beneficiaries under the overlapping trusts or plans in the year. For this purpose "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 qualified under section 165 (a) including a plan that qualifies under section 23 (p) (1) (B). The employees who are beneficiaries under overlapping trusts or plans in a year include all the employees who, in the year, are beneficiaries of the funds accumulated under one or more of the overlapping trusts or plans.

(b) Under section (1) (F) any excess of the total amount otherwise deductible for the taxable year under section 23 (p) (1) (A) (B) or (C) for overlapping trusts or plans of 25 percent of the compensation otherwise paid or accrued during the year to all the employees who are beneficiaries under such trusts or plans is deductible for such year but is deductible for succeeding taxable years, in order of time, so that the total deduction for such trusts or plans for a succeeding taxable year is equal to the lesser of

(1) 30 percent of the compensation otherwise paid or accrued during the taxable year to all the employees who are beneficiaries under such trusts or plans in the year, or

(2) The sum of (1) the smaller of (a) 25 percent of the compensation otherwise paid or accrued during the taxable year to all the employees who are beneficiaries under such trusts or plans in the year, or (b) the total of the amounts otherwise deductible under section 23 (p) (1) (A) (B) or (C) for the year for such trusts or plans and (ii) any carry-over to the year from prior years under section 23 (p) (1) (F) (i.e., any excess otherwise deductible under section 23 (p) (1) (A), (B), or (C) for a prior taxable year beginning after December 31, 1941, but not deducted for such succeeding taxable years, in order of time, because of the limitations under section 23 (p) (1) (F) (c) The limitations under section 23 (p) (1) (F) are determined and applied after all the limitations, deductions otherwise allowable, and carry-overs under section 23 (p) (1) (A) (B) and (C) have been determined and applied, and, in particular, after the effect has been given to the carry-over provision in section 23 (p) (1) (A) (iv) and in the second and third sentences of section 23 (p) (1) (C) Where the limitations under section 23 (p) (1) (F) reduce the total amount deductible, the excess deductible in succeeding years is treated as a carry-over which is distinct from, and additional to, any excess contributions carried over and deductible in succeeding years under the provisions in section 23 (p) (1) (A) (iv) or in the third sentence of section 23 (p) (1) (C). The application of the limitations of section 23 (p) (1) (F) to the treatment of carry-overs for a case where the taxable years are calendar years and the overlapping trusts or plans consist of a pension trust and a profit-sharing trust put into effect in 1952 and covering the same employees may be illustrated as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Taxable (calculated) dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>502 52 58 59 60</td>
</tr>
<tr>
<td>1953</td>
<td>510 52 58 59 60</td>
</tr>
<tr>
<td>1954</td>
<td>510 52 58 59 60</td>
</tr>
<tr>
<td>1955</td>
<td>510 52 58 59 60</td>
</tr>
</tbody>
</table>

(d) In applying the provisions of section 23 (p) (1) (F) in the case of deductions for contributions paid prior to September 1, 1942, the amounts otherwise deductible under section 23 (p) (1) (A) (B) or (C) for the taxable year beginning in 1942 and any carry-over from that year under section 23 (p) (1) (F) are computed after giving effect to the provisions of section 162 (d) (1) (C) of the Revenue Act of 1942. See § 23.23 for any excess contributions carried over (p–12) of Regulations 111 (25 CFR, 1949, Supp.)

§ 39.23 (q) Statutory provisions; deductions from gross income; charitable and other contributions by corporations.

Sec. 23. Deductions from gross income. In computing the income thereon shall be allowed as deductions:

(q) Charitable and other contributions by corporations. In the case of a corporation, contributions or gifts in any amount 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, veteran rehabilitation service, literary, or educational purposes or for the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after December 31, 1946, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes), 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, for the disallowance of certain charitable, etc., deductions otherwise allowable under this paragraph, see sections 3813 and 162 (g) (2) or

(3) Posts or organizations of war veterans, or auxiliary units of, or trusts or foundations for, any such posts or organizations, if such posts, organizations, units, trusts, or foundations are organized in the United States or any of its possessions and if no part of their net earnings inure to the benefit of any private shareholder or individual;

(4) The United Nations, but only if such contributions or gifts (A) are to be used exclusively for the acquisition of a site in the city of New York for its headquarters, and (B) are made after December 1, 1946, and before December 2, 1947, to an amount which does not exceed 5 per centum of the taxpayer's net income as computed without the benefits of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

§ 39.23 (q)
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In the case of a corporation reporting its net income on the accrual basis, at the close of the taxable year any contribution or gift to organizations described in section 23 (q), with the exceptions hereinafter provided, payment of which is made after the close of the taxable year and on or before the 15th day of the following month, the following section shall be considered as paid during such taxable year. Such election shall be made only at the time of the filing of the return for the taxable year, and shall be signed in such manner as the Commissioner, with the approval of the Secretary, shall by regulations prescribe.

Section 11. Deduction of tax deductions and exemptions [Internal Revenue Act of 1950].

(a) Notwithstanding any other provisions of law, no deduction for Federal income tax purposes shall be allowed in the case of a contribution or gift to any organization if the same is made after the close of the taxable year, and shall be signified in such manner as the Commissioner, with the approval of the Secretary, shall by regulations prescribe.

§ 39.23 (q)-1 Contributions or gifts to corporations.

(a) A corporation may, subject to the limitations provided by section 23 (q) of this section, such corporation, in the case of a contribution or gift to any organization described in section 23 (q) of this section, such deduction shall, to the extent provided by section 23 (q) of this 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 method of accounting employed by the corporation in keeping its books and records. As to charitable contributions, contributions not deductible under section 23 (a) of this section shall be considered as paid during such taxable year, and shall be signified in such manner as the Commissioner, with the approval of the Secretary, shall by regulations prescribe.

Sec. 23. Deductions from gross income; dividends paid by banking corporations.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

1. (1) Dividends paid to a charitable organization--

(a) In the case of any charitable, etc., deduction described in section 23 (q), with the exceptions hereinafter provided, payment of which is made after the close of the taxable year and on or before the 15th day of the following month, the following subsection shall be considered as paid during such taxable year, and shall be signed in such manner as the Commissioner, with the approval of the Secretary, shall by regulations prescribe.

(b) The provisions of § 39.23 (o)-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 amount thereof, the contemporaneous and approximate date of the actual payment of the contribution or gift, the substantiation of the claims for deductions when required by the Commissioner, and (2) 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).

(c) A corporation reporting its net income on the accrual basis may elect to have considered as paid during the taxable year any contribution or gift to organizations described in section 23 (q), with the exceptions hereinafter provided, payment of which contribution or gift is made after the close of the taxable year and on or before the fifteenth day of the following month, such contribution or gift shall be considered as paid during such taxable year, and shall be signed in such manner as the Commissioner, with the approval of the Secretary, shall by regulations prescribe.

§ 39.23 (q)-1

In the case of a building and loan association which operates in whole or in part as a serial association, which maintains a bonus plan, or which issues shares subject to fines, penalties, forfeitures, or other withdrawal fees, there is deductible under section 23 (q) (1) the total amount credited as dividends upon such shares, credited to a bonus account for such shares for the taxable year, and (2) the total amount credited as dividends for the taxable year, notwithstanding that as a customary condition of withdrawal:

1. Amounts invested in, and earnings credited to, share, shares, must be withdrawn in multiples of even shares, or
2. Such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon, such shares, such bonus account or series of shares, as a fine, penalty, forfeiture or other withdrawal fee.

(b) Social associations, bonus plans, etc. In the case of a building and loan association which operates in whole or in part as a serial association, which maintains a bonus plan, or which issues shares subject to fines, penalties, forfeitures, or other withdrawal fees, there is deductible under section 23 (q) (1) the total amount credited as dividends upon such shares, credited to a bonus account for such shares for the taxable year, and (2) the total amount credited as dividends for the taxable year, notwithstanding that as a customary condition of withdrawal:

1. Amounts invested in, and earnings credited to, share, shares, must be withdrawn in multiples of even shares, or
2. Such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon, such shares, such bonus account or series of shares, as a fine, penalty, forfeiture or other withdrawal fee.

(b) Special associations, bonus plans, etc. In the case of a building and loan association which operates in whole or in part as a serial association, which maintains a bonus plan, or which issues shares subject to fines, penalties, forfeitures, or other withdrawal fees, there is deductible under section 23 (q) (1) the total amount credited as dividends upon such shares, credited to a bonus account for such shares for the taxable year, and (2) the total amount credited as dividends for the taxable year, notwithstanding that as a customary condition of withdrawal:

1. Amounts invested in, and earnings credited to, share, shares, must be withdrawn in multiples of even shares, or
2. Such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon, such shares, such bonus account or series of shares, as a fine, penalty, forfeiture or other withdrawal fee.

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1. Amounts invested in, and earnings credited to, share, shares, must be withdrawn in multiples of even shares, or
2. Such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon, such shares, such bonus account or series of shares, as a fine, penalty, forfeiture or other withdrawal fee.

(b) Special associations, bonus plans, etc. In the case of a building and loan association which operates in whole or in part as a serial association, which maintains a bonus plan, or which issues shares subject to fines, penalties, forfeitures, or other withdrawal fees, there is deductible under section 23 (q) (1) the total amount credited as dividends upon such shares, credited to a bonus account for such shares for the taxable year, and (2) the total amount credited as dividends for the taxable year, notwithstanding that as a customary condition of withdrawal:

1. Amounts invested in, and earnings credited to, share, shares, must be withdrawn in multiples of even shares, or
2. Such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon, such shares, such bonus account or series of shares, as a fine, penalty, forfeiture or other withdrawal fee.
the gross income of his wife, payment of 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 section.

[Sec. 23 (u) as added by sec. 120 (b), Rev. Act 1942]

§ 39.23 (u)–1. Periodic alimony payments. (a) A deduction is allowable under section 22 (k) with respect to periodic payments in the nature of, or in lieu of, alimony or an allowance for support actually paid by the taxpayer during his taxable year and required to be included in the income of the payee wife or former wife, as the case may be, under section 22 (k) as to the amounts required to be included in the income of the wife or former wife, as §1,000, in any one taxable year for her life. The court retained Juris-

[(k)-1. The deduction under this subsection shall not be in excess of $1,250 multiplied by the number of exemptions allowed under section 22 (b) (1) (B) or (C), one for each taxpayer and for any dependent minor children. The adjusted gross income of H and W in 1952 is $9,000. They pay medical expenses of $3,000 related to insurance or otherwise for the care of their single individual or a married individual making a separate return and not in excess of $9,500, the case of a joint return of husband and wife. (2) The application of this paragraph may be illustrated by the following example: Example. H and W make a joint re-

[Sec. 23 (w) as added by sec. 124 (d), Rev. Act 1942]

§ 39.23 (v)–1. Medical, dental, etc., expenses. (1) The deduction under this subsection shall be $5,000 less 5 percent of the adjusted gross income; or (2) if the deduction under this subsection, for any taxable year, is in excess of 5,000, the deduction shall be $5,000 less 5 percent of the adjusted gross income.

[Sec. 23 (w) as added by sec. 124 (d), Rev. Act 1942]

§ 39.23 (v)–2. Medical, dental, etc., expenses. (1) The deduction under section 23 (b) (1) (A), the amount of which shall be limited to $1,000, in any one taxable year is $3,000, computed as follows:

Payment for medical care in 1952. $9,000
Less 6 percent of $4,000 (adjusted gross income) $240
Excess of medical expenses in 1952 over 5 percent of adjusted gross income $7,000
Allowable deduction for 1952 ($1,250) multiplied by 5 exemptions allowed under section 22 (b) (1) (A) and (B) but not in excess of $4,350 ($9,000) $5,000

§ 39.23 (v)–3. Medical, dental, etc., expenses. (2) There is no five percent limitation on the deduction for medical expenses paid by an employer to a married individual making a separate return and not in excess of $3,000, the case of a joint return of husband and wife. (2) The application of this paragraph may be illustrated by the following example: Example. H and W make a joint re-

§ 39.23 (v)–4. Medical, dental, etc., expenses. (1) The deduction under section 23 (b) (1) (A), the amount of which shall be limited to $1,000, in any one taxable year is $3,000, computed as follows:

Payment for medical care in 1952. $9,000
Less 6 percent of $4,000 (adjusted gross income) $240
Excess of medical expenses in 1952 over 5 percent of adjusted gross income $7,000
Allowable deduction for 1952 ($1,250) multiplied by 5 exemptions allowed under section 22 (b) (1) (A) and (B) but not in excess of $4,350 ($9,000) $5,000

§ 39.23 (v)–5. Medical, dental, etc., expenses. (2) There is no five percent limitation on the deduction for medical expenses paid by an employer to a married individual making a separate return and not in excess of $3,000, the case of a joint return of husband and wife. (2) The application of this paragraph may be illustrated by the following example: Example. H and W make a joint re-

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dies before attaining the age of 65 even though such spouse, had she not died, would have attained the age of 65 before the close of the taxable year of the taxpayer.

(2) The application of this paragraph may be illustrated by the following examples:

Example (1). Taxpayer E, who attained the age of 65 years on February 22, 1952, makes his return for the calendar year 1952. During the year 1952, E has adjusted gross income of $8,000, and pays the following medical bills: (a) $340 (3 percent of adjusted gross income) for the medical care of himself and his spouse, and (b) $320 (4 percent of adjusted gross income) for the medical care of his dependent son. The allowable deduction under section 23 (x) for 1952 is $540. No deduction is allowable for the amount of $320 paid for medical care of the dependent son since the amount of such payment (determined without regard to the payments for the care of the taxpayer and his spouse) does not exceed 5 percent of adjusted gross income.

Example (2). Taxpayer W and W make a joint return for the calendar year 1952 on which four exemptions are allowed (exclusive of exemp- 

...
Deduction allowable for Saturday, September...

...rendered to B, his wife, in the payer's spouse or dependent, the deduction from gross income; death. In determining whether such...

...amount provided by section 23 (z)...
A's proportionate part of total corporate expenses based on his stock ownership (% of $9,000) ... $1,380

Since the portion of A's payment allocable to real estate taxes and interest is only $743.48, that amount instead of $900 is allowable as a deduction in computing A's net income for 1952.

Example (3). The facts are the same as in example (2) except that the amount paid by A to the X Corporation in 1952 is $1,000 instead of $1,140. A is entitled under section 23 (z) to a deduction of $652.17 in computing his net income for 1952.

The deduction is computed as follows:

Total amount paid by A $1,000.00

A's proportionate part of real estate taxes and interest based on his stock ownership (% of $9,000) ... $1,380.00

Amount of A's payment representing real estate taxes and interest (% of $1,380.00) ... $652.17

A's allowable deduction ... $652.17

Since the portion of A's payment allocable to real estate taxes and interest is only $652.17, that amount instead of $900 is allowable as a deduction in computing A's net income for 1952.
(5) Short period. In the case of a taxable year of less than twelve months on account of a change in the accounting period, the standard deduction shall be allowed.

(6) Determination of status. For the purposes of this subsection—

(A) The determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during the year, in which case such determination shall be made as of the time of such death; and

(B) An individual legally separated from his spouse under a decree of divorce or separate maintenance shall not be considered as married.

(Change of election. Under regulations prescribed by the Secretary, a change of an election to take, or not to take, the standard deduction for any taxable year may be made after the filing of the return for such year. If the spouse of the taxpayer filed a separate return for any taxable year corresponding, for the purposes of paragraph (4), to the taxable year of the taxpayer, the change shall not be allowed unless, in accordance with such regulations—

(A) The spouse makes a change of election with respect to the standard deduction for the taxable year in which such change of election would be allowed through the application to the return of section 39.23(a) and in lieu of such credits allowable under section 39.23(a), the other spouse shall be allowed the standard deduction.

(B) The taxpayer and his spouse consent in writing to the assessment, within such period as may be agreed upon with the Secretary, of any liability attributable to such change of election, even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

This paragraph shall not apply if the tax liability of the taxpayer's spouse, for the taxable year corresponding to such period in which such change of election would otherwise be allowed, is less than the smaller of:

1. The standard deduction provided for in section 39.23(a) and in lieu of such credits allowable under section 39.23(a) and
2. The tax imposed on the taxpayer under Supplement T, if the net income of one spouse is less than $5,000 and the combination of the adjusted gross income shown on the return of the other spouse is less than $5,000, but the correct adjusted gross income is in fact $5,000 or more, then:

(I) If the taxpayer has elected to pay the tax imposed under Supplement T, it shall be deemed that he has elected to take the standard deduction, or

(ii) If the taxpayer has not elected to pay the tax under Supplement T, it shall be deemed that he has elected to take the standard deduction.

(c) Husband and wife. (1) In the case of husband and wife (except as qualified below), if the net income of one spouse is determined without regard to the standard deduction, the other spouse may not elect to take the standard deduction. If a joint return is filed and does not elect to take the standard deduction, such deduction shall be determined by reference to the aggregate adjusted gross income of both spouses. If Form 1040A is filed as a combined return, the standard deduction is allowed through the application to the adjusted gross income shown on such return of the tax table in Supplement T. See §39.31-2 limiting the use of Form 1040A as a combined return to cases in which the aggregate adjusted gross income of the spouses is less than $3,000.

(2) In the case of husband and wife (except as qualified below), if the net income of one spouse is determined without regard to the standard deduction, the other spouse may not elect to take the standard deduction. If a joint return is filed and does not elect to take the standard deduction, the other spouse may elect to take the standard deduction and, hence, may not file Form 1040A as his or her return. Thus, if A and B have adjusted gross incomes of $6,000 and $3,000, respectively, and A files Form 1040 and does not elect to take the standard deduction, B must file Form 1040 but may file Form 1040A. If A files Form 1040 and elects to take the standard deduction, B may file Form 1040A. If A files Form 1040 and elects to take the standard deduction, B may file Form 1040A but must file Form 1040. Taking Form 1040A does not. Thus, if A together with the other spouse of B's adjusted gross income of $3,000. If A files Form 1040 and does not elect to take the standard deduction, B may file Form 1040A but must file Form 1040. Taking Form 1040A does not allow B to take the standard deduction. If B files Form 1040 and elects to take the standard deduction, A may file Form 1040A but must file Form 1040. Taking Form 1040A does not allow A to take the standard deduction. In such cases, however, if both elect to take the standard deduction, A must file Form 1040, but B may file Form 1040A or, in the case of A, file Form 1040 and compute the tax under Supplement T. Under either alternative, effect is given to the standard deduction through the application of Supplement T.

§ 39.23 (aa)-(1)
(3) The restriction upon the right of a married person to elect the standard deduction in his separate return is applicable with respect to the taxable years of the husband and wife ending in the same calendar year, except that in the event of the death of one spouse the restriction is applicable with respect to the taxable year ending with death and the taxable year of the surviving spouse in which such death occurs. The restriction as to the spouse by whom the death occurs is legally separated under a decree of divorce or separate maintenance and so separated as to the marital status of the parties is deemed to have been dissolved at the time of the death of the other spouse for the purpose of the allowance of the standard deduction shall be made as of the last day of such individual’s taxable year, unless his spouse dies during such taxable year, in which event the determination shall be made as of the date of the death of such spouse.

(4) The provisions of this paragraph may be illustrated by the following examples:

Example (1). Taxpayer A and his wife B both make their returns on a calendar year basis. In July 1952 they enter into a separation agreement which provides for no decree of divorce or separate maintenance to be issued until March 1953. If A itemizes and claims his actual deductions on his return for the calendar year 1952, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.

Example (2). Taxpayer A makes his returns on the basis of a fiscal year ending June 30. His wife B makes her returns on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction for the calendar year 1952 if the income of A for the short taxable year ending with the date of his death is determined without regard to the standard deduction.

(d) Change of election to take, or not to take, the standard deduction. (1) A change of the election to take, or not to take, the standard deduction for any taxable year may be made before or after the time prescribed for filing the return for the taxable year. However, the period of two years in section 3761 within which claim for credit or refund of tax must be made is not extended by the right to effect a change of election. See § 39.32-2-1.

(2) If the spouse of the taxpayer filed a separate return for any taxable year that corresponds, for the purpose of section 23 (aa) (1) (see paragraph (c) of this section) to the taxable year of the taxpayer, a change of election may not be made by the taxpayer unless (i) the spouse makes a change of election in such separate return with respect to the standard deduction consistent with the change of election sought by the taxpayer, and (ii) the taxpayer and his spouse file a consent in writing to the assessment of income for the taxable year at any time as may be agreed upon, of any deficiency or excess, whether to the extent attributable to such change of election even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

(3) A change of election for any taxable year shall not be permitted if the tax liability of the taxpayer for the taxable year, or of the taxpayer’s spouse for the taxable year, is determined without regard to the standard deduction consistent with the purpose of section 23 (aa) (4) (see paragraph (c) of this section) to the taxable year of the taxpayer, has been compromised under the provisions of section 3761.

§ 39.23 (bb) Statutory provisions; deductions from gross income; circulation expenditures.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:-(a) Allowance of deduction. Section 23 (bb) provides for the deduction from gross income (notwithstanding the provisions of section 24 (a) and any regulations thereunder) of items not deductible from gross income of all expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical; expenditure shall not be allowed with respect to the portion of such expenditures as, under regulations prescribed by the Secretary, is character which is subject to the allowance for depreciation provided in section 23 (1), but allowances for depreciation shall be computed as the Commissioner deems necessary.

Example (1). The provisions of this paragraph may be illustrated by the following examples:

Example (2). Taxpayer A makes his return on the basis of a fiscal year ending June 30. His wife B makes her return on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.

Example (3). Taxpayer A makes his return on the basis of a fiscal year ending June 30. His wife B makes her return on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.

(2) Change of election to take, or not to take, the standard deduction. (1) A change of the election to take, or not to take, the standard deduction for any taxable year may be made before or after the time prescribed for filing the return for the taxable year. However, the period of two years in section 3761 within which claim for credit or refund of tax must be made is not extended by the right to effect a change of election. See § 39.32-2-1.

(2) If the spouse of the taxpayer filed a separate return for any taxable year that corresponds, for the purpose of section 23 (aa) (1) (see paragraph (c) of this section) to the taxable year of the taxpayer, a change of election may not be made by the taxpayer unless (i) the spouse makes a change of election in such separate return with respect to the standard deduction consistent with the change of election sought by the taxpayer, and (ii) the taxpayer and his spouse file a consent in writing to the assessment of income for the taxable year at any time as may be agreed upon, of any deficiency or excess, whether to the extent attributable to such change of election even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

(3) A change of election for any taxable year shall not be permitted if the tax liability of the taxpayer for the taxable year, or of the taxpayer’s spouse for the taxable year, is determined without regard to the standard deduction consistent with the purpose of section 23 (aa) (4) (see paragraph (c) of this section) to the taxable year of the taxpayer, has been compromised under the provisions of section 3761.

§ 39.23 (bb) Statutory provisions; deductions from gross income; circulation expenditures.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:-(a) Allowance of deduction. Section 23 (bb) provides for the deduction from gross income (notwithstanding the provisions of section 24 (a) and any regulations thereunder) of items not deductible from gross income of all expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical; expenditure shall not be allowed with respect to the portion of such expenditures as, under regulations prescribed by the Secretary, is character which is subject to the allowance for depreciation provided in section 23 (1), but allowances for depreciation shall be computed as the Commissioner deems necessary.

Example (1). The provisions of this paragraph may be illustrated by the following examples:

Example (2). Taxpayer A makes his return on the basis of a fiscal year ending June 30. His wife B makes her return on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.

Example (3). Taxpayer A makes his return on the basis of a fiscal year ending June 30. His wife B makes her return on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.

(2) Change of election to take, or not to take, the standard deduction. (1) A change of the election to take, or not to take, the standard deduction for any taxable year may be made before or after the time prescribed for filing the return for the taxable year. However, the period of two years in section 3761 within which claim for credit or refund of tax must be made is not extended by the right to effect a change of election. See § 39.32-2-1.

(2) If the spouse of the taxpayer filed a separate return for any taxable year that corresponds, for the purpose of section 23 (aa) (1) (see paragraph (c) of this section) to the taxable year of the taxpayer, a change of election may not be made by the taxpayer unless (i) the spouse makes a change of election in such separate return with respect to the standard deduction consistent with the change of election sought by the taxpayer, and (ii) the taxpayer and his spouse file a consent in writing to the assessment of income for the taxable year at any time as may be agreed upon, of any deficiency or excess, whether to the extent attributable to such change of election even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

(3) A change of election for any taxable year shall not be permitted if the tax liability of the taxpayer for the taxable year, or of the taxpayer’s spouse for the taxable year, is determined without regard to the standard deduction consistent with the purpose of section 23 (aa) (4) (see paragraph (c) of this section) to the taxable year of the taxpayer, has been compromised under the provisions of section 3761.

§ 39.23 (bb) Statutory provisions; deductions from gross income; circulation expenditures.

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:-(a) Allowance of deduction. Section 23 (bb) provides for the deduction from gross income (notwithstanding the provisions of section 24 (a) and any regulations thereunder) of items not deductible from gross income of all expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical; expenditure shall not be allowed with respect to the portion of such expenditures as, under regulations prescribed by the Secretary, is character which is subject to the allowance for depreciation provided in section 23 (1), but allowances for depreciation shall be computed as the Commissioner deems necessary.

Example (1). The provisions of this paragraph may be illustrated by the following examples:

Example (2). Taxpayer A makes his return on the basis of a fiscal year ending June 30. His wife B makes her return on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.

Example (3). Taxpayer A makes his return on the basis of a fiscal year ending June 30. His wife B makes her return on the calendar year basis. A died in October 1952. In such case, since A and B were married as of the date of his death, B may not elect the standard deduction on her return for such year since B is considered as married to A at the end of the taxable year by reason of the separation agreement (as added by agreement) on the last day of 1952.
The amount of expenditures which are applicable only in respect of the excess of the purposes in the case of such expenditures paid or entitled to a taxpayer for the taxable year, and the number of units benefited by such expenditures sold during the taxable year. The principles outlined in §23 (dd)-(1) contain rules relating to the treatment of losses resulting from abandonment.

(2) The amount of the deduction allowable during the taxable year is an amount A, which bears the same ratio to B (the total deferred development expenditures for a particular mine or deposit reduced by the amount of such expenditures deducted in prior taxable years) as C (the number of units of the ore or mineral benefited by such expenditures sold during the taxable year) bears to D (the number of units of ore or mineral benefited by such expenditures remaining as of the taxable year) bears to E (the number of units of ore or mineral benefited by such expenditures remaining as of the taxable year). The amount A, which bears the same ratio to B as C bears to D, plus the number of units benefited by such expenditures remaining as of the taxable year, bears to E (the number of units sold during the taxable year). The estimate is subject to revision in accordance with that section in the event it is ascertainable as the result of operations or development that the remaining units are materially greater or less than the number of units remaining from a prior election. The estimates in paragraphs (f) and (g) contain rules relating to the treatment of losses resulting from abandonment.

(1) The taxpayer may elect to deduct as expenses incurred the character described herein, has made the election to defer such expenditures, and therefore the development property remaining a royalty interest therein, he shall be allowed the allowable deduction described in subparagraph (3) of this paragraph.

(4) The election referred to in this paragraph shall be made for each mine or deposit by a clear indication on the return or by a statement filed with the district director of internal revenue with whom the return was filed not later than six months after the filing of the return for the taxable year to which such election is applicable, or, in the case of the taxable year to which such election is applicable, by a statement filed not later than six months after the filing of the return. The election shall be binding for the taxable year with respect to which the election was made.

§39.23 (dd)—1 Repayment of certain loans by mutual savings banks, building and loan associations, and cooperative banks. There is deductible, under section 23 (dd) from the gross income of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank without capital stock organized and operated for mutual purposes and without profit, amounts paid by the taxpayer during the taxable year in repayment of loans made before September 1, 1951, by (1) the United States or any agency or instrumentality thereof which is wholly owned by the United States, or (2) any mutual fund established under the laws of any State. For the purposes of this section, expenditures paid or incurred during the taxable year while the mine or deposit is in the producing stage, such election must be for all of the excess of such expenditures over the net receipts during the taxable year from the mine or deposit in excess of the existence, location, extent, or quality of any deposit of ore or other mineral, and paid or incurred prior to the beginning of the taxable year. If the mine or deposit is in the development stage, such election shall be binding for the taxable year with respect to which the election was made.

§39.23 (dd)—2 Repayment of certain loans by mutual savings banks, building and loan associations, and cooperative banks. There is deductible, from the gross income of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank without capital stock organized and operated for mutual purposes and without profit, amounts paid by the taxpayer during the taxable year in repayment of loans made before September 1, 1951, by (1) the United States or any agency or instrumentality thereof which is wholly owned by the United States, or (2) any mutual fund established under the laws of any State, amounts paid by such institutions during the taxable year in repayment of loans made before September 1, 1951, by the United States or any agency or instrumentality thereof which is wholly owned by the United States, and amounts paid to a mutual fund established under the authority of the laws of any State, amounts paid by such institution in repayment of loans made by the Reconstruction Finance Corporation before September 1, 1951, and deductible under this section. Section 23 (dd) is applicable, however, in the case of amounts paid to an agency or instrumentality not wholly owned by the United States.

§39.23 (ee)—(ff) Statutory provisions; deductions from gross income; repayment by mutual savings banks, etc. of certain loans. In computing net income there shall be allowed as deductions:

(1) Election to defer. A taxpayer entitled to the deduction under section 23 (cc) (1) may, in lieu of making such deduction in the year when the expenditures for development were paid or incurred, elect under section 23 (cc) (2) to treat such expenditures as deferred expenses to be deductible, ratably as the units of the ore or mineral benefited by the expenditures are sold. In the case of such expenditures paid or incurred while the mine or deposit is in the development stage, the election is applicable only in respect of the excess of such expenditures paid or incurred dur-
development stage of the mine or deposit, so much of such expenditures as does not exceed $75,000 in any taxable year shall be considered as expenditures paid or incurred by the taxpayer by the United States in lieu of taking such deduction to which he is entitled in the taxable year in which the mine or deposit was first brought into production. If, however, the taxpayer, in a subsequent year, has not claimed the benefits of section 23 (ff) (1) of this section as defer such expenditures and thereafter has never claimed the benefits of section 23 (ff) (1) of this section as deferred discovery or exploration expenditures reduced to B (the total deferred discovery or exploration expenditures attributable to a grant or loan made to the taxpayer by the United States), he shall be allowed the deduction indicated in subparagraph (2) of this paragraph.

The amount of the deduction allowable during the taxable year is equal to the amount received by the taxpayer during the taxable year from governmental units, or from any person or persons, by virtue of any act of Congress making such amount deductible for purposes of this section. The portion of the amount of such expenditures deducted which has either been allowed a deduction under section 23 (ff) (1) of this section, has not exceed $75,000. This subsection shall not apply to expenditures which are treated under paragraph (2) as deferred expenses to be deducted in the year of production.

§ 39.23 (ff)–1 Discovery or exploration expenditures—(a) Allowance of deduction. (1) Subject to the limitation prescribed in paragraph (c) of this section, section 23 (ff) (1) provides for a deduction from the adjusted basis of the mine or deposit of such expenditures as are paid or incurred by the taxpayer before the beginning of the development stage. The expenditures thus described include those by which the taxpayer may be entitled to the deduction under section 23 (ff) (1) or (2).

(b) Election to defer (1) A taxpayer entitled to the deduction under section 23 (ff) (1) may, in lieu of taking such deduction to which he is entitled in the taxable year in which the mine or deposit was first brought into production, elect under section 23 (ff) (2) to treat any portion of such deductible expenditures as deferred expenses to be deducted in the year of production or discovery or exploration were paid or incurred, elect under section 23 (ff) (2) to treat any portion of such deductible expenditures as deferred expenses to be deducted in the year of discovery or exploration undertaken by other persons as may be reflected in the acquisition cost paid or incurred by the taxpayer for the property.

(2) As to the deductibility of expenditures attributable to a grant or loan made to the taxpayer by the United States, the provisions of section 23 (ff) (1) and (2) shall be treated for the encouragement of the exploration, development, or mining of critical and strategic minerals, see section 22 (ff), (10). The expenditures thus described include any expenditures paid or incurred after the existence of ores or minerals discovered or explored by reason of such expenditures are sold. An election provided under paragraph (2) applicable to any taxable year shall be binding for such year.

(3) Limitation. This subsection shall not apply to expenditures which are treated as official or incurred by the taxpayer before the beginning of the mine or deposit benefited by such expenditures paid or incurred by the taxpayer before the existence of ores or minerals discovered or explored by reason of such expenditures are sold.

(4) Adjusted basis of mine or deposit. The expenditures which are treated under paragraph (2) as deferred expenses shall be taken into account in computing the adjusted basis of the mine or deposit provided, but such amounts, and the adjustments to basis provided in section 113 (b) (11) (xx) of this chapter, shall be considered as expenditures paid or incurred by the taxpayer in determining the adjusted basis of the property for the purpose of computing a deduction for depletion under section 114.

Example (1). Assume that a taxpayer who has not claimed the benefits of section 23 (ff) (1) and (2) of this section, has not claimed the benefits of section 23 (ff) (1) of this section as deferred discovery or exploration expenditures in previous years. If, in any year, the taxpayer has been allowed a deduction under section 23 (ff) (1) or (2) for expenditures paid or incurred by the taxpayer which have been allowed a deduction under section 23 (ff) (1) of this section, he shall be allowed the deduction indicated in subparagraph (2) of this paragraph.

Thus, if in any four preceding years, the amount of such expenditures deducted under section 23 (ff) (1) of this section exceeded $75,000, the amount of such expenditures deductible under section 23 (ff) (1) or (2) shall be limited to the amount received by the taxpayer from governmental units, or from any person or persons, by virtue of any act of Congress making such amount deductible for purposes of this section. The amount of such expenditures deductible under section 23 (ff) (1) or (2) shall be limited to the amount received by the taxpayer from governmental units, or from any person or persons, by virtue of any act of Congress making such amount deductible for purposes of this section.
had acquired the deposit in 1954 in a similar distribution from X corporation which, in the year 1955, the corporation was decreed by a court to be insolvent. The amounts paid as damages for breach of promise to marry and attorneys' fees paid in a suit for divorce or separate maintenance proceeding which is attributable to the production or collection of amounts includable in gross income are paid within a period of four years after the end of the taxable year in which the examination of an Army officer to the extent only that it is especially required by his profession and does not merely take the place of articles required in civilian life is deductible. The cost of a sword is an allowable deduction, but the cost of a uniform is not. For deduction of extraordinary medical expenses (including amounts paid for accident or health insurance) under section 22 (c)...

§ 39.24 (a)–2 Capital expenditures—(a) Expenditures except non-depreciable mine development expenditures. Amounts paid for increasing the capital value of or for making good the depreciable expenditure (for which a deduction has been made) of property are not deductible from gross income. See section 23 (1) (a)–3. (2) Amounts paid as alimony or allowance for support upon divorce or separation are not deductible except as provided in section 23 (a). (3) Any amount in excess of the cost of a uniform is not deductible. If the father is entitled to the services of his minor children, any allowances which he gives them, whether paid in consideration of services or otherwise, are non-deductible in his return of income. Amounts paid as damages for breach of promise to marry and attorneys' fees and other costs of suit to recover such damages are not deductible. Attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the court, when the taxpayer is directly or indirectly a beneficiary under such a policy, may be treated as an ordinary and necessary business expense. Amounts paid or accrued on indebtedness insured or continued to purchase a single premium life insurance or endowment contract for the purposes of this paragraph, if substantially all the proceeds of such policy paid or received by the insured may be excluded from gross income whether the beneficiary is an individual or a corporation, except in the case of certain transfers as provided in § 39.32 (b)–5 and in the case of a spouse to whom such proceeds are income under section 22 (c). See generally section 22 (b) (1) and (2) and the regulations thereunder.

§ 39.24 (a)–4 Amounts allocable to exempt income—(a) Class of exempt income. (1) As used in this section, the term "class of exempt income" means any class of income, including interest only income, to the extent that such an item or class of income is required to be included in gross income under any provision of the Internal Revenue Code, as above defined, or otherwise at least constitutionally exempt from taxation. (2) The object of section 24 (a) (1) is to extend the tax benefits of the provision that certain expenditures are allocable to interest (whether or not any amount of interest is received or accrued) to a greater extent than is constitutionally required. (3) Any amount paid or accrued for necessary business expenses is part of the cost of the property. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is deductible as an ordinary and necessary business expense. Amounts paid or accrued for necessary business expenses. Amounts paid or accrued under section 22 (a) (2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter, or an amount otherwise allowable under section 22 (a) (2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.

§ 39.24 (a)–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 callers there in connection with his professional work (his place of business being elsewhere) a part of the rent is deductible as a business expense. However, he uses part of the house for his office, such portion of the rent 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 paid in consideration of services or otherwise, are non-deductible in his return of income. Amounts paid as damages for breach of promise to marry and attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the court, when the taxpayer is directly or indirectly a beneficiary under such a policy, may be treated as an ordinary and necessary business expense. Amounts paid or accrued on indebtedness insured or continued to purchase a single premium life insurance or endowment contract for the purposes of this paragraph, if substantially all the proceeds of such policy paid or received by the insured may be excluded from gross income whether the beneficiary is an individual or a corporation, except in the case of certain transfers as provided in § 39.32 (b)–5 and in the case of a spouse to whom such proceeds are income under section 22 (c). See generally section 22 (b) (1) and (2) and the regulations thereunder.

§ 39.24 (a)–4 Amounts allocable to exempt income—(a) Class of exempt income. (1) As used in this section, the term "class of exempt income" means any class of income, including interest only income, to the extent that such an item or class of income is required to be included in gross income under any provision of the Internal Revenue Code, as above defined, or otherwise at least constitutionally exempt from taxation. (2) The object of section 24 (a) (1) is to extend the tax benefits of the provision that certain expenditures are allocable to interest (whether or not any amount of interest is received or accrued) to a greater extent than is constitutionally required. (3) Any amount paid or accrued for necessary business expenses is part of the cost of the property. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is deductible as an ordinary and necessary business expense. Amounts paid or accrued for necessary business expenses. Amounts paid or accrued under section 22 (a) (2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter, or an amount otherwise allowable under section 22 (a) (2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.

§ 39.24 (a)–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 callers there in connection with his professional work (his place of business being elsewhere) a part of the rent is deductible as a business expense. However, he uses part of the house for his office, such portion of the rent 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 paid in consideration of services or otherwise, are non-deductible in his return of income. Amounts paid as damages for breach of promise to marry and attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the court, when the taxpayer is directly or indirectly a beneficiary under such a policy, may be treated as an ordinary and necessary business expense. Amounts paid or accrued on indebtedness insured or continued to purchase a single premium life insurance or endowment contract for the purposes of this paragraph, if substantially all the proceeds of such policy paid or received by the insured may be excluded from gross income whether the beneficiary is an individual or a corporation, except in the case of certain transfers as provided in § 39.32 (b)–5 and in the case of a spouse to whom such proceeds are income under section 22 (c). See generally section 22 (b) (1) and (2) and the regulations thereunder.
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 deductions under section 23 all items referable to the production of exempt income, as above defined.

(b) Determination of amounts allocable to a class of exempt income. A deduction may be allowed for the amount of any item or part thereof allocable to a class of classes of exempt income. For example, expenses paid or incurred for the production or collection of income which is wholly exempt from income taxes, such as interest or dividends of a type not includible in gross income, are not deductible expenses.

(c) Taxable interests in classes of taxable income. Items, or parts of such items, directly attributable to any class or classes of exempt income, shall be allocated thereto; and items, or parts of such items, directly attributable to any class or classes of taxable income, shall be allocated thereto.

(2) If an item is indirectly attributable both to taxable income and exempt income, a reasonable proportion thereof, as determined in the light of all the facts and circumstances in each case, shall be allocated to each. Apportionments must in all cases be reasonable.

§ 39.24 (a)-5 Single premium life insurance or endowment contracts. Amounts paid or accrued on indebtedness incurred or continued, directly or indirectly, to finance a single premium life insurance or endowment contract are not deductible under section 23 (b) or any other provision of chapter 1. This prohibition applies even though the insurance is not on the life of the taxpayer. A contract shall be considered a single premium life insurance or endowment contract, for the purposes of this section, if substantially all the premiums on such contract are paid within a period of four years from the date on which the contract was purchased.

§ 39.24 (a)-6 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) (1) of this section may be capitalized at the election of the taxpayer. Thus, taxes and other expenses paid or incurred 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. (1) The following items may upon the election of the taxpayer, in the manner provided for by the preceding paragraph, be treated as chargeable to capital account (either as a component of original cost or other basis, for the purposes of section 113 (a) or as an adjustment to basis, for the purposes of section 113 (b) (1) (A)), notwithstanding that they are expressly deductible under section 23: (i) In the case of unimproved and unproductive real estate, the interest on a mortgage, and other carrying charges,

(ii) In the case of real property, whether improved or unimproved, and whether productive or unproductive, expenditures (otherwise deductible) paid or incurred in the development thereof or in the construction of an improvement on the property, other than expenditures paid or incurred after the election of the taxpayer. Thus, taxes of such owner imposed on the property or to pay for transporting or importing machinery or other fixed assets. An election under subparagraph (1) (ii) of this paragraph does not preclude the taxpayer from deducting such taxes for the taxable year in which they are incurred. The term "property" for this purpose may include, in the case of items included in subparagraph (1) (ii) of this paragraph, the act of transporting, installing, or putting into use by the taxpayer for a prior year.

(iii) Any other taxes and carrying charges chargeable to capital account which in the opinion of the Commissioner are, under sound accounting principles, chargeable to capital account.

(2) If for any taxable year there are two or more items, such as social security taxes, use taxes, or any other type of items above described, relating to the same project to which the election is applicable, the taxpayer may elect to capitalize one type or more types of such expenses, though he does not elect to capitalize the remaining items or to capitalize items of the same type relating to other projects. However, if several items of the same type are incurred with respect to a single project the election to capitalize must, if exercised, be exercised as to all items of that type.

(3) Assume that an election is made under subparagraph (1) (ii), (iii) or (iv) of this paragraph to capitalize a given charge incurred with respect to a particular project, charges of the same type with respect to the particular project in subsequent years, whether they be social security taxes, use taxes, sales taxes, or any other item enumerated in any of these subparagraphs, may be capitalized at the election of the taxpayer for any taxable year.

(4) The following examples are illustrative of the application of the provisions of this paragraph:

Example (1). A in 1953 and 1954 pays annual taxes and interest on a mortgage on a piece of property. During 1953, the property is vacant and unproductive, but throughout 1953, A operates the property as a parking lot. A may capitalize the taxes and mortgage interest paid in 1953 but not the taxes and mortgage interest paid in 1953.

Example (2). X began in February 1953 the erection of a building for business purposes. X paid 65,000 social security taxes, which in his 1953 return he elected to capitalize. X must continue to capitalize the social security taxes paid in connection with the erection of the building until its completion in 1954.

Example (3). Assume the facts in example (2) except that in November 1953, X also began to build a factory which was completed in 1955. In 1953 X pays $5,000 social security taxes in connection with the erection of the building and an election to capitalize the social security taxes paid in erection.
Example (d). X in 1952 began the erection of a building for himself, which would take three years to complete. X in 1952 paid $4,000 social security taxes and $8,000 interest on a loan in connection with this building. As capital account was treated under a provision of section 24 (b) (2) of this section, the interest charges are deductible notwithstanding that a deduction is expressly provided therefor in section 23. Any item not charged to capital account which is otherwise deductible under section 23 is deductible. A may capitalize the social security taxes although no deduction is expressly provided therefor. In 1952, B, a general manager, B, spends nine-tenths of his time in the general management of the remaining tenth in supervising the construction work. A treats as expenses $3,000 of B's salary and charges the same to capital account. A may also capitalize $120 of the $120 social security taxes.

§39.24 (b) 1. Losses from sales or exchanges of property, not deductible, for the purposes of section 24 (a). (b) Losses from sales or exchanges of property—(1) Losses disallowed. In computing net income no deduction shall be allowed with respect to any losses arising from such sales or exchanges, directly or indirectly, between individuals (including fiduciaries); but stock constructively owned by an individual by reason of the application of subparagraph (A), (B), or (C), shall not be treated as stock constructively owned by an individual by reason of the application of subparagraph (B), or (C), of this section, and may be so treated nor does it have available to it capital account not allocated to certain items. Thus, items which are otherwise deductible are deductible notwithstanding that they are otherwise deductible. An item (whether a deduction is expressly provided therefor or not) may be so treated nor does it have available to it capital account not allocated to certain items. Such items which are otherwise deductible are deductible.

(2) Losses from sales or exchanges of property—(d) Losses disallowed. In computing net income no deduction shall be allowed with respect to any losses arising from such sales or exchanges, directly or indirectly, between individuals (including fiduciaries) or a corporation and an individual shareholder (see section 24 (b) (2) (D) or (E)); or between two corporations (see section 24 (b) (1) (C)).

(b) Corporations (including shareholders) In the case of sales or exchanges of property, the case of distributions in liquidation) where a corporation not acting in a fiduciary capacity is a party to the transaction, under certain circumstances no deduction shall be allowed with respect to losses arising from such sales or exchanges, directly or indirectly, between a corporation and an individual shareholder (see section 24 (b) (1) (C)).

(c) Manner of exercising election. If the taxpayer elects to capitalize an item or items under this section, such election shall be exercised by filing with the original return a statement for that year indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account (either as a component of original cost or other basis, for the purposes of section 113 (a) or as an adjustment to basis, for the purposes of section 113 (b) (1)).

(d) Allocation. If any tax or carrying charge with respect to property is in part a type of item described in paragraph (A), (B), or (C), of this section, such item or items with respect to which no election was treated as a capital item is given, a reasonable proportion of such tax or carrying charge, determined in the light of all the facts and circumstances in each case, shall be allocated to each item. Apportionment must in all cases be reasonable.

Example. A, the owner of a factory on which a new addition is under construction, in 1952 pays its general manager, B, a salary of $4,000 and social security taxes of $120. B spends nine-tenths of his time in the general management of the remaining tenth in supervising the construction work. A treats as expenses $3,000 of B's salary and charges the same to capital account. A may also capitalize $120 of the $120 social security taxes.

§39.24 (b) 1. Losses from sales or exchanges of property, not deductible, for the purposes of section 24 (a). (b) Losses from sales or exchanges of property—(1) Losses disallowed. In computing net income no deduction shall be allowed with respect to any losses arising from such sales or exchanges, directly or indirectly, between individuals (including fiduciaries); but stock constructively owned by an individual by reason of the application of subparagraph (A), (B), or (C), shall not be treated as stock constructively owned by an individual by reason of the application of subparagraph (B), or (C), of this section, and may be so treated nor does it have available to it capital account not allocated to certain items. Such items which are otherwise deductible are deductible.

(2) Losses from sales or exchanges of property—(d) Losses disallowed. In computing net income no deduction shall be allowed with respect to any losses arising from such sales or exchanges, directly or indirectly, between a corporation and an individual shareholder (see section 24 (b) (1) (C)).

(b) Corporations (including shareholders) In the case of sales or exchanges of property, the case of distributions in liquidation) where a corporation not acting in a fiduciary capacity is a party to the transaction, under certain circumstances no deduction shall be allowed with respect to losses arising from such sales or exchanges, directly or indirectly, between a corporation and an individual shareholder (see section 24 (b) (1) (C)).

(c) Manner of exercising election. If the taxpayer elects to capitalize an item or items under this section, such election shall be exercised by filing with the original return a statement for that year indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account (either as a component of original cost or other basis, for the purposes of section 113 (a) or as an adjustment to basis, for the purposes of section 113 (b) (1)).

(d) Allocation. If any tax or carrying charge with respect to property is in part a type of item described in paragraph (A), (B), or (C), of this section, such item or items with respect to which no election was treated as a capital item is given, a reasonable proportion of such tax or carrying charge, determined in the light of all the facts and circumstances in each case, shall be allocated to each item. Apportionment must in all cases be reasonable.

Example. A, the owner of a factory on which a new addition is under construction, in 1952 pays its general manager, B, a salary of $4,000 and social security taxes of $120. B spends nine-tenths of his time in the general management of the remaining tenth in supervising the construction work. A treats as expenses $3,000 of B's salary and charges the same to capital account. A may also capitalize $120 of the $120 social security taxes.
corporation, either directly or indirectly, in order to be considered as constructively owned by him or the corporation which is owned, directly or indirectly, by or for any member of his family.

(d) Illustrations of the application of section 24 (b). The application of section 24 (b) may be illustrated by the following examples:

Example (1). On July 1, 1952, the M Corporation owned all of the stock of the O Corporation, a personal holding company which was a holding company under section 501. On that day all of the outstanding stock of the M Corporation was acquired by A. By the application of the rule provided in section 24 (b) (2) (A), the stock in the O Corporation owned by the M Corporation is considered to be owned constructively by A, the sole stockholder of the M Corporation.

Example (2). On June 15, 1952, all of the stock of the N Corporation was owned in equal proportions by A and A's partner, AP. Except in the case of distributions in complete or partial liquidation, the N Corporation, no deduction is allowable under section 24 (b) (1) with respect to losses from sales or exchanges of property made on July 1, 1952, between any of such individuals or corporations, except as between A and AP and between AP and the N Corporation.

§ 39.24 (c) Statutory provisions; items not deductible; unpaid expenses and interest.

Sec. 24. Items not deductible. 

(c) Unpaid expenses and interest. In computing net income no deduction shall be allowed under section 24 (a) (3) or (b) (2) (A), in respect to losses from sales or exchanges of property made on July 1, 1952, between any of such individuals or corporations, except as between A and AP and between AP and the N Corporation.

§ 39.24 (c) Statutory provisions; items not deductible; unpaid expenses and interest.
(2) Interest on obligations of instrumentalities of the United States. The amount received as interest on obligations of a corporation organized under Act of Congress, if (A) such corporation is an instrumentality of the United States; and (B) such interest is included in gross income under section 22; and (C) the interest is not taken into account, as amended and supplemented, such interest is exempt from normal tax. (Reduction of credit under paragraph (2) on account of amortizable bond premium, see section 125.)

(3) Normal tax exemption. [Repealed by sec. 107 (b), (2), Rev. Act 1945.]

(4) Earned-income definitions. [Repealed by sec. 107 (b), 108, Rev. Act 1945.]

(b) Credits for both normal tax and surrogate—(1) Credits. There shall be allowed for the purposes of both the normal tax and the surrogate, the following credits against net income:

(A) An exemption of $600 for the taxpayer; and an additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(B) (i) An additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year; and

(ii) An additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse has no gross income and is not the dependent of another taxpayer; and for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(C) (i) An additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year.

(ii) An additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. For the purposes of this clause the determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year, in which case such determination shall be made as of the time of such death.

(iii) For the purposes of this subparagraph an individual is blind if his central visual acuity does not exceed 20/200 in the better eye with corrective lenses, or his visual acuity is less than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 50 degrees.

(D) An exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $600, except that the exemption shall not be allowed in respect of a dependent who has made a joint return with his spouse under section 51 for the taxable year beginning in such calendar year.

(2) Determination of status. For the purposes of this subsection—

(A) The determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and

(B) An individual legally separated from his spouse for purposes of divorce or of separate maintenance shall not be considered as married.

(3) Definition of dependent. As used in this chapter the term "dependent" means any of the following persons over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer:

(A) A son or daughter of the taxpayer, or a descendant of either,

(B) A stepson or stepdaughter of the taxpayer,

(C) A brother, sister, stepbrother, or stepsister of the taxpayer,

(D) The father or mother of the taxpayer, or an ancestor of either,

(E) A stepfather or stepmother of the taxpayer,

(F) A son or daughter of a brother or sister of the taxpayer,

(G) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer.

As used in this paragraph the terms "brother" and "sister" include a brother or sister by the half-blood. For the purposes of determining whether a child of the taxpayer is the child of the taxpayer or the child of the taxpayer's spouse, the child shall be deemed to be the child of both parents if the child is the legitimate child of both of such parents, or if the child is the illegitimate child of the child's mother and of any other person whose relationship to the child is not greater than that of the child's mother to the child.

§39.25-1 Credits of individuals for purpose of normal tax. The taxpayer's net income as determined pursuant to sections 21 to 24, inclusive, is reduced, for the purpose of computing the normal tax by (a) the income exempt from normal tax, (b) the credits for both normal tax and surrogate under section 25 (b).

§39.25-2 Credits of individuals for purpose of normal tax and surrogate—(a) In general. For the purposes of the normal tax and the surrogate on individuals, there are allowed as credits against net income the exemptions specified in section 25 (b). Such credits include (1) the exemptions for an individual taxpayer and (2) the additional exemptions for a blind taxpayer and a blind spouse, and (4) the exemptions for dependents of the taxpayer.

(b) Exemptions for individual taxpayer and spouse and surrogate (so-called personal exemptions). There are allowed by section 25 (b) (1) (A) an exemption of $600 for the taxpayer and an additional exemption of $600 for each dependent of the taxpayer; if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. Since, in the case of a joint return, there are two taxpayers and, under section 61 (b) (9), there is only one income for the two taxpayers on such return—i.e., their aggregate income—two exemptions of $600 are allowed on such return for each taxpayer.

(c) Additional exemptions. If in any case a joint return is made by the taxpayer and his spouse, no exemption is allowed any other person for such spouse even though such other person would have been entitled to claim an exemption for such spouse as a dependent if such joint return had not been made.

(d) Exemptions for taxpayer attaining the age of 65 and spouse attaining the age of 65 (so-called old-age exemptions). (1) Section 25 (b) (1) (B) provides an additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year. An additional exemption of $600 is also allowed to the taxpayer for his spouse if a separate return is made by the taxpayer and if the spouse has attained the age of 65 before the close of the taxable year of the taxpayer and, for the calendar year in which the taxable year of the taxpayer begins, the spouse has no gross income and is not the dependent of another taxpayer. If a husband and wife make a joint return, an old-age exemption of $600 will be allowed as to each taxpayer spouse who has attained the age of 65 before the close of the taxable year for which the joint return is made. The exemptions under section 25 (b) (1) (B) are in addition to the exemptions for the taxpayer and spouse under section 25 (b) (1) (A).

(2) In determining the age of an individual for the purposes of the exemption for old age, the last day of the taxable year of the taxpayer is the controlling date. Thus, in the event of a separate return by a husband and wife, the joint exemption for old age shall be allowed to an individual who is under the age of 65 but has filed a separate return if such individual is over 65 on or before the close of the taxable year of the husband. In no event shall the additional exemption for old age be allowed in respect of a separate return of the taxpayer with respect to a spouse who dies before attaining the age of 65 even though such spouse would have attained the age of 65 before the close of the taxable year of the taxpayer.

For the purposes of the old-age exemption, an individual attains the age of 65 on the first day of the day preceding his sixty-fifth birthday. Accordingly, an individual whose sixty-fifth birthday falls on January 1 in a given year attains the age of 65 on the last day of the calendar year immediately preceding.

(d) Exemptions for the blind. (1) Section 25 (b) (1) (C) provides an additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year. An additional exemption is also allowed to the taxpayer for his spouse if the spouse is blind and, for the calendar year in which the taxable year of the
taxpayer begins, has no gross income and is not the dependent of another taxpayer. The determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year. The determination shall be made as of the time of such death.

(2) The exemptions for the blind are in addition to the exemptions for the taxpayer (or, if the taxpayer is a nonresident alien, in addition to the exemptions under section 25 (b) (1) (A) and are also in addition to the exemptions under section 25 (b) (1) (B) for taxpayers and spouses attaining the age of 65 years. Thus, a single individual who has, before the close of his taxable year, attained the age of 65 years and who is blind at the close of his taxable year is entitled, in addition to the personal exemption of $600, to two further exemptions, each of $600, one by reason of his age and the other by reason of his blindness. If a husband and wife make a joint return, an exemption of $1,200 shall be allowed as to each taxpayer spouse who is blind at the close of the taxable year for which the joint return is made.

(3) A taxpayer receiving an exemption allowed by section 25 (b) (1) (G) for a blind taxpayer or a blind spouse shall, if the individual for whom the exemption is claimed is not totally blind as of the last day of the taxable year of the taxpayer (or in the case of a spouse who dies during such taxable year as of the time of such death) attach to his return a certificate from a physician, registered optometrist or a registered optometrist stating that as of the applicable status determination date in the opinion of such physician or optometrist (I) the central visual acuity of the individual for whom the exemption is claimed did not exceed 20/200 in the better eye with correcting lenses or (II) such individual's visual acuity was accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees. If such individual is totally blind as of the last day of the taxable year and with respect to which the credit provision is applicable, the return shall be attached to the return a statement by the person or persons making the return setting forth such fact.

(4) Exemptions for dependents. Section 25 (b) (1) (D) allows to a taxpayer an exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $600, who receives more than one-half of his support from the taxpayer for such calendar year and who does not file a joint return with his spouse. For the purposes of this credit a dependent is a person who is related to the taxpayer within one of the following relationships: child, stepchild; brother; sister; brother or sister by the half blood; stepbrother or stepsister; parent; the ancestors of such parent; stepfather or stepmother; son or daughter of the taxpayer's brother or sister; brother or sister of the taxpayer's father or mother; son-in-law; daughter-in-law; mother-in-law; or sister-in-law. In the case of a joint return it is not necessary that the prescribed relationship exist between the person claimed as a dependent and the taxpayer who furnishes the support; if such individual is claimed as a dependent by either spouse, whether by reason of his age and the other reason of his blindness. If a husband and wife making a joint return, an exemption of $1,200 shall be allowed as to each taxpayer spouse who is blind at the close of the taxable year for which the joint return is made.

(2) The only exemption allowed for a dependent of the taxpayer is that provided by section 25 (b) (1) (D) The exemptions provided by section 25 (b) (1) (D) (old-age exemptions) and section 26 (b) (3) (exemptions for the blind) are allowed only for the taxpayer or his spouse. Thus, if a taxpayer provides the entire support of his father, who meets all the requirements of a dependent, for his father as a dependent, and is not entitled to any of the exemptions provided by section 25 (b) (1) (D) or section 26 (b) (3) (exemptions for the blind) because such individual is not entitled to any additional exemption because of his father's age.

(3) Determination of husband and wife status. The determination of whether such individual is married shall be made as of the close of his taxable year, unless his spouse dies during such year, in which case such determination shall be made as of the time of such death. If a child is born to or adopted by the taxpayer after the close of the year in which the child is born, the child shall be considered a child of such person by blood. A citizen or subject of a foreign country may not be claimed as a dependent, unless he is a resident of the United States, Canada, or Mexico at some time during the calendar year in which the taxable year of the taxpayer begins. Whether or not over half of a person's support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer shall be determined by reference to the amount of expense incurred by the taxpayer for such support. A payment to a wife which is includible in the gross income of such wife shall not be considered a payment by her husband for the support of any dependent.

(4) Alien residents of Puerto Rico. A nonresident alien individual who is a bona fide resident of Puerto Rico during the entire taxable year and subject to tax under sections 11 and 12 is allowed as credits against net income the exemp-

§ 39.26 (a)

Rules and Regulations

Sec. 26. Credits of corporations. In the case of a corporation, the following credits are allowed to an individual as a credit for purposes of normal tax by section 25 (a) (1) or (2). (For reduction of credit under this section see also amortizable bond premium, see section 125.)

[Sec. 26 (a) as amended by sec. 126 (1) (3), Rev. Act 1942]

§ 39.26 (a)–1 Credit of corporation for interest on obligations of the United States or its instrumentalities. The amount received as interest upon obligations of the United States or of a corporation organized under the Act of Congress which is subject to taxation under the Act authorizing the issue of such obligations, as amended and supplemented, is in the case of individuals exempt from gross income for which is included in gross income under section 22.

§ 39.26 (b) Statutory provisions; credits of corporations; dividends received.

Sec. 26. Credits of corporations. In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(a) (1) (A) of the amount received as dividends (other than dividends described in paragraph (a) on the preferred stock of a public utility) from a domestic corporation which is subject to tax under sections 11 and 12 is allowed. An amount equal to the sum of—

(1) In general. 86 per centum of the amount received as dividends (other than dividends described in paragraph (a) on the preferred stock of a public utility) from a domestic corporation which is subject to tax under sections 11 and 12 is allowed. An amount equal to the sum of—

(2) Certain preferred stock.—(A) Calendar year 1951. * * *

(B) Dividends received. An amount equal to the sum of—

(2) Certain preferred stock.—(A) Calendar year 1951. * * *

(B) Dividends received. An amount equal to the sum of—

(3) Dividends received from certain foreign corporations. In the case of dividends received from a foreign corporation (other than a foreign personal holding company) which is subject to taxation under this chapter, if an undivided interest in the foreign corporation is less than 36 months ending with the close of such foreign corporation's taxable year in which such dividends are paid or, if the corporation has not been in existence for 36 months at the close of such taxable year, for the period the foreign corporation has been in existence as of the close of such tax-
For the purposes of computing adjusted net earnings or profits for a taxable year in which the dividends are paid (computed as of the close of such taxable year), each corporation with respect to which the credit for dividends received is allowed under section 115 (a) accumulated after the beginning of such uninterrupted period shall not exceed an amount which bears the same ratio to 65 per cent of such dividends received as the gross income of such foreign corporation for the taxable year from sources within the United States bears to its gross income from all sources for such taxable year, and

(b) An amount equal to 85 per cent of the dividends received on certain preferred stock of public utilities, other than money, if the whole or any part of a dividend paid in respect to such property, the shareholder shall receive after August 31, 1930, is taxable only on its gross income from sources within the United States and has derived such property from all sources for such taxable year, and

For determination of earnings or profits distributed in any taxable year, see section 115 (b).

For the purpose of this subsection (but not for the purpose of computing adjusted net income), if the whole or any part of a dividend is received August 31, 1930, in property other than money, then, with respect to such property, the shareholder shall not be considered to have received as a dividend an amount in excess of the adjusted basis of such property. The credit allowed with respect to such dividends is determined at the time of distribution, and is determined by comparing the increased depreciation deduction allowed with respect to such property with respect to which the credit is allowed, multiplied by an amount equal to the following percent of such dividends received by the corporation during the taxable year:

For taxable years beginning before Apr. 1, 1954

For taxable years beginning after Apr. 1, 1954, and Mar. 31, 1954


(a) Dividends on stock of certain foreign corporations. (1) A credit is provided in section 26 (b) (2) for dividends received on certain preferred stock of certain public utility corporations subject to taxation under chapter 1 of the Internal Revenue Code. Such credit is allowable only for dividends received on the preferred stock of a public utility with respect to which the credit for dividends paid is not allowable to the distributing corporation under section 26 (h) with respect to the dividends on its preferred stock, such corporate credit per centum of such dividends. The credit of a corporation under section 26 (b) (2) for a taxable year is, except as provided in paragraph (d) of this section, an amount equal to 85 per cent of such dividends.

(2) Received out of the foreign corporation's earnings or profits for its taxable year in which the dividends are paid (computed as of the close of such taxable year), which has accumulated after the beginning of the applicable uninterrupted period, but not in excess of an amount which bears the same ratio to 85 percent of such dividends received as the gross income of the foreign corporation from sources within the United States bears to its gross income from all sources for such taxable year, and

(ii) Dividends received on certain preferred stock of public utilities. A credit is provided in section 26 (b) (2) for dividends received on certain preferred stock of certain public utility corporations subject to taxation under chapter 1 of the Internal Revenue Code. Such credit is allowable only for dividends received on the preferred stock of a public utility with respect to which the credit for dividends paid in section 26 (h) is allowable to the distributing corporation. The credit of a corporation under section 26 (b) (2) for a taxable year is, except as provided in paragraph (d) of this section, an amount equal to 85 percent of such dividends received as the gross income of the foreign corporation from sources within the United States for that portion of the applicable uninterrupted period which ends at the beginning of its taxable year in which the dividends are paid bears to its gross income from all sources for the same portion of such applicable uninterrupted period.

(3) The determination of earnings or profits distributed in any taxable year shall be made in accordance with the principles of section 311 (b) of the Internal Revenue Code. For the determination of the source of Income, see section 119 and the regulations thereunder.

(4) The application of section 26 (b) (3) may be illustrated by the following examples:

Example (1). Corporation A (a foreign corporation filing its income tax return on a calendar year basis) receives dividends of $3,000 on its stock of a domestic corporation during the calendar years 1941, 1942, and 1943. Corporation A is a foreign corporation subject to taxation under chapter 1 of the Internal Revenue Code.

(2) The credit of a corporation under section 26 (b) (2) for a taxable year is, except as provided in paragraph (d) of this section, an amount equal to 85 percent of such dividends.
(d) Limitations on credit. No credit is allowable under section 26 (b) in respect of dividends received from a corporation under subtitle A of subchapter X of subchapter A of chapter 1 of subtitle A of title 26 of the United States Code (15 U.S.C. 1948). The credit under section 26 (b) (that is, the sum of the credits determined under paragraphs (a) and (c) of this section) is limited to 85 percent of the corporation's adjusted net income computed without regard to the deduction for net operating loss allowed by section 23 (a) for the purpose of section 26 (b) and this section (but not for the purpose of computing adjusted net income). If the whole or any part of a dividend is received in property other than money, the amount of such dividend in property in such property shall not be considered to be in excess of the adjusted basis of such property in the hands of the distributing corporation at the time of the distribution increased in the amount of gain or decreased in the amount of loss recognized to the distributing corporation by reason of such property being included in the amount of gross income from sources within the possession of the United States. The credit under section 26 (b) is computed as follows:

- The net operating loss deduction computed in section 122 shall not be allowed.  
- The section 102 net income for the taxable year in the case of the tax imposed under subchapter A of chapter 1.
- The Supplement P net income for the taxable year, in the case of the tax imposed under subchapter X of subchapter A of chapter 1.
- The net income for the taxable year, in the case of the tax imposed under subchapter X of subchapter A of chapter 1.

(2) (i) The section 102 net income for the taxable year in the case of the corporation for the preceding taxable year (shown to have been incurred before December 31), and if it had distributed $50,000 on December 31, 1952, the dividends received credit allowed to Corporation B would be $15,000, computed by multiplying $17,000 (85 percent of $20,000 earnings or profits accumulated after the beginning of the uninterrupted period) by 90 percent (the portion of the gross income of Corporation A derived from sources within the United States during that portion of the uninterrupted period ending at the beginning of the taxable year).

Example. For 1952, the corporation X had a net income of $750,000, computed on the accrual basis and without the net operating loss deduction provided in section 23 (a), capital losses of $500,000, and no capital gains. Its Federal normal tax and surtax for 1952 was $500,000, computed on the accrual basis and computed under section 122, as a deduction under section 23 (a). For 1953 its gross income was $1,000,000, and its allowable deductions were $1,500,000. Included in such deductions was $500,000 for net operating loss attributable to 1961, and computed under section 122. There was likewise included in such deductions $500,000 for depletion based on discovery value, if depletion had been computed without reference to discovery value or to percentage depletion, the amount of such depletion would have been $100,000. For 1962 the corporation had $500,000 of wholly tax-exempt interest, and paid $200,000 in interest on indebtedness incurred to carry obligations from which such tax-exempt interest was derived. The net operating loss credit available to such corporation for 1963 is computed as follows:

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<th>Year</th>
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<th>Amount</th>
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<td>Less: Excess of depletion deduction computed on basis of discovery value (without reference to discovery value or percentage depletion ($800,000 minus $600,000))</td>
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<td></td>
<td>Gross income contemplated by section 26 (e) (3)</td>
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<tr>
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<td>Excess of deductions over gross income for 1953</td>
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<tr>
<td>1953</td>
<td>Net income for 1953 (computed without net operating loss deduction provided in section 23 (e))</td>
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<td>Less: Capital losses not allowed by section 117 (d)</td>
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<td>Federal normal tax and surtax for 1953 not allowed as a deduction under section 23</td>
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<td>Section 102 net income for 1953</td>
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§ 39.26 (c) Statutory provisions; credits of corporations; net operating loss of preceding year.
Section 28. Credits of corporations. In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

- Net operating loss of preceding year
  - Amount of credit. The amount of net operating loss (as defined in paragraph (2) of the corporation for the preceding taxable year
    - But not in excess of (A) the section 102 net income for the taxable year, in the case of the corporation, as determined 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.

Example. For 1952 the corporation X had a net income of $750,000, computed on the accrual basis and without the net operating loss deduction provided in section 23 (a), capital losses of $500,000, and no capital gains. Its Federal normal tax and surtax for 1952 was $500,000, computed on the accrual basis and computed under section 122, as a deduction under section 23 (a). For 1953 its gross income was $1,000,000, and its allowable deductions were $1,500,000. Included in such deductions was $500,000 for net operating loss attributable to 1961, and computed under section 122. There was likewise included in such deductions $500,000 for depletion based on discovery value, if depletion had been computed without reference to discovery value or to percentage depletion, the amount of such depletion would have been $100,000. For 1962 the corporation had $500,000 of wholly tax-exempt interest, and paid $200,000 in interest on indebtedness incurred to carry obligations from which such tax-exempt interest was derived. The net operating loss credit available to such corporation for 1963 is computed as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>Deductions for 1952</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>1953</td>
<td>Less: Excess of depletion deduction computed on basis of discovery value (without reference to discovery value or percentage depletion ($800,000 minus $600,000))</td>
<td>$200,000</td>
</tr>
<tr>
<td></td>
<td>Net operating loss deduction</td>
<td>$600,000</td>
</tr>
<tr>
<td></td>
<td>Deductions as limited by sections 26 (e) (2) (A) and 26 (e) (2) (O)</td>
<td>$700,000</td>
</tr>
<tr>
<td></td>
<td>Gross income for 1953</td>
<td>$500,000</td>
</tr>
<tr>
<td></td>
<td>Gross income contemplated by section 26 (e) (3)</td>
<td>$500,000</td>
</tr>
<tr>
<td>1952</td>
<td>Excess of deductions over gross income for 1953</td>
<td>$200,000</td>
</tr>
<tr>
<td>1953</td>
<td>Net income for 1953 (computed without net operating loss deduction provided in section 23 (e))</td>
<td>$700,000</td>
</tr>
<tr>
<td></td>
<td>Less: Capital losses not allowed by section 117 (d)</td>
<td>$550,000</td>
</tr>
<tr>
<td></td>
<td>Federal normal tax and surtax for 1953 not allowed as a deduction under section 23</td>
<td>$20,500</td>
</tr>
<tr>
<td></td>
<td>Section 102 net income for 1953</td>
<td>$170,500</td>
</tr>
</tbody>
</table>
The credit for the net operating loss for the preceding year available to the X Corporation for 1953 is $179,590. Inasmuch as the excess of deductions over income, as computed above, is greater than the section 102 net income for 1953, the net operating loss for the X Corporation for 1953 is equal to the section 102 net income for 1953. If the excess of deductions over income for the year 1952, as computed above, were smaller than the section 102 net income for 1953, the entire amount of such excess would be allowed as the net operating loss for 1953.

(1) 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 A of chapter 2.

§ 39.26 (d) Statutory provisions: credits of corporations; earnings or profits of bank affiliates.

Sec. 26. Credits of corporations. In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(d) Bank affiliates. In the case of a holding company affiliate (as defined in section 26 (a), (d) of this title) of the taxpayer and the aggregate of the earnings or profits which the Board of Governors of the Federal Reserve System certifies to the taxpayer has been devoted by such affiliate during the taxable year to the acquisition of readily marketable assets other than bank stock in compliance with section 514A of the Revised Statutes. The aggregate of the credits allowable under this subsection for all taxable years beginning after December 31, 1955, shall not exceed the amount required to be devoted under such section 514A to such purposes, and the amount of the credit for any taxable year shall not exceed the adjusted net income for such year.

§ 39.26 (d)-1 Bank affiliates. (a) The credit provided in section 26 (d) is allowed—
(1) To a holding company affiliate of a bank, as defined in section 2 of the Banking Act of 1933 (12 U. S. C. 221a) 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; and

(2) In the amount of the earnings or profits of such holding company affiliate which, in compliance with section 514A of the Revised Statutes (12 U. S. C. 61) has been devoted by it during the taxable year to the acquisition of readily marketable assets other than bank stock; and

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

No credit is allowable under section 26 (d) for the amount of readily marketable assets in excess of what is required by such section 514A 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 such section 514A to the acquisition of readily marketable assets other than bank stock.

(b) Every taxpayer claiming and making a deduction 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 circumstances under 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 earnings or profits devoted to the acquisition of readily marketable assets which must be accrued and maintained by a holding company affiliate to which a voting permit has been granted, see section 514A (b) and (c).

§ 39.26 (e)–(h) Statutory provisions: credits of corporations; cross references: dividends paid on certain preferred stock.

Sec. 26. Credits of corporations. In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(e) Income subject to excess profits tax. [Repealed by cc. 122 (g) (1), Rev. Act 1915.]

(f) Dividends paid credit. For corporation dividends paid credits, see section 27.

Sec. 28 (g) as amended by cc. 105 (d), Rev. Act 1942.

(g) Consent dividends credit. For corporation consent dividends credit, see section 28.

Sec. 28 (g) as amended by cc. 105 (d), Rev. Act 1942.

(h) Credit for Dividends Paid on Certain Preferred Stock. (1) Amount of credit. In the case of a public utility, (A) [Applicable only to calendar years 1911, (B) for taxable years beginning before March 1, 1951, and before April 1, 1954, an amount equal to 25 per centum of the lesser of (1) the amount of dividends paid during the taxable year on its preferred stock or (2) the adjusted net income for such taxable year minus the credit for dividends received in subsection (b) for such year, and (C) for a taxable year beginning after March 31, 1954, an amount equal to 25 per centum of the lesser of (1) the amount of dividends paid during the taxable year on its preferred stock or (2) the adjusted net income for such taxable year minus the credit for dividends received in subsection (b) for such year.

For the purpose of the credit provided in this subsection the amount of dividends paid shall not include any amount distributed in the current taxable year with respect to dividends unpaid and accumulated in any taxable year ending prior to October 1, 1942. Amounts distributed in the current taxable year with respect to dividends unpaid and accumulated during any taxable year ending after March 31, 1942, shall be subtracted from the basic surplus credit provided in section 27.

(2) Definitions. As used in this subsection, subsection (b), and sections 15 and 16—

(A) Public utility. The term "public utility" means a public utility corporation as defined in section 2 of the Federal Power Act of 1935, or in the sale of electric energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by any state or political subdivision thereof or by an agency or instrumentality of the United States.

(B) Preferred stock. The term "preferred stock" means stock issued prior to October 1, 1952, which, during the whole of the taxable year (or the part of the taxable year after its issuance) was stock the dividends in respect of which were cumulative, limited to the sum amount, and payable in preference to the payment of dividends on other stock.

Stock issued on or after October 1, 1942, shall be deemed for the purposes of this paragraph to have been issued prior to October 1, 1943, if it was issued (including issuance to replace bonds or debentures issued to prior to October 1, 1942, or to refund or replace other preferred stock (including stock which is preferred stock by reason of this sentence), but only to the extent that the par or stated value of the new stock does not exceed the par or stated value of the bonds or debentures issued prior to October 1, 1942, or the other preferred stock, which such new stock is issued to refund or replace. The determination of whether stock was issued to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock shall be made under regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

Sec. 26 (b) as added by cc. 133, Rev. Act 1942; amended by cc. 115, Rev. Act 1943; cc. 121 (g) (1), 122 (b), Rev. Act 1950; sec. 116, Revenue Act 1950; sec. 122 (b), Rev. Act 1951.

§ 39.26 (b)–1 Credit for dividends paid on preferred stock of public utilities—(a) Amount of credit. (1) A credit is provided in section 26 (b) for dividends paid during the taxable year on certain public utility corporations (see paragraph (b) of this section) on certain preferred stock; see paragraph (e) of this section. This credit is an amount equal to a specified percent of the lesser of (1) the amount of the dividends paid during the taxable year by a public utility on its preferred stock or (2) the adjusted net income for such taxable year plus the credit for dividends received in section 27 (b) for such year.

For taxable years beginning before April 1, 1954, and ending after March 31, 1954, the specified percent applicable for the respective taxable years is as follows:

<table>
<thead>
<tr>
<th>Percent</th>
<th>For taxable years beginning before April 1, 1954</th>
<th>For taxable years ending March 31, 1954</th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td>27</td>
<td>27</td>
</tr>
</tbody>
</table>

§ 39.26 b-1.
see § 39.108-2. However, the amount of dividends paid in a given taxable year shall not exceed the amount distributed in such year with respect to dividends unpaid and accumulated in any taxable year ending before October 1, 1942. If any distribution in the current taxable year with respect to dividends unpaid and accumulated for a prior taxable year, such distribution will be deemed to have been made with respect to the earliest year or years for which there are dividends unpaid and accumulated, whether or not the public utility states that the distribution was made with respect to such year or years and even though the public utility states that the distribution was made with respect to a later year or years. If it is later determined that such distribution was made with respect to the earliest year or years, the excess of such distribution over the amounts actually distributed in such years shall be deemed as dividends from the subsequent taxable year.

If there are no dividends unpaid and accumulated with respect to a taxable year ending before October 1, 1942, a public utility may however, receive credit for dividends paid with respect to any taxable year. If there are no dividends unpaid and accumulated with respect to a taxable year ending before October 1, 1942, a public utility may however, receive credit for dividends paid with respect to a prior taxable year. If there are no dividends unpaid and accumulated with respect to a taxable year ending before October 1, 1942, a public utility may however, receive credit for dividends paid with respect to a prior taxable year.

If there are no dividends unpaid and accumulated with respect to a taxable year ending before October 1, 1942, a public utility may however, receive credit for dividends paid with respect to a prior taxable year. If there are no dividends unpaid and accumulated with respect to a taxable year ending before October 1, 1942, a public utility may however, receive credit for dividends paid with respect to a prior taxable year. If there are no dividends unpaid and accumulated with respect to a taxable year ending before October 1, 1942, a public utility may however, receive credit for dividends paid with respect to a prior taxable year.

(2) The amount allowable as a credit under section 26 (h) shall be subtracted from the basic surtax credit otherwise computable in the case of preferred stock on or after October 1, 1942.

(b) Public Utility. As used in section 26 (h) and this section, public utility means a corporation engaged in the furnishing of telephone service, or in the sale of electric energy, or water if the rates charged by such corporation for 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. If a schedule of rates has been filed with any of the above bodies having the power to disapprove such rates, then such rates shall be deemed as established or approved rates even though such body has taken no action on the filed schedule. Rates fixed by contract between the corporation and the purchaser, except where the purchaser is the United States, a State, the District of Columbia, or an agency or political subdivision of the United States, a State, or the District of Columbia, shall not be considered as established or approved rates in those cases where they are not subject to direct control, or where no maximum rate for such contract rates has been established. In the case of the United States, a State, the District of Columbia, or any agency or political subdivision thereof. The credit provided in section 26 (h) will not be allowed solely because part of the gross proceeds from the issuance of such new stock consists of the revenue derived from such furnishing or sale at rates which are not so regulated, provided the corporation establishes to the satisfaction of the Commissioner (1) that the revenue from regulated rates and the revenue from unregulated rates are derived from the operation of a single interconnected and coordinated system within a single area or region in one or more states, and (2) that the regulation to which it is subject in part of its operating territory is effective to control rates within the unregulated territory so that the rates within the unregulated territory have been and are substantially as favorable to users and consumers as are the rates within the regulated territory.

(c) Preferred stock. (1) For the purposes of section 26 (h) and this section, preferred stock means stock which was issued prior to October 1, 1942, and which during the whole of the taxable year (or the part of the taxable year after the actual date of its issue) was stock nonparticipating as to earnings or profits otherwise than in dividends which are not cumulated with respect to the current taxable year. However, if any dividends on such stock have been declared but not paid, the credit provided in section 26 (h) shall be deemed as having been paid with respect to the current taxable year.

(2) Stock issued on or after October 1, 1942, under certain circumstances will be considered as having been issued before October 1, 1942. If the new stock is issued on or after October 1, 1942, to refund or replace bonds or debentures which were issued before October 1, 1942, or to refund or replace other stock which was preferred stock, the credit allowable under section 26 (h) but the appropriate allocable portion of the total amount of dividends paid on such stock will be considered as having been paid on stock which was issued before October 1, 1942.

(4) The provisions of section 26 (h) and (ii) may be illustrated by the following example:

(5) Whether or not stock issued on or after October 1, 1942, was issued to refund or replace bonds or debentures, or other preferred stock which the new stock was issued to refund or replace. In such case, the par or stated value of which does not exceed the par or stated value of the new stock which was issued before October 1, 1942.
consider the entire transaction, including the issuance of such stock, the date of such issuance, the retirement of the old bonds, debentures, or preferred stock, and the date of such retirement, in order to determine whether such new stock really was issued to take the place of bonds, debentures, or other preferred stock of the corporation or whether it represents something essentially new in an economic sense in the corporation's financial structure. For example, a public utility, which has outstanding bonds issued prior to October 1, 1942, issues new stock on March 1, 1944, in order to secure funds; by which such bonds, debentures, or other preferred stock of the corporation may be refunded or replaced. Such stock may be considered as having been issued to refund or replace bonds issued prior to October 1, 1942. Whether the money used to retire the bonds can be traced back and identified as the money paid in for the stock will have evidentiary value, but will not be conclusive evidence. For example, if the stock was issued to refund or replace the bonds, whether the entire issue of bonds, debentures, or preferred stock was refunded will be important, but not decisive, in making such determination.

(6) Stock issued on or after October 1, 1942, by a corporation to refund or replace bonds or debentures of a second corporation which were issued prior to October 1, 1942, or to refund or replace other preferred stock of such second corporation, may be considered as having been issued prior to October 1, 1942, if such new stock was issued (1) in a transaction which is a reorganization within the meaning of section 112 (g) (1) or (2) in a transaction to which section 112 (b) (10) relating to reorganization of certain insolvent corporations, or so much of section 112 (d) or (e) as relates to section 112 (b) (10) is applicable; or (3) in a transaction which is subject to the provisions of Supplement R, relating to exchanges and distributions in obdrance to orders of the Securities and Exchange Commission. Whether the stock actually was issued to refund or replace bonds or debentures of the second corporation issued prior to October 1, 1942, or to refund or replace preferred stock of such second corporation, shall be determined under the same principles as if only one corporation were involved.

A corporation may issue stock to refund or replace its own bonds, debentures, or other preferred stock even though the issuance of such stock may not fall within one of the categories enumerated above.

§ 39.26 (1) Statutory provisions: credits of corporations; percentage of normal-tax net income of Western Hemisphere trade corporations.

Sec. 26. Credits of corporations. In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax:—

(1) Provisions of this paragraph shall be inapplicable to the case of a Western Hemisphere trade corporation (as defined in section 1059 (B)).

(2) Calendar year 1951.

(3) Taxable years beginning after March 31, 1951, and before April 1, 1954.

§ 39.26 (b) Basic surtax credit.

§ 39.27 (b)–1 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 content dividends credit provided in section 26, and 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;

(2) The net operating loss credit provided in section 26 (c) (1);

(3) The bank affiliate credit provided in section 26 (d).

The aggregate of the amounts under paragraphs (2) and (3) shall not exceed (A) the amount of the credit provided in section 26 (a) (1), in the case of the tax imposed by section 122; (B) the Supplement P net income for the taxable year, in the case of the corporation 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.

[Sec. 27 (b) as amended by sec. 152 (b), Rev. Act 1943]

§ 39.27 (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 deduction under section 26 (a) (relating to the credit for dividends paid on certain preferred stock of certain public utilities corporation) and less the amount allowable as a deduction under section 121 (relating to the deduction of dividends paid on certain preferred stock of certain banks and trust companies):

For taxable years beginning after April 1, 1954, and ending after March 31, 1955, see § 39.108-2.

§ 39.27 (a) Statutory provisions: corporation dividends paid credit; definition.

Sec. 27. Corporation dividends paid credit.—(a) Definition in general. As used in this chapter with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

(2) The dividend carry-over to such year, computed as provided in subsection (c); and

(b) Smaller of the following:

(1) The sum of the net operating loss credit for the preceding taxable year as provided in section 26 (e) (1) and the bank affiliate credit provided in section 26 (d).

(2) The section 102 net income for the taxable year, in the case of tax imposed by section 102; (d) the Supplement P net income for the taxable year, in the case of computations required under Supplement P; or (d) the Subchapter A net income for the taxable year, in the case of tax imposed under Subchapter A of chapter 2.

§ 39.27 (b)–2 Dividends paid.—(a) When dividends are considered paid. (1)
§ 39.27 (c) Statutory provisions; corporation dividends paid credit; dividend carry-over.

Statutory provisions:

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 of the basic surtax credit for the first preceding taxable year over the subchapter A net income for such year.

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.

In computing the dividend carry-over, the subchapter A net income of any carryover taxable year shall be determined as if the corporation was, under the law applicable to such taxable year, a personal holding company.

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 and a basic surtax credit of $250,000 for 1949. For 1950 its subchapter A net income is $200,000 and its basic surtax credit is $300,000, and for 1951 its subchapter A net income and its basic surtax credit are each $175,000. Its dividend carry-over to 1952 is $150,000, computed as follows:

1. Basic surtax credit for 1950 $350,000
2. Less subchapter A net income for 1950 $200,000
   Result: $150,000 dividend carry-over

Example (2). The Y Corporation, which makes its income tax returns on the calendar year basis, has subchapter A net income of $125,000 and a basic surtax credit of $225,000 for 1949. For 1950 its subchapter A net income is $200,000 and its basic surtax credit is $300,000, and for 1951 its subchapter A net income is $175,000. Its dividend carry-over to 1952 is $150,000, computed as follows:

1. Basic surtax credit for 1950 $350,000
2. Less subchapter A net income for 1950 $100,000
   Result: $250,000 dividend carry-over

Since the basic surtax credit for 1951 exceeds the subchapter A net income for that year, neither the excess of such basic surtax credit over the subchapter A net income for such year exceeds the subchapter A net income for such year, nor the excess of the basic surtax credit for the third preceding taxable year (1950) over the subchapter A net income for such year, nor the excess of the basic surtax credit for such year and the excess of the basic surtax credit for the third preceding taxable year (1950). The dividend carry-over to 1952 is $150,000.

Example (3). 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 1950. For 1951 its subchapter A net income is $150,000 and its basic surtax credit is $200,000, and for 1952 its subchapter A net income and its basic surtax credit are each $175,000. Its dividend carry-over to 1953 is $150,000, computed as follows:

1. Basic surtax credit for 1950 $350,000
2. Less subchapter A net income for 1950 $100,000
   Result: $250,000 dividend carry-over
§39.27 (d) Statutory provisions; corporation dividends paid credit; dividends in kind.

Sec. 27. Corporation dividends paid credit; dividends in kind.

(d) Dividends in kind. If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the amount with respect thereto which shall be used in computing the basic surtax credit shall be the fair market value of the property at the time of the payment, whichever is the lower.

§39.27 (d)–1 Dividends in kind. (a) Section 27 (d) imposes limitations upon the extent to which dividends paid in assets (other than money) may be recognized for purposes of determining the amount of the allowance for dividends paid which may be included in the basic surtax credit. Irrespective of the form of the corporate resolution by 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:

(1) The adjusted basis of such property in the hands of the corporation as provided for in section 113; or

(2) The fair market value of the property.

(b) 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 reacquired 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, indorser, or surety.

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

Example. The S Corporation, in 1954, purchased stock of the Y Corporation for $100,000. In 1955 such stock had a fair market value of $70,000. During the period of its ownership of such stock, the S Corporation received distributions amounting to $65,000 out of earnings or profits of the Y Corporation accumulated before March 1, 1953. In 1953 the S Corporation used said stock for the payment of a dividend. The allowance for dividends paid for purposes of inclusion in the basic surtax credit for 1953 is $70,000, computed as follows:

- Purchase price, or cost of stock...$100,000
- Less tax-free distribution...$65,000
- Adjusted basis of stock in the hands of the corporation at the time of the dividend payment...$35,000
- Fair market value of stock at the time of the dividend payment...$70,000

An allowance for dividends paid for purposes of inclusion in the basic surtax credit for 1953 with respect to such stock.

§39.27 (e)–1 Dividends in obligations of the corporation. (a) A dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. In the event that the face value, or the fair market value, of the dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, or the fair market value, at the time the obligation is redeemed by the corporation of the excess of the amount for which redeemed over the face market value at the time of the dividend payment (to the extent allocable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

§39.27 (e)  Corporate dividends paid credit.

(e) Dividends in obligations of the corporation. If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. In the event that the face value, or the fair market value, of the dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, or the fair market value, at the time the obligation is redeemed by the corporation of the excess of the amount for which redeemed over the face value, or the fair market value, at the time of the dividend payment (to the extent allocable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

§39.27 (e)–1 Dividends in obligations of the corporation. (a) Section 27 (e) is concerned solely with the amount of the allowance for dividends paid for purposes of inclusion in the basic surtax credit to the extent that dividends are paid by a corporation in its own obligations. If the corporation ultimately pays a dividend in its own obligations (regardless of the form of the corporate resolution by which the dividend is declared) the amount of the allowance for dividends paid to which it is entitled with respect thereto for any taxable year in which such dividend is paid is limited to the lesser of the face value or fair market value of such obligations as of the date of payment. If in a taxable year of the corporation beginning after December 31, 1935, the allowance for dividends paid as of the date of payment is limited to the fair market value of the corporate obligations distributed and the corporation redeems such obligations, the corporation becomes entitled to an additional allowance for dividends paid in computing the basic surtax credit for the taxable year in which it redeems such obligations, but only in the event that the amount at which such obligations are redeemed is higher than their fair market value at the time of the distribution. The amount of such additional allowance is the excess of the price at which such obligations are redeemed over their fair market value at the time of the distribution, subject to the redemption that such excess be diminished by any amounts which were allowable as deductions for amortized bond discount or bond issue commissions and expenses allocable to the obligations. The redemption, in computing the net income of the corporation for any taxable year. A corporation is entitled to such additional al-
lowance regardless of the identity of the holders of the obligations at the time of their redemption.

(b) As used in this section, the term "obligations" means any legal liability on the part of the corporation (not including as a guarantor, indorser, or surety) regardless of when incurred, to pay a fixed or determinable sum of money (even if it will not be available to the corporation as a deduction in computing the basic surtax credit) under the terms of the obligation.

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

Example. The X Corporation, which makes its income tax returns on the calendar year basis, declared a dividend of $85,000 in 1946, payable in that year in its five percent bonds at 6%. Pursuant to such declaration, bonds having an aggregate face value of $100,000 were issued during 1946 in payment of the dividend. The fair market value of the bonds at the time of issuance was $75,000. The dividends paid credit for 1946 was the 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 obligations.

The bonds were redeemed in 1952. The redemption prior to the redemption of the bonds at face value deducted in its returns over the life of the bonds the $15,000 bond discount resulting from the payment in 1946 of the $85,000 dividend in bonds having a face value of $100,000. The allowance for dividends paid for purposes of computing the basic surtax credit with respect to the bond redemption for the taxable year 1952, in which the redemption of the bonds occurs, is $10,000, computed as follows:

Redemption price of bonds $100,000
Less fair market value of bonds when dividend was paid in 1946 76,000
Difference 24,000
Amount treated as dividend paid for purposes of the basic surtax credit under this section 10,000

$39.27 (f) Statutory provisions; corporation dividends paid credit; taxable stock dividends.

Sec. 27. Corporation dividends paid credit.

(a) Taxable stock dividends. In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115 (e), the amount with respect to which the basic surtax credit shall be the fair market value of the stock or stock right at the time of payment.

(b) Taxable stock dividends. The allowance for dividends paid provided by section 27 (b) (1) is limited by section 27 (f) in the case of distributions in the form of stock dividends or stock rights, to distributions which are taxable dividends in the hands of shareholders under section 115 (e). The allowance, however, is limited in amount to the fair market value of such stock or stock rights at the time of payment of the dividend. As to a distribution by corporation of its own capital stock held as an investment, see § 39.27 (d) (1). The amount of the allowance is equal to the amount of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, to distributions properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for the purposes of this section, includes only amounts representing the par or stated value of the stock with respect to which the 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 like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913.

Example. The Y Corporation, which makes its income tax returns on the calendar year basis, was organized on January 1, 1910, 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 $7 per share and $100 per share on the liquidation of the corporation. In 1920, the company declared a dividend of $100 per share on the stock, payable on the liquidation of the corporation. In priority to any payments on common stock, and to participate equally with the common stock in either instance after the common stock had received a similar amount. However, the preferred stock was redeemable in whole or in part at the option of the board of directors at any time at $100 per share plus its proportion of the earnings of the company at the time of such redemption, in 1910 the preferred stock was issued at $100 per share, for a total of $200,000. On July 15, 1920, the company had a paid-in surplus of $5,000, consisting of the premium received on the preferred stock; earnings or profits of $30,000 accumulated prior to February 28, 1913, and earnings or profits accumulated since February 28, 1913, of $75,000. On July 15, 1920, the option with respect to the preferred stock was exercised and the entire amount of such stock was redeemed at $141 per share or a total of $282,000. On a total of $200,000 in a transaction upon which gain or loss to the distributories resulting from the exchange was determined and recognized under the Internal Revenue Code, such transaction being only a partial liquidation under section 115 (e). The amount of the distribution allocable to capital account was $116,000 ($100,000 attributable to the preferred stock, $8,000 attributable to paid-in surplus, and $10,000 attributable to earnings or profits accumulated after February 28, 1913). The remainder, $25,000 ($141,000, the amount of the distribution less $116,000, the amount allocable to capital account) is properly chargeable to the earnings or profits accumulated since February 28, 1913, and is allowable as dividends paid.

(c) Credit in respect of earnings or profits transferred under tax-free transactions. (1) If, as a result of one or more transactions described in section 112, a corporation's earnings or profits accumulated after February 28,
1913, and its undistributed earnings or profits of the taxable year, shall have been the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferee's taxable year which is included in the taxable year of the liquidation shall be treated as a dividend paid only in the taxable year or out of such earnings or profits of the transferee corporation. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the purposes of the allowance for dividends paid, any such distribution so allocated shall be treated as a dividend paid only in the computation of the basic surtax credit allowable to the transferee, and must be consistently so treated by both corporations for the current and succeeding taxable years. Each corporation shall file as part of its returns for the taxable year involved (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 115, the status at that time of the earnings of both corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferee corporation, and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No allowance for dividends paid based upon such apportionment and allocation will be permitted unless the Commissioner is satisfied that the transferee corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph.

(2) The provisions of subparagraph (1) of this paragraph may be illustrated by the following example:

**Example.** The P Corporation, which makes its income tax returns on the calendar year basis, has a capital stock of $50,000 outstanding. The S Corporation, which makes its returns on the calendar year basis and was constituted as of December 1, 1912, at that time, the S Corporation had earnings or profits accumulated subsequent to February 28, 1912, in the amount of $50,000. In addition to earnings or profits for 1912 of $50,000, 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, 1912, in the amount of $50,000, in addition to earnings or profits for 1912 of $50,000, 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, 1912, in the amount of $50,000, in addition to earnings or profits for 1912 of $50,000, and an adjusted net income of $45,000. It had paid no dividends prior to its liquidation. The P Corporation pays dividends as follows: June 15, 1912, $25,000; December 15, 1912, $50,000; December 15, 1912, $25,000; March 15, 1913, $25,000. No portion of the dividends paid on June 15 and December 15 prior to the liquidation and the portion of the dividend paid on March 15, 1913, after the close of the taxable year of the S Corporation may be allocated to the S Corporation. The dividend paid on December 15 may, by appropriate corporate action, be made as one distribution out of the 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 115, (b), the earnings or profits of the P Corporation and the S Corporation are subject to the limitation of $100,000.

§ 39.27 (b) [Statutory provisions; corporation dividends paid credit; preferential dividends.]

Sec. 21. Corporation dividends paid credit.

*(a) Preferential dividends.* The amount of any distribution (although each portion thereof is received by a shareholder as a taxable dividend) made by any shareholder resident with a consent distribution (as defined in section 28 (a) (4)), 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 within any class of stock, as compared with another class in the same company, and with no preference to one class of stock as compared with another class in the same company. A person is entitled (without reference to waivers of their rights by shareholders) to such preference.

For a distribution made in connection with a consent distribution, see section 28.

§ 39.27 (b) [Preferential distributions.]

(a) Section 27 (h) (1) imposes a limitation upon the general rule that a corporation is entitled to an allowance for dividends paid with respect to all dividends which are paid by it. Prior to its liquidation, the P Corporation had distributed $85 a share payable in cash on each of August 1, 1952, to A and B, and on September 15, 1952, it declared dividends of $3 a share payable in cash on each of October 1, 1952, to B, C, and D. No allowance for dividends paid was permitted under section 27 (h) with respect to any part of the dividends paid on August 1, 1952, or October 1, 1952.

(b) The corporation in this paragraph may be illustrated by the following examples:

**Example (1).** A, B, C, and D are the owners of all the shares of A common stock in the M Corporation, which makes its income tax returns on a calendar year basis. With the consent of all the shareholders, the M Corporation, on July 15, 1952, distributed a dividend of $5 a share payable in cash on each of August 1, 1952, to A and B. On September 15, 1952, it declared dividends of $3 a share payable in cash on each of October 1, 1952, to B, C, and D. No allowance for dividends paid was permitted under section 27 (h) with respect to any part of the dividends paid on August 1, 1952, or October 1, 1952.

**Example (2).** The N Corporation, which makes its income tax returns on a calendar year basis, has earnings or profits of $1,900,000 (consisting of 1,000 shares of common stock of a par value of $100) and earnings or profits accumulated subsequent to February 28, 1912, in the amount of $30,650. In the year 1952 the N Corporation distributes $7,500. In cancellation of 50 shares of the stock owned by three of the four shareholders of the corporation. No allowance for dividends paid is permissible 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 85 per share and on which no dividends have been paid for two years, and 10 shares of common, owned by F. On December 31, 1952, the corporation distributes a dividend of $125 to E and $75 to F. The corporation is entitled to an allowance for any part of such dividend paid, since there has been a preference to F. If, however, the corporation had distributed $100 to F, it would not have been entitled to include $125 in its basic surtax credit as a dividend paid.

§ 39.27 (i) [Statutory provisions; corporation dividends paid credit; nontaxable distributions.]

Sec. 27. Corporation dividends paid credit.

*(i) Nontaxable distributions.* If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to tax, the allowance for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit.

§ 39.27 (ii) [Nontaxable distributions.]

(a) No allowance for dividends paid is permitted under this chapter with respect to any part of the distribution by a corporation to its shareholders which is—

(1) Not out of earnings or profits of the taxable year or out of earnings or profits of the current taxable year or the taxable year subsequent to February 28, 1912, (see section 115) or, in the case of distributions in liquidation, not properly chargeable to earnings or profits of the corpo-
ration accumulated after February 28, 1913, under section 27 (g).

(2) In the case of a corporation which was classified as a personal service corporation under the Revenue Act of 1918 or the Revenue Act of 1921, out of earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 219 of the Revenue Act of 1921 (see section 115 (e)) or

(3) A distribution in stock of the corporation or rights to acquire its stock which does not constitute income to its shareholders within the meaning of the sixteenth amendment to the Constitution (see section 115 (f))

(b) The effect of sections 27 (b) and (i) is that no allowance for dividends paid may be included in the basic surtax credit with respect to any distribution unless each of the shareholders of that class, who are subject to taxation under chapter 28, is entitled to such a share in the distribution as a result of the distribution. (See also section 27 (g.).)

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

Example. A, B, and C are shareholders of the X Corporation, a personal holding company, whose taxable year ends on June 30 of a fiscal year ending July 31. A is an educational corporation exempt from income tax under section 101. On July 15, 1952, the X Corporation declared $300,000 in cash to all shareholders, $50,000 to each. The X Corporation had a deficit in earnings and profits as of the beginning of its taxable year amounting to $300,000, but had a Subchapter A net income for the taxable year of the amount of $100,000. Its earnings and profits for the taxable year were only $30,000. It was entitled under section 28 (c) (1) to a net operating loss credit of $30,000. The distributions from the X Corporation will constitute a taxable dividend in the hands of B and C only to the extent of $40,000, $20,000 to each, respectively, because the amount paid out of the deficit as determined by the proportionate part of the net operating loss credit. See § 39.115 (a).-1. The X Corporation, in making the distribution, made no allowance for dividends paid in the amount of $70,000 with respect to the distribution on July 15.

§ 39.28 (a) Statutory provisions; consent dividends credit; definitions.

Sec. 28. Consent dividends credit—(a) Definitions. As used in this section—

(1) Consent stock. The term "consent stock" means the class or classes of stock entitled, after the payment of preferred dividends (as defined in paragraph (2)), to a share in the distribution (other than in partial liquidation) within the taxable year of all the remaining earnings or profits, which share constitutes the same proportionate part of the distribution as the amount of the remaining earnings or profits, which constitutes the same proportionate part of the distribution as the amount of the distribution.

(2) Preferred dividends. The term "preferred dividends" means a distribution (other than in partial liquidation) which is not payable during the last month of the taxable year of the corporation, as constituted as of the consent dividends day (as defined in paragraph (1)), and is payable to a shareholder on the consent dividends day (as defined in paragraph (4)).

(3) Consent dividends day. The term "consent dividends day" means the last day of the taxable year of the corporation, unless after the payment of preferred dividends (as defined in paragraph (2)) there had actually been distributed in cash and received by each shareholder making a contribution under section 27 (g) in the same manner as in subsection (d), the specific amount stated in such consent.

§ 39.28 (a)-1 Consent stock. (a) As defined in section 28 (a) (1) the term "consent stock" includes what is generally known as common stock. It also includes participating preferred stock, the participation rights of which are unlimited.

(b) The application of section 28 (a) (1) may be illustrated by the following example:

Example. If in the case of the X Corporation there was only one class of stock outstanding, it would all be consent stock. If, on the other hand, there were two classes of amount of $5,000,000. Its earnings and profits were $2,000. Nevertheless the corporation, which is entitled to receive dividends in the amount of $600 per share on class A and $300 per share on class B, and class A was entitled to 6 percent before any distribution could be made on class B, but class B was entitled to everything distributed after class A had received its 6 percent, only class B stock would be consent stock. Similarly, if class A, after 5 percent, was entitled to an equal or in some fixed proportion with class B until it had received a second 6 percent, after which class B alone was entitled to some fixed amount, then only class B stock would be consent stock. The same result would follow if the order of preference were exactly reversed. Thus, if class B 6 percent, then class A a second 6 percent, either alone or in conjunction with class B, then class B the remainder. If, however, class B stock is entitled to ultimate participation without limit as to amount, then it, too, may be consent stock. For example, if class A is to receive 5 percent and then share equally or in some fixed proportion with class B in the remainder of the earnings or profits distributed, A stock and class B stock are consent stock.

§ 39.28 (a)-2 Preferred dividends. (a) As defined in section 28 (a) (2) the term "preferred dividend" includes all fixed amounts (whether determined by percentage or by value), a stated return (on a certain number of dollars per share, or otherwise) the distribution (other than in liquidation) of which is not payable during the last month of the taxable year of the corporation, precedent to a further distribution (other than in liquidation) of earnings or profits. A distribution, though expressed in terms of a fixed amount, is not a preferred dividend; however, unless it is preferred over a subsequent distribution within the taxable year upon some other class or classes of stock than the one on which it is payable.

(b) The application of section 28 (a) (2) may be illustrated by the following example:

Example. If, in the case of the X Corporation, there are only two classes of stock outstanding, class A and class B, and class A is entitled to a distribution regardless of the order of preference is class A $60 per share, class B $40 per share, then class A and class B in fixed proportions until class A receives 6 cents more per share, then class B the remainder, all of class A's $90 per share and $50 per share of the amount distributed to class B. The term class B is entitled to receive in connection with the payment to class A of its last $3 per share is not a preferred dividend, because the payment of such amount is preferred over no subsequent distribution except one made on class B itself. Finally, if a distribution may be made on class A, on class B, then on class A and class B share and share alike, the distribution on class A is not a preferred dividend, because the distribution on class B of $60 is both preferred dividends.

§ 39.28 (a)-3 Consent dividends; consent dividends day. The term "consent dividends day" is defined in section 28 (a) (3) if there were no prefered distribution as defined in section 28 (a) (5) payable during the last month of the corporation's taxable year, the consent dividends day is the last of such taxable year. If there were one or more only the class of stock on which was payable a partial distribution, the consent dividends day is the last of such days. The day upon which shareholders under the terms of the resolution of the board of directors directing the distribution, are entitled to receive the distribution is the day it is payable.

§ 39.28 (a)-4 Consent dividends, consent dividends credit. The term "consent dividends credit" does not include any actual distributions but is limited to the hypothetical distribution evidenced by shareholders' consents. The consent dividends day is the day specified in the consent of all the amounts specified in the several consents, whether or not, if actually distributed, such amounts would have constituted in whole or in part a return of capital.

(b) Section 28 (a) (4) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year, has two classes of stock outstanding, consisting of 500 shares, 200 of which are owned by A, and 300 by B. On December 31, 1952, the corporation distributed $600 to A and $300 to B, and the corporation reduces A's tax liability to $500 in his gross income as a taxable dividend. At the beginning of 1953 the corporation had no accumulated earnings or profits. For the taxable year 1953 the earnings and profits of $2,000. Nevertheless the corporation will be deemed to have made a consent distribution of $1,500 on December 31.

§ 39.28 (a)-5 Partial distribution. (a) As defined in section 28 (a) (5) the term "partial distribution" means a distribution (other than in liquidation) which is not payable in full during the last month of the taxable year of the corporation, but is payable before the distribution is required to be made, under the terms of the resolution of the board of directors directing the distribution, or payable within the taxable year of the corporation, or in the case of a personal service corporation, within the taxable year of the corporation, if the corporation is entitled to receive a tax credit for the partial distribution, the consent dividends credit; definitions. The term "consent dividends credit" includes all fixed amounts (whether determined by percentage or by value), a stated return (on a certain number of dollars per share, or otherwise) the distribution (other than in liquidation) of which is not payable during the last month of the taxable year of the corporation, precedent to a further distribution (other than in liquidation) of earnings or profits. A distribution, though expressed in terms of a fixed amount, is not a preferred dividend; however, unless it is preferred over a subsequent distribution within the taxable year upon some other class or classes of stock than the one on which it is payable.
(b) 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 two classes of outstanding stock, class A and class B, each of which is consent stock. Class A, consisting of 900 shares, is entitled to a preference of $5 per share, after which class B, consisting of 500 shares, is to receive $3 per share, whereupon class A and class B are to share equally in any further distributions of earnings or profits. On December 15, 1952, the X Corporation distributes $3,000 per share on class A stock and $5 per share on class B stock. Such distribution, to the extent of $1,500 paid on class A stock, is a partial distribution.

§ 39.23 (a) -4 Preferential distribution. (a) A preferential distribution is an actual distribution (other than the distribution of a preferred dividend as defined in section 28 (a) (2)) or a consent distribution to one class of consent stock in the aggregate amount of $5,000 or more, to one or more shareholders of the same class or to one class of consent stock as compared with any other class of consent stock. Such a preference exists if there is distributed to any shareholder (in proportion to the number of shares held by him) more or less than the pro rata part of a distribution as compared with the distribution made to any other shareholder of the same class, or if there is distributed to all the shareholders of one of two classes of outstanding stock in any amount which would have constituted a dividend. The amount which would have constituted a dividend in any class of outstanding stock is the difference between the amount there actually has been distributed or paid in the stock to, or for the benefit of, the shareholders in such class and the amount which would have been allowed to the corporation, therefore, if the consent dividend credit, therefore, cannot exceed the amount of the consent dividends credit, in the several consents. It may, however, be credited to the extension of the tax credit for any other distributions of earnings or profits.

§ 39.23 (b) -2 Liquidation of consent stock. (a) 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.

(b) The application of section 28 (b) (2) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has class A stock outstanding, owned in equal amounts by A and B. On December 15, 1952, the corporation makes a distribution of $3 per share to each of class A and class B, and $5,000 to C. The distribution is preferential. If A and B each receives a distribution of $5,000, and C consents to include $5,000 in gross income as a taxable dividend, the combined actual and consent dividends credit is preferential. Similarly, if no one receives a distribution in cash, but A and B each consents to include $5,000 as a taxable dividend in gross income but C agrees to include only $5,000, the consent distribution is preferential.

Example (2). The Y Corporation, which makes its income tax returns on the calendar year basis, has only two classes of stock outstanding, each class being consent stock and consisting of $500 shares. Class A, with a par value of $10 per share, is entitled to one-third of any distribution of earnings and profits. Class B, with a par value of $20 per share, is entitled to one-third of any distribution of earnings and profits. On December 15, 1952, there is distributed on the class A stock $5 per share, or $1,500, and on the class B stock $2 per share, or $1,000. The distribution is preferential, inasmuch as the class B stock would have been entitled to $666.67 more than its pro rata share of the distribution.

§ 39.23 (b) Statutory provisions; consent dividends credit; corporations not entitled to credit.

§ 39.23 (c) Statutory provisions; consent dividends credit; allowance.

§ 39.23 (d) Statutory provisions; consent dividends credit; shareholders' consents.

§ 39.23 (e) Statutory provisions; consent dividends credit; corporations not entitled to credit.

§ 39.23 (f) Statutory provisions; consent dividends credit; shareholders' consents.

§ 39.23 (g) Statutory provisions; consent dividends credit; corporations not entitled to credit.

(b) The operation of 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, whereby five shares of class A stock, had been canceled or exchanged for five shares of class B stock, the dividend rights of which would have constituted a dividend. The amount which would have constituted a dividend in any class of stock is the difference between the amount there actually has been distributed or paid and the amount which would have been allowed to the corporation, therefore, if the consent dividend credit, therefore, cannot exceed the amount of the consent dividends credit, in the several consents. It may, however, be credited to the extension of the tax credit for any other distributions of earnings or profits.

(b) The application of section 28 (b) (2) 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 in equal amounts by A and B. It makes no distributions during the taxable year. Earnings and profits for the calendar year 1952 amount to $10,000, but if $10,000 had actually been distributed by the X Corporation, the consent dividend credit would have constituted a dividend. The consent dividend credit, if less than $10,000, would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend.

(b) The provisions of section 28 (e) 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 in equal amounts by A and B. It makes no distributions during the taxable year. Earnings and profits for the calendar year 1952 amount to $10,000, but if $10,000 had actually been distributed by the X Corporation, the consent dividend credit would have constituted a dividend. The consent dividend credit, if less than $10,000, would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend. The consent dividend credit would have constituted a dividend.
ers, on the last day of the taxable year, of the corporation, of any class of consent stock; and

(2) Unless in each such consent the shareholder agrees that he will include as a taxable dividend, in his return for the taxable year in which or with which the taxable year of the corporation ends, a specific amount; and

(3) Unless the consents filed are made by such of the shareholders and the amount specified in each consent is such, that the consent distribution would not have been a preferential dividend; and

(A) If there was no partial distribution during the last month of the taxable year of the corporation, or

(B) If there was such a partial distribution, then when considered in connection with such partial distribution; and

(4) Unless in each consent made by a shareholder who is taxable with respect to a dividend only if received from sources within the United States, such shareholder agrees that the specific amount stated in the consent shall be considered as a dividend received by him from sources within the United States; and

(5) Unless each consent filed is accompanied by a cash, or some other medium of payment as the Commissioner may by regulations authorize, in an amount equal to the amount required by section 231 (a) or 144 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. The amount accompanying the consent shall be credited against the tax imposed by section 211 (a) or 231 (a) upon the shareholder.

[Sec. 28 (d) as amended by sec. 186 (e) (1) Rev. Act 1942]

§ 39.28 (d)-1 Making and filing of consents. (a) A consent shall be made in duplicate on Form 973 in accordance with this section 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 any class of consent stock, i. e., the person who would have been required to include in gross income any dividends on such stock accorded on the last day of the taxable year of such stock. Form 973 shall contain or be verified by a written declaration that it is made under the penalties of perjury.

In the consent such person must agree:

(1) To include in his gross income for his taxable year in which or with which the taxable year of the corporation ends a specific amount as a taxable dividend; and

(2) 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 considered as a dividend received by him from sources within the United States.

(b) 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. With such return, and not later than the due date thereof, the corporation must file two duly executed duplicate originals of each consenting shareholder's consent, and a return of Form 973 showing by classes the 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 information required by section 211 to be contained or verified by a written declaration that it is made under the penalties of perjury.

(c) In the event that any consent filed by the corporation is made by a shareholder to whom the payment of a dividend in cash on the last day of the taxable year of the corporation would have made it necessary for the corporation 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 bank is located does not permit the certification to be rescinded prior to presentation by the corporation;

(4) A cashier's check of a domestic bank; or

(5) A draft on a domestic bank or a foreign bank maintaining a United States agency or 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.

[Sec. 28 (d) as amended by sec. 186 (e) (1) Rev. Act 1942]

§ 39.28 (d)-2 Consent distribution must be nonpreferential. The application of section 231 (d) (2) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has 200 shares of stock outstanding, owned by A and B in equal amounts. On December 15, 1952, the corporation distributes $600 to B and $100 to A. On December 19, 1953, A executes an indorsement to B for $500. In his gross income as a taxable dividend, though such amount is not distributed to him, the X Corporation, assuming the other requirements of section 231 have been complied with, is entitled to a consent dividends credit of $500. Though considered by themselves, both the partial distribution of $700 and the consent distribution of $500 are preferable, when considered together they constitute a single nonpreferential distribution of $1,500.

§ 39.28 (e) Statutory provisions; consent dividends credits; consent distribution as part of entire distribution.

Sec. 28. Consent dividends credit. * * *

(e) Consent distribution as part of entire distribution. If during the last month of the taxable year with respect to which shareholders' consent distribution by the corporation under subsection (d) there is made a partial distribution, then, for the purposes of this chapter, such partial distribution and the consent distribution shall be considered as having been made in connection with each other and each shall be considered together with the other as one entire distribution.

§ 39.28 (e)-1 Consent and partial distributions to be considered together. The rule provided in section 28 (e), that a consent distribution and a partial distribution so to be considered as having been made in connection with each other and as together forming parts of an entire distribution, is not limited to the purposes of section 28, but is applicable in connection with the provisions of chapter 1. Thus, such rule is to be applied to determine whether a partial distribution is a preferential dividend under section 27 (h).

§ 39.28 (f) Statutory provisions; consent dividends credit; taxability of amounts specified in consents.

Sec. 28. Consent dividends credit. * * *

(1) Taxability of amounts specified in consents. The total amount specified in a consent filed under subsection (d) shall be included as a taxable dividend in the gross income of the shareholder making such consent, and, if the shareholder is taxable with respect to a dividend only if received from sources within the United States, shall be included in the computation of his tax as a dividend so received; regardless of—

(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, and actual distribution made before, would have been in whole or in part a taxable dividend;

(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.

§ 39.28 (f)-1 Taxability of amounts specified in consents. (a) Once a shareholder's consent is filed, the full amount specified therein shall be included in his gross income as a taxable dividend, and, in cases where the shareholder is taxable on a dividend only if received from sources within the United States, shall be treated as a dividend so received; regardless of—

(1) Whether he actually so includes it in his return;

(2) Whether he would have been taxable on all or any part of such amount as a dividend if it had been distributed to him in cash; and

(3) Whether the corporation, as a result of filing such consents, is entitled to any consent dividends credit or to a smaller consent dividends credit than the sum of the amounts specified in the several consents.

(b) The ground upon which a consent dividends credit is denied the corporation does not affect the taxability of a shareholder whose consent has been filed for the amount specified in his consent. Thus, he is taxable on the full amount so specified, though the corporation receives no credit or a smaller credit than the sum of the amounts specified in each of the consents, if the corporation has no earnings and profits or a smaller amount of earnings and profits than the sum of the amounts specified in the consents, and the total amount specified in shareholder's consent which has been filed is also taxable to him as a dividend though a consent dividends credit.
dividends credit is denied the corporation because (1) preferred dividends have not been paid, (2) it shall be considered 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) (3) and § 39.28 (d) (1).

§ 39.28 (g) Statutory provisions; consent dividends credit; corporate shareholders.

Sec. 28. Consent dividends credit. • • • (g) Corporate shareholders. If the shareholder who makes the consent is a corporation, the basis of his stock 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.

§ 39.28 (g) Treatment of amount specified in consent of corporate shareholder

(a) From the standpoint of computing a shareholder's income for a taxable year relative to which he has agreed to include a specific amount in his 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 as of the close of the taxable year.

(b) The effect of a corporate shareholder's consent upon the computation of its earnings and profits may be illustrated by the following example:

Example. A X Corporation has one shareholder, the Y Corporation, whose consent to include $10,000 in its gross income for the calendar year 1952 has been made and filed. The earnings and profits of the X Corporation for the calendar year 1952 amount to $6,000, there being at the beginning of that year $5,000 accumulated earnings or profits. The Y Corporation must nevertheless include in its gross income $10,000 as a taxable dividend. Assume the Y Corporation to have begun the year 1952 with $5,000 accumulated earnings and profits, to have made no distributions during the year, and (without considering the amount specified in its consent) to have had neither profits nor losses during the year. Its earnings and profits for the year will be $10,000, and its accumulated earnings and profits at the close of the year will be $15,000.

§ 39.28 (h) Statutory provisions; consent dividends credit; basis of stock in hands of shareholders; effect on capital account of corporation.

Sec. 28. Consent dividends credit. • • • (h) Basis of stock in hands of shareholders; effect on capital account of corporation.

The amount specified in a consent made under subsection (g) shall be treated for the purpose of adjusting the basis of the consent stock with respect to which the consent was granted, as though it had been reinvested by the shareholder as a contribution to the capital of the corporation; but only in an amount which bears the same ratio to the consent dividends credit of the corporation as the capital of the shareholder's consent stock bear to the total amount of consent stock with respect to which consents are allowed.

§ 39.28 (i) Effect on capital account of corporation. The amount of the consent dividends credit that consent allows (e) shall be considered as paid in order to be a contribution to the capital of the corporation, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced.

§ 39.28 (j) Effect on basis of stock in hands of shareholders and capital account of corporation. The application of sections 28 (b) (3) (1) and 28 (b) (3) (2) 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 $50 in his gross income as a dividend, but B refuses to do so. The X Corporation therefore distributes $50 to B in cash during the last month of its taxable year. The income tax consequence denoted by A's consent and the actual distribution to B are treated together, as though one distribution of $100 had been made. The earnings and profits of the X Corporation for 1952, however, amount to only $60, there being at the beginning of that year $50 accumulated earnings or profits. If, therefore, the entire $100, which is the sum of A's consent distribution and B's actual distribution, has been wholly distributed, 50 percent thereof would have been a dividend, includable in the X Corporation's basic surplus credit, and 50 percent a return of capital. Applying the principle stated in the last section, the following results are obtained:

(a) In the case of the X Corporation:

(1) Its consent dividends credit is $50, being 80 percent of the amount specified in A's consent;

(2) Its basic surplus credit, assuming it has no net operating loss in the preceding taxable year, is $40.

(b) In the case of A:

(1) A is taxable on $50 as a dividend;

(2) The basis of his stock is reduced by $10.

§ 39.28 (k) Statutory provisions; consent dividends credit; amounts not included in shareholder's return.

Sec. 28. Consent dividends credit. • • • (k) Amounts not included in shareholder's return. (1) Apportionments not included in shareholder's return. The failure of a shareholder of consent stock to include in his gross income for the proper taxable year the amount specified in the consent that is allowed by the corporation, shall have the same effect, with respect to the deficiency resulting therefrom, as is provided in section 272 (4) with respect to a deficiency resulting from a mathematical error appearing on the face of the return.

Credits Against Tax

§ 39.31-38 Statutory provisions; credits against tax; taxes of foreign countries and possessions of the United States; cross references; tax withheld on wages.

Sec. 31. Taxes of foreign countries and possessions of the United States. The amount of income, war profits, or excess profits taxes imposed by foreign countries or possessions of the United States shall be allowed as credits against the tax imposed by chapter 1, relating to tax on self-employment income, to the extent provided in section 101.

Sec. 32. Taxes withheld at source. The amount of tax withheld at the source under section 143 or 144 shall be allowed as a credit against the tax.

Sec. 33. Credits for overpayments. For credits against the tax, the overpayments of taxes imposed by this chapter for other taxable years, see section 222.

Sec. 34. Credits against victory tax.

Repealed by sec. 163 (a) (3), Rev. Act 1943.

Sec. 35. Credit for fax withheld on wages. The amount deducted and withheld at the source under Subchapter D of Chapter 9 during any calendar year upon the wages of any individual shall be allowed as a credit against the income tax imposed by this chapter for the taxable year beginning in such calendar year. If more than one taxable year begins in any such calendar year, the amount shall be allowed as a credit against the tax for the last taxable year so beginning.

Sec. 36 as added by sec. 172 (1) (2), Rev. Act 1942; amended by sec. 3, Current Tax Payment Act 1943.

§ 39.35-1 Credit for tax withheld on wages. (a) The tax deducted and withheld at the source upon wages under subchapter D of chapter 9 is allowable as a credit against the tax imposed by chapter 1 upon the recipient of the income.

If the tax has not been paid over to the Government by the employer, see section 34. (b) For the credit to be allowable, the recipient of the income is the person subject to tax imposed under chapter 1 upon the wages from which the tax was withheld. For instance, if a husband and wife domiciled in a State recognized as a community property State for Federal tax purposes 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.

(a) The credit shall be allowed against the tax imposed by chapter 1 for the taxable year of the recipient of the income which begins in such calendar year. If such recipient has more than one taxable year beginning in such calendar year, the credit shall be allowed against the tax for the last taxable year so beginning.

§ 39.35-2 Credit for "open-end refunds" of employee social security tax.—(a) In general. (1) In the case of an employee receiving wages from more than one emp-
player during the calendar year, amounts may be deducted and withheld as employee social security tax under section 1401 with respect to more than $3,600 wages (for example, on $4,500 if the employer is paid $4,500 by one employee and $2,000 by another). Section 1401 (d) permits, under certain conditions, a so-called "special refund" of the amount of such employer social security tax deducted and withheld with respect to wages in excess of $3,600 by reason of the employee working for more than one employer during the calendar year.

Any person who is entitled to a special refund of employee tax with respect to wages received during a calendar year and who is also required to file an income tax return for such calendar year (or for his last taxable year beginning in such calendar year) may obtain the benefits of such special refund only by claiming credit for such special refund in the same manner as if such special refund were an amount deducted and withheld as income tax at the source under subchapter D of chapter 9. The credit with respect to a special refund is allowed if the refund is claimed on a return, or if it is allowed as a credit for such year, for the wages with respect to which the special refund of tax is claimed. See section 1401 (d) (3) and (4) and § 408.802 (c) of this chapter (Regulations 128) pertaining to tax under subchapter A of chapter 9 (Federal Insurance Contributions Act).

For special provisions for claiming special refunds in the case of employees not required to file income tax returns, see § 408.802 (a) (2) of this chapter (Regulations 128).

(b) Federal and State employees. The provisions of this section shall apply to the amount of a special refund (under section 1401 (d) (A) or (B)) allowable to an employee of a Federal agency or to an employee of any State or political subdivision thereof (or any instrumentality of any one or more of the foregoing).

§ 39.41 Statutory provisions; accounting periods and methods of accounting; general rule.

§ 39.41-1 Computation of net income. Net income must be computed with respect to a tax year. The provisions of this section shall apply to the annual accounting period of any State or political subdivision thereof.

§ 39.41-2 Bases of computation and changes in accounting methods. (a) A taxpayer engaged in a business of any kind or character whose accounting method is or who is required to use an accrual method of accounting shall be permitted to use the proper method of accounting for purposes of taxation, secure the consent of the Commissioner, for any reason or for any reason other than his income, the computation shall be made in the manner as in the opinion of the Commissioner clearly reflects it.

§ 39.41-3 Accounting and other matters. (a) The provisions of this chapter (Regulations 128) are applicable in the case of the Internal Revenue Code and, for the purpose of determining the basis of valuation employed in keeping books means any change in the accounting treatment of items of income or deductions, such as a change from cash receipts and disbursements to the accrual method, or vice versa, a change in the basis of valuation employed in the computation of inventories (see §§ 39.22 (c)–1 to 39.22 (c)–6, inclusive), a change in the method of accounting employed in keeping books in the case of a taxpayer maintaining books in the case of a taxpayer who is required to maintain books of account, and any other specialized basis of computing net income such as the crop basis (see § 39.22 (a)–7 and 39.22 (a)–11).

Application for permission to change the method of accounting employed and the basis upon which the return is made shall be filed within 60 days after the beginning of the taxable year to be covered by the return. The application shall be accompanied by a statement specifying the classes of items differently treated under the two methods and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effective. See section 22 (d) and §§ 39.22 (d)–1 to 39.22 (d)–11, inclusive, with respect to a change in the first-out method of inventorying goods.

§ 39.41-4 Accounting periods and methods of accounting; general rule.

§ 39.41-5 Computation of net income.
straight accrual basis. In cases where permission to make such change is granted, the taxpayer will be required to return as additional income for the taxable year in which the change is made all the profit not theretofore returned as income pertaining to the payments due on installment sales contracts as of the close of the preceding taxable year.

§ 39.41—Methods of accounting. It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounts and books as will enable him to do so. (See section 54 and § 39.54—1.) Among the essentials are the following:

(a) In all cases in which the production, purchase, or sale of merchandise or any kind of productive factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be begun or extended beyond the year end of the year and used in computing the net income of the year (see section 22 (c) and §§ 39.22 (c)—1 to 39.22 (c)—8, inclusive)

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

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

§ 39.41—Accounting period. The return of a taxpayer is made and his income computed for his taxable year, which in general means his fiscal year, or the calendar year if he has not elected to file a return on a fiscal year basis. (See section 49.) The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. If no such return is made, however, he is required to use the calendar year. (See section 49.) In any case in which the taxpayer has elected to operate on a calendar year basis, his taxable year is the calendar year. The Commissioner, at his discretion, may permit changes in the fiscal year if he deems necessary, to change to a different period in accordance with the approved method of accounting followed by the taxpayer. See §§ 39.41—1 to 39.41—3, inclusive. As to income from short-term obligations issued at discount, see § 39.42—6, and as to income from long-term obligations issued on a discount basis, see § 39.42—7. If no determination of the amount of compensation is made 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 it is required to be shown, for the taxable period in which the return is rendered on the receipts and disbursements basis. If a person sues in one year on a pecuniary claim or for property, and money or property is thereafter recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. See § 39.52 (c)—1. Except as otherwise stated in this paragraph, such items as claims for compensation under canceled Government contracts constitute income for the year in which the receipt is otherwise definitely determined, if the return is rendered on the accrual basis; or for the year in which received, if the return is rendered on the basis of cash receipts and disbursements. For the termination of a war contract as defined by section 3 of the Contract Settlement Act of 1946, 41 U. S. C. 163 for the termination of any other Government contract as to which the right to compensation is definitely fixed and the measure thereof is determinable with reasonable accuracy if the return is rendered on a basis other than cash receipts and disbursements, compensation for the termination shall, unless a different method of reporting is prescribed or approved by the Commissioner, constitute income for the taxable year in which falls the effective date of the termination, except that if any part of the compensation is attributable to costs, expenses, or losses of which the taxpayer becomes aware before the effective date of the termination, and it is otherwise definitely determinable, the income attributable to such part shall be included in the income of such taxable period as of the date of such effective date. (See section 39.42—8.)

§ 39.42—Statutory provisions; accounting periods and methods of accounting; period in which items of gross income included.

Sec. 42. Period in which items of gross income included—(a) General rule. The provisions of this section shall be applied on a calendar year basis, and no such item shall be included in the gross income for the taxable year in which received by the taxpayer, unless such item is included under section 42; however, under methods of accounting prescribed under section 41, any such amounts are to be properly accounted for as of a different taxable year. (b) In the case of a taxpayer whose net income is computed upon the basis of the fiscal year method of accounting, amounts (except amounts includable in gross income as a part of the taxpayer's permanent year, under section 162) accrued only by reason of the death of the taxpayer shall not be included in such return. The amount of such income shall be included in the tax year in which falls the date of the taxpayer's death.

Sec. 42 as amended by sections 114, 115 (c), Rev. Act 1941: sec. 134 (e), Rev. Act 1942; sec. 2, Pub. Law 12 (60th Cong.).

§ 39.42—1 When included in gross income. In general, the gross income of the taxpayer for the taxable year, which is the period of 12 consecutive months ending the last day of any month other than December, and the period in which they are received, if the return is rendered on the accrual basis; or, for the taxable year in which they are received, if the return is rendered on the basis of cash receipts and disbursements, is to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included in the gross income for such year as of a different taxable year. For the purpose of this section, "taxable year" means the period of 12 consecutive months ending the last day of any month other than December, and the period in which they are received, if the return is rendered on the accrual basis; or, for the taxable year in which they are received, if the return is rendered on the basis of cash receipts and disbursements.

§ 39.42—2 When included in gross income. In general, the gross income of the taxpayer for the taxable year, which is the period of 12 consecutive months ending the last day of any month other than December, and the period in which they are received, if the return is rendered on the accrual basis; or, for the taxable year in which they are received, if the return is rendered on the basis of cash receipts and disbursements, is to be included in the gross income for such year as of a different taxable year. For the purpose of this section, "taxable year" means the period of 12 consecutive months ending the last day of any month other than December, and the period in which they are received, if the return is rendered on the accrual basis; or, for the taxable year in which they are received, if the return is rendered on the basis of cash receipts and disbursements.

§ 39.42—3 When included in gross income. In general, the gross income of the taxpayer for the taxable year, which is the period of 12 consecutive months ending the last day of any month other than December, and the period in which they are received, if the return is rendered on the accrual basis; or, for the taxable year in which they are received, if the return is rendered on the basis of cash receipts and disbursements, is to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included in the gross income for such year as of a different taxable year. For the purpose of this section, "taxable year" means the period of 12 consecutive months ending the last day of any month other than December, and the period in which they are received, if the return is rendered on the accrual basis; or, for the taxable year in which they are received, if the return is rendered on the basis of cash receipts and disbursements.
under the Railway Mail Pay Act of 1916 by the Interstate Commerce Commission, as compensation for the transportation of mail during 1950 and prior years, see section 611 (a) of the Revenue Act of 1951.

(b) Last taxable year of decedent. For the taxable year in which falls the date of death of a taxpayer, there shall be included in computing net income of the taxpayer only amounts properly includible under the approved method of accounting followed by the taxpayer, or, if the taxpayer followed such method, only amounts received during such year. However, if the taxpayer followed the accrual method of accounting, amounts accrued only by reason of his death shall not be included in computing net income for such year, except that, if the taxpayer was a member of a partnership, his share of the partnership income for the partnership year ending with its dissolution on account of or set apart for a taxpayer in computing his net income. The approved accounting practice of the partnership in its income and not being changed by reason of the taxpayer's death. Thus, if the partnership computes its income on the basis of cash receipts and disbursements, the partnership income for the year ending with the dissolution, a distributive share of which is included in the taxpayer's income, shall be so computed. If the partnership used the accrual method of accounting, its income shall be computed according to such practice. For example, if a law partnership keeps its books on the accrual method of accounting, it is entitled to certain contingent fees which are accrued only upon the completion of the cases involved, such partnership will compute its income for the year ending with its dissolution on account of the death of the taxpayer without accruing, on account of the death of the partner at such time, any such contingent fees not yet accrued by reason of the partnership's income for the taxable year in which falls the date of death of a taxpayer the gain described in section 61(a) relating to gain upon the disposition of installment obligations, except, as otherwise provided in that section. See §39.44-5. This amount must be included in computing net income regardless of the method of accounting followed by the taxpayer.

§39.42-2 Income not reduced to possession. Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to or set apart for the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, must be an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until a later date, such crediting on the books of the corporation does not constitute receipt.

§39.42-3 Examples of constructive receipt. If interest coupons have matured and are payable, but have not been cashed, such interest, though not collected when due and payable, shall be included in gross income for the year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. The interest shall be included in gross income even though the coupons are exchanged for other property instead of being cashed. The amount of defaulted coupons is income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. If a dividend is declared payable on December 31 and the corporation intended to and did follow its practice of paying the dividends by checks mailed so that the shareholders would not receive them until January of the following year, such dividends are not considered to have been unqualifiedly made subject to the demand of the shareholders prior to January, when the checks were actually received. As to the distributive share of the profits of a partner in a partnership, see section 188. Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require so many days' notice before withdrawals are permitted, is income to the depositor to the extent of the amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income in the year of the maturity of the share. If a dividend is declared payable to a shareholder when credit is made to his account but remaining on hand at the time of completion.

§39.42-4 Long-term contracts. (a) Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the method of accounting followed by the taxpayer, except as otherwise provided in that section. See §39.44-5. This amount must be included in computing net income regardless of the method of accounting followed by the taxpayer.

§39.42-5 Subtraction for redemption of trading stamps. (a) If a taxpayer, for the purpose of promoting his business, issues with sales trading stamps or premium coupons redeemable in merchandise or cash, he should be computing the income from such sales subtract only the amount which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users of trading stamps or premium coupons engaged in similar businesses. The taxpayer shall file for each of the first four quarters of the taxable year a statement showing:

(1) The total issue of stamps during each year;

(2) The total stamps redeemed in each year; and

(3) The rate, in percentage, which the stamps redeemed in each year bear to the total stamps issued in such year, regardless of the year when such redeemed stamps were issued.

(b) A similar statement shall be also presented showing the experience of other users of stamps or coupons whose experience is relied upon by the taxpayer to determine the amount to be subtracted from the gross income. The Commissioner will examine the basis used in each return, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive, appropriate adjustment will be made.
§ 39.42-6 Noninterest-bearing obligations issued at discount. (a) If a taxpayer owns any noninterest-bearing obligation issued at discount and redeemable for fixed amounts increasing at stated intervals, and if the increase in redemption price of such obligation occurring in the taxable year does not constitute income for the year in which it occurs under paragraph (b) of the 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 it occurs rather than in 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 by him. It shall apply to the taxable year for which such return is filed, and shall be binding for all subsequent years until terminated by the 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 accounting for the redemption price of such obligations. Although the election, once made, is binding upon the taxpayer, it does not apply to a transfer of such taxpayer's interest in the obligation after the election is filed.

(b) 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 increase 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 increases in the amount of $50 cents on each such date, the amount deemed to accrue in that year would be $50 cents. If at the beginning of the first taxable year to which the election applies the taxpayer owns non-interest-bearing bonds of the prescribed character and time, 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 1932, a taxpayer who makes his returns on the calendar year basis and computes his net income on the cash receipts and disbursements basis holds United States savings bonds, Series G, having a maturity value of $5,000, which he purchased on January 1, 1947, for $3,750. The taxpayer holds no other obligation of the type described in this section. In his return for 1932 the taxpayer elects to treat the increases in the redemption price of such bonds occurring in such year as income to him for such year. Under this section he is required to report with respect to such bonds the increase in redemption price after January 1, 1947, of $500, which $500 represents the increase in the redemption price before 1932 and $300 represents the increase in the redemption price in 1932.

§ 39.42-7 Short-term obligations issued on discount basis. In the case of any obligation of the United States or any series or type of State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue for the taxable year in which such 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. If a taxpayer who computes his net income on the accrual basis purchases upon issuance a United States Treasury bill 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 is includible in the gross income of the taxpayer for the taxable year in which the amount or portion thereof is includible in gross income.

§ 39.43 Statutory provisions; accounting periods and methods of accounting; period for which deductions and credits taken.

§ 39.43-1 Paid or incurred and paid or accrued. (a) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting used in computing net income. In the case of a taxpayer who computes his net income on the cash receipts and disbursements basis, such terms shall be construed as follows:

(1) The deduction or credit shall be taken as of the taxable period in which it was actually "paid or incurred," or of the taxable year in which it was actually "paid or accrued." In the case of a taxpayer who computes his net income on an accrual basis, the deduction or credit shall be taken as of the taxable period in which the facts necessary to make a correct return of income and deduction, and so long as the taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was actually "paid or incurred," or of the taxable year in which it was actually "paid or accrued," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which his holdings are based. Each year's return, so far as practicable, shall be filed with the return of the preceding year. The provisions of paragraphs (a) and (b) of this section are in general applicable with respect to the terminal year during which the taxpayer dies. However, if the taxpayer followed the accrual method of accounting, there shall be included in computing net income for the year in which the deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death, the expenses of a partnership to the extent allocable to the decedent's distributive share of the losses of a partnership at the time of his death. No change in the accounting method of the partnership need be made because of the taxpayer's death when the income and losses of the partnership are not subject to the approval of the Commissioner and the account of the decedent's distributive losses, at the time of his death, is carried forward by the partnership to a subsequent taxable year in which the account of the decedent's distributive losses is chargeable to the partnership. For purposes of this section, the term "deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death" shall be defined as the amount of the decedent's distributive share of the losses of a partnership at the time of his death. The Commissioner will decide whether the case is within the exception provided for in section 27 of the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable. The provisions of paragraphs (a) and (b) of this section are in general applicable with respect to the terminal year during which the taxpayer dies. However, if the taxpayer followed the accrual method of accounting, there shall be included in computing net income for the year in which the deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death, the expenses of a partnership to the extent allocable to the decedent's distributive share of the losses of a partnership at the time of his death. No change in the accounting method of the partnership need be made because of the taxpayer's death when the income and losses of the partnership are not subject to the approval of the Commissioner and the account of the decedent's distributive losses, at the time of his death, is carried forward by the partnership to a subsequent taxable year in which the account of the decedent's distributive losses is chargeable to the partnership. For purposes of this section, the term "deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death" shall be defined as the amount of the decedent's distributive share of the losses of a partnership at the time of his death. The Commissioner will decide whether the case is within the exception provided for in section 27 of the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

(b) In any case in which, owing to mandatory, exchange, or other restrictions imposed by a foreign country, an amount otherwise constituting gross income for the taxable year from sources within the United States is not includible in the gross income of the taxpayer for the taxable year, the provisions of paragraphs (a) and (b) of this section shall apply to such amount as a basis of credit for foreign income tax in such cases.

(c) The provisions of paragraphs (a) and (b) of this section are in general applicable with respect to the terminal year during which the taxpayer dies. However, if the taxpayer followed the accrual method of accounting, there shall be included in computing net income for the year in which the deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death, the expenses of a partnership to the extent allocable to the decedent's distributive share of the losses of a partnership at the time of his death. No change in the accounting method of the partnership need be made because of the taxpayer's death when the income and losses of the partnership are not subject to the approval of the Commissioner and the account of the decedent's distributive losses, at the time of his death, is carried forward by the partnership to a subsequent taxable year in which the account of the decedent's distributive losses is chargeable to the partnership. For purposes of this section, the term "deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death" shall be defined as the amount of the decedent's distributive share of the losses of a partnership at the time of his death. The Commissioner will decide whether the case is within the exception provided for in section 27 of the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

§ 39.43-2 When charges deductible. Each year's return, so far as practicable, both as to gross income and deductions, theretofore, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expressions, "liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year." The expression, "deficit" does not apply to any deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death. No change in the accounting method of the partnership need be made because of the taxpayer's death when the income and losses of the partnership are not subject to the approval of the Commissioner and the account of the decedent's distributive losses, at the time of his death, is carried forward by the partnership to a subsequent taxable year in which the account of the decedent's distributive losses is chargeable to the partnership. For purposes of this section, the term "deductible amount accrued solely by reason of his death other than his distributive share of the losses of a partnership at the time of his death" shall be defined as the amount of the decedent's distributive share of the losses of a partnership at the time of his death. The Commissioner will decide whether the case is within the exception provided for in section 27 of the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable. However, if the taxpayer followed the accrual method of accounting, the amount or portion thereof is includible in gross income. See § 39.131 (d)-(1) for the treatment of foreign income tax imposed with respect to such amount as a basis of credit for foreign income tax in such cases.
these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judged thereby, on other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on accounts of damages for personal injuries, or other causes, are deductible from gross income when the claim is adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequent to its occurrence, however, taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss as the final return. (See section 322.) A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

§ 39.44

Statutory provisions: accounting periods and methods of accounting; installment basis.

Sec. 44. Installation basis—(a) Dealers in personal property. Under regulations prescribed by the Commissioner with the approval of the Secretary, persons regularly selling or otherwise disposing of personal property on the installment plan may return as income thereinfrom in any taxable year the 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 realty and casual sales of personal property (other than property of a kind which must be maintained or held to enable an accurate computation to be made on such basis in accordance with the provisions of this chapter). The income from a casual sale or other casual disposition of personal property (other than property of a kind which must be maintained or held to enable an accurate computation to be made on such basis in accordance with the provisions of this chapter) may be reported on the installment basis only if (1) the sale price exceeds $1,000 and (2) the initial payments do not exceed 30 percent of the selling price.

(c) If for any reason the purchaser defaults in any of his payments, and the vendor repossesses the property or the money paid therefor, whether title thereto had been retained by the vendor or transferred to the purchaser, gain or loss for the year in which the repossession occurs is to be computed as provided in section 39.44-5. The basis in the hands of the vendor of the obligations of the purchaser which are satisfied or discharged upon the repossession or are applied by the vendor to the purchase or bid price of the property. Such gain or loss is to be measured by the difference between the fair market value of the property repossessed and the basis in the hands of the vendor of the obligations of the purchaser which are satisfied, discharged, or applied, with proper adjustment for any other amounts realized or costs incurred in connection with the repossession. (See also § 39.44-5.)

§ 39.44-1

Sale of personal property on installment plan. (a) Dealers who sell on the installment plan usually adopt one of four ways of protecting themselves in case of defaults in payment: (1) By an agreement that title is to remain in the vendor until the purchaser has completed his part of the transaction. (2) By a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the selling price; (3) By a present or implied sale of title to the purchaser, who at the same time executes a conveyance in the form of a chattel mortgage to the vendor; or (4) By conveyance to a trustee pending performance of the contract and subject to its provisions.

(b) The general purpose and effect being the same in all of these cases, the same rule is uniformly applicable. The general rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title is retained in the vendor, is liable for the income which would be returnable were the obligations satisfied, discharged, or applied, with proper adjustment for any other amounts realized or costs incurred in connection with the repossession. (See also § 39.44-5.)
§ 39.44-3 Sale of real property involving deferred payments. (a) Under section 44 deferred-payment sales of real property include (1) agreements of purchase and sale which contemplate that a conveyance of the property at the outset, but only after all or a substantial portion of the selling price has been paid, and (2) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

(b) Such sales, either under paragraph (a) (1) or (2) of this section fall within the meaning of the term "initial payments," the "total contract price," the "total contract price minus the amount of the mortgage or whether the mortgage is assumable, and the "total profit realized or to be realized when the property is sold for bears to the total contract price.

(c) If the purchaser defaults in any of his payments, and the vendor returning interest on the installment basis reacquires the property sold, whether title thereto had been retained by the vendor or transferred to the purchaser in, or prior to, the purchase, the total profit realized or to be realized when the property is paid for bears to the total contract price.

§ 39.44-4 Deferred-payment sale of real property not on installment plan. (a) In transactions included in § 39.44-3 (a) (1) the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received by him which the total profit realized or to be realized when the property is paid for bears to the total contract price.

(b) If the vendor has retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor plus the fair market value at the time of repossessing of fixed improvements placed on the property by the purchaser and (2) the sum of the profits previously returned as income in connection therewith and representing the amount previously recognized as gain or loss from the transaction, shall be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.
(c) If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and if in excess of such basis, shall be taxable to the extent of the excess realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

§ 39.44-5 Gain or loss upon disposition of installment obligations. (a) The entire amount of gain or loss resulting from the disposition or satisfaction of installment obligations, computed in accordance with section 44 (d) is recognized under the Internal Revenue Code unless the disposition is within one of the exceptions made by the Code. Such an exception is provided in section 44 (d) with respect to distributions under section 112 (b) (6) and in section 112 (b) (4) and (5) with respect to exchanges.

(b) The application of section 44 (d) may be illustrated by the following examples:

Example (1). In 1950 the M Corporation sold a piece of unimproved real estate to B for $20,000, being acquired for the property in 1939 at a cost of $10,000. During 1950 the company received $5,000 cash and vendor's notes for the remainder of the selling price, or $15,000, payable in subsequent years. In 1952, before the vendee made any payments, the company sold the notes for $13,500 in cash. The corporation makes its returns on the calendar year basis. The income to be reported for 1952 is $18,000, computed by the following:

Proceeds of sale of notes $13,500
Selling price of property $20,000
Cost of property $10,000
Total profit $10,000
Total contract price $20,000
Percent of profit, or proportion of such payment as would be returnable as income by the decedent if he had lived and received such payment.
Face value of notes $15,000
Amount of income returnable as a dividend, and 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. The bonds shall be subject to the approval of the Commissioner, 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 section and shall be disposed of at such time and place as the Commissioner may prescribe.

(c) In the case of a decedent who dies possessed of installment obligations, no gain on account of the transmission at death 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 the executor of his last will or legates with the Commissioner, a bond on Form 1132 conditioned upon the return as income, by any person receiving any payment in satisfaction of such obligations, the proportion of such payment as would be returnable as income by the decedent if he had lived and received such payment. The bond shall be subject to the approval of the Commissioner, 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 section and shall be disposed of at such time and place as the Commissioner may prescribe.

3. The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and hence ever exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

The term "controlled taxpayer" means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.

The term "true net income" means, in the case of a controlled taxpayer, the net income (or, as the case may be, any item or item of income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, or arrangement), been a separate and independent unit, with the other member or members of the group at arm's length. It does not mean the income, the deductions, the allowances thereof, the element of income, the deductions, credits, or allowances, resuting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, the actuarial controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties other than the actuarial controlling it).

(b) Scope and purpose. (1) The purpose of section 45 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 interests controlling a group of controlled taxpayers are assumed to control each uncontrolled taxpayer to conduct its affairs that its transactions and accounting records truly reflect the net income from the property and business of each of the controlled taxpayers. If 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, deductions, credits, or allowances, or of any item of 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.

(c) In the case of any controlled taxpayer, whether single or a part of a consolidated 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 consolidated net income.

(2) 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. It is not intended (except in the case of the computation of consolidated net income under a consolidated return) to effect in any case such a change of accounting period, the allocation of gross income, deductions, credits, or allowances, or any item of gross income, deductions, credits, or allowances, 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 consolidated taxpayer, the Commissioner may, in 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, deductions, credits, or allowances. The authority to determine true net income extends to any case in which either because of design or accident the taxable net income, 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.

§ 39.46 Statutory provisions; accounting periods and methods of accounting; change of accounting period.

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.

§ 39.46-1 Change of accounting period—(a) Short taxable years ending prior to July 1, 1953. If a taxpayer (other than a subsidiary corporation filing a consolidated return) has elected to change its accounting period by reason of the provisions of § 24.14 of this chapter (Rules 129) or § 60 of this chapter (Rules 123), the Commissioner, if the conditions shown below are met, shall make application direct to the Commissioner on Form 1128 at least 60 days prior to the close of the fractional part of the calendar year for which a return would be required to effect the change if the short taxable year ends before July 1, 1953, and, before using the new period for income tax purposes, the changes in accounting period are approved by the Commissioner. If a change of accounting period of a subsidiary is required for income tax purposes under § 24.14 of this chapter (Regulations 129), the information required on Form 1128 shall be furnished by the subsidiary at or before the time of filing the consolidated income tax return. For the due date of returns for fractional parts of a year, see § 39.53-1. Where a timely application is made to compute the net income of an individual taxpayer upon the close of the fiscal year, the return for such fiscal year as that of such individual's spouse, permission so to compute net income will be granted even though such permission will allow the individual and his spouse to reduce their taxes by taking the advantage of section 12 (d) (the so-called "income splitting" provision) through filing of a joint return, so long as the change to a calendar year basis which is considered sufficient by the Commissioner for denying such permission. If the change is approved by the Commissioner, the taxpayer shall thereafter make his returns and compute his net income upon the basis of the new accounting period. See section 47.

(b) Short taxable years ending after June 30, 1953—(1) General. A change of accounting period for income tax purposes requiring a return for a short taxable year ending after June 30, 1953, is authorized, except where inconsistent with the beginning of the calendar year of the affiliated group for which a consolidated return would be required. The Commissioner may, in 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, deductions, credits, or allowances, disallow, suspend, or revoke the permission to compute net income on the basis of the new accounting period. See section 47.

(2) Cases in which approval of change of accounting period is required. The prior approval of the Commissioner will be required before a taxpayer may change his accounting period if any of the following conditions exist:

(i) At any time during fiscal years ending with the calendar year which includes the beginning of the short taxable year required to effect the change of accounting period, the taxpayer has changed his accounting period for income tax purposes. For the purpose of this subparagraph a change of accounting period for income tax purposes by a partnership shall be considered as a change by each member thereof and a change by any member shall be deemed to be a change by the partnership. Likewise, a change of accounting period for income tax purposes by a trust shall be considered as a change by each beneficiary thereof and a change by a beneficiary shall be deemed to be a change by the trust. Accounting periods ending after June 30, 1953, are required to be filed on or before the 15th day of the third full calendar month following the close of the short taxable year, for the new accounting period to be authorized, except where inconsistent with the beginning of the calendar year of the affiliated group for which a consolidated return would be required. The Commissioner may, in 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, deductions, credits, or allowances, disallow, suspend, or revoke the permission to compute net income on the basis of the new accounting period.

(2) Change of accounting period during the year 1954. If a taxpayer has elected to file consolidated returns (other than a subsidiary corporation filing a consolidated return) in order to file his returns on a fiscal year basis ending March 31, 1954, when annualized in accordance with § 39.47-9, equals at least 90 percent of his net income for the calendar year 1953, he is authorized to change his accounting period by filing, on or before June 15, 1954, a tax return for the short taxable year beginning January 1 and ending March 31, 1954. Thereafter, he shall make his annual returns and compute his net income on the basis of a fiscal year ending March 31. If X preferred, he could have changed to a fiscal year basis ending the last day of January, February, September, October, or November. However, if X had elected to file consolidated returns (other than a subsidiary corporation filing a consolidated return) in order to file his returns on a fiscal year basis ending the last day of April, May, June, July, or August the prior approval of the Commissioner would be required. In the case of a change would result in a return for a short taxable year ending more than 3 months and less than 6 months after the close of the accounting period regularly used by X.

(4) Approval of change of accounting period. Where prior approval of a change of accounting period is required, application shall be filed on Form 1123 with the Commissioner at his office at Washington, D. C., on or before the 15th day following the close of the short taxable year for which a return would be required to effect the change of accounting period. In general, an application for a change of accounting period will be approved where the taxpayer establishes valid business reasons for making such change, and where the period intended to be made primary for the purpose of effecting a tax saving shall not be allowed except where such tax saving results from the application of section 12 (d) on the so-called "income splitting" provision, in the case where a husband and wife adopt the same accounting period in order to file a joint return and no other reason appears which is considered sufficient by the Commissioner for denying such permission.

(5) Change of accounting period by a subsidiary corporation filing a consolidated return. The foregone provisions of this paragraph have no application in the case of a subsidiary corporation required to change its accounting period for filing of filing of consolidated return. See § 24.14 of this chapter (Regulations 129) in such a case, if a change of accounting period is made on or after July 1, 1953, such corporation shall complete Form 1128 and forward it to the district director of internal revenue with whom the consolidated return is to be filed at or before the time of filing of such consolidated return.

§ 39.47 Statutory provisions; accounting periods and methods of accounting;
returns for periods of less than 12 months.

Sec. 47. Returns for a period of less than twelve months—(a) Returns for short period resulting from change of accounting period. If a taxpayer, with the approval of the Commissioner, changes the accounting period of a taxable year from fiscal year to calendar year a separate return shall be made for the period between the close of the fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(b) Income computed on basis of short period. Where a separate 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 regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury, whenever at the beginning of a year, then the income shall be computed on the basis of the period for which separate return is made.

(c) Income placed on annual basis—(1) General rule. If a separate return is made under subsection (a) of this section, the net income computed 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 income thereof by one and dividing by the number of months in the short period. The tax shall be such part of the tax computed on such annual basis 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 short period, computed as if 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 amounts which bear the same ratio to the full exemptions allowed unless the taxpayer, at such time as the change in accounting period becomes effective, elects to compute the tax on the basis of such annual accounting period. His net income for the period for which return is made bears to 12 months, the credit for dividends received included in the net income, which amount is placed on an annual basis when such net income is placed on an annual basis. Similarly, the credit for interest on United States obligations should reflect the amount of such interest as increased with respect to the amount placed on an annual basis as part of the net income which is placed on an annual basis.

(3) The following examples illustrate the application of this paragraph:

Example (1). A citizen of the United States made a return for the 10-month period ended October 31, 1920, on account of a change in accounting period. His net income for such 10-month period was $100,000. He was entitled to the normal tax and surtax on $10,000. On account of the provision in section 26 (a), the 1921 tax was $72,000, computed as follows: Normal tax $80,000 less 20% of normal tax $16,000 normal tax $64,000 surtax on $16,000 $4,800 total tax on annual basis $68,800.

Example (2). The X Corporation made a return for the 8-month period ended August 31, 1952, on account of a change in accounting period. The net income of the Corporation for such 8-month period was $72,000, including $4,000 interest on obligations of the United States made a return for the 10-month period ending December 31, 1952, on account of a change in accounting period. His net income for such 10-month period was $120,000, included in the net income, which amount is placed on an annual basis when such net income is placed on an annual basis. Similarly, the credit for interest on United States obligations should reflect the amount of such interest as increased with respect to the amount placed on an annual basis as part of the net income which is placed on an annual basis.

§ 39.47-1 Returns for periods of less than 12 months. (a) 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 whenever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The returns for the first year after the change in accounting period. His not in existence at the end of the twelve-month period or does not include a taxable year of less than 12 months. Even though the taxpayer may have customarily made his returns on the basis of a calendar year, 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 the provisions of this section.

(d) Earned income. [Repealed by sec. 107, Rev. Act 1943.]

(e) Reduction of credits against net income. In the case of a return made for a fractional part of a year under section 146 the provisions of section 25 (b) shall be reduced to amounts which bear the same ratio to the full exemptions so provided as the number of months in the period for which return is made bears to twelve months.

(2) Closing of taxable year in case of short return. For closing of taxable year in case of jeopardy, see section 146.

(f) Returns where taxpayer not in existence for the period. If taxpayer was in existence at the end of the twelve-month period as the net income computed on the return for such annual basis as the number of months in the short period is of twelve months beginning with the first day of the short period, computed as if such twelve-month period were a taxable year which is placed on an annual basis and tax computed on such annual basis is therefore required.

The tax shall be reduced to amounts which bear the same ratio to the full exemptions allowed unless the taxpayer, at such time as the change in accounting period becomes effective, elects to compute the tax on the basis of such annual accounting period. His net income for the period for which return is made bears to 12 months, the credit for dividends received included in the net income, which amount is placed on an annual basis when such net income is placed on an annual basis. Similarly, the credit for interest on United States obligations should reflect the amount of such interest as increased with respect to the amount placed on an annual basis as part of the net income which is placed on an annual basis.

(3) The following examples illustrate the application of this paragraph:

Example (1). A citizen of the United States made a return for the 10-month period ended October 31, 1920, on account of a change in accounting period. His net income for such 10-month period was $100,000. He was entitled to the normal tax and surtax on $10,000. On account of the provision in section 26 (a), the 1921 tax was $72,000, computed as follows: Normal tax $80,000 less 20% of normal tax $16,000 normal tax $64,000 surtax on $16,000 $4,800 total tax on annual basis $68,800.

Example (2). The X Corporation made a return for the 8-month period ended August 31, 1952, on account of a change in accounting period. The net income of the Corporation for such 8-month period was $72,000, including $4,000 interest on obligations of the United States
FEDERAL REGISTER

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Multiplied by 12.—$144,000.00

Dividends received placed on an annual basis ($144,000.00—$) = 12,000.00

Subtracting: Credit provided in section (a) for dividends received (85 percent of $18,000) = $15,300.00

Surtax net income—$2,700.00

Interest on United States obligations subject to credit provided in section 26 (a) = $5,000.00

Multiplied by 12.—$60,000.00

Subtracting: Credit provided in section 26 (a) for interest placed on an annual basis ($48,000.00—$) = 6,000.00

Normal tax net income—$86,700.00

Normal tax on $86,700.00 = $26,010.00

Surtax on $26,010.00 = $2,618.18

Total tax on annual basis = $28,628.18

Amount of tax for 10-month period

[(49,904 × 12) ÷ 10] = 59,884.00

Amount of tax for 10-month period = $18,000

Subtracting: Credit provided in section 26 (a) for dividends received (85 percent of $15,300) = $12,944.00

Normal tax on $92,700.00 = $26,195.00

Surtax on $26,195.00 = $2,618.18

Total tax on annual basis = $28,813.18

The following examples illustrate the application of section 47 (c) (2).

Example: The facts are the same as in example (1) in paragraph (a) (3) of this section. In the period from November 1, 1952, to December 31, 1952, the taxpayer had net income of $28,000. The taxpayer filed an application for permission to treat November 1, 1952, to December 31, 1952, as a taxable year under paragraph (c) of this section for a reduction of the amount of tax which would be due if the income for the short period were not placed on an annual basis, or $28,000, the tax for the short period is reduced to $28,628.18, the tax computed by reference to the income for the 12-month period.

Example (2). The facts are the same as in example (1) of this subparagraph, except that during the period from November 1, 1952, to December 31, 1952, the taxpayer had no income, but has deductible business expenses of $1,000. His net income for the 12-month period from January 1, 1952, to December 31, 1952, is therefore, $9,000. The taxpayer filed an application under paragraph (c) of this section for a reduction of his tax under the provisions of section 47 (c) (2). The tax computed on the basis of the net income for the period from January 1, 1952, to December 31, 1952, without placing such net income on an annual basis is $2,364.00. The tax computed under section 47 (c) (2) by reference to the actual net income for the 12-month period from January 1, 1952, to December 31, 1952, is $2,509.00, computed as follows:

Net income for 12-month period—$3,000.00

Less: Exemptions for normal tax and surtax = $1,200.00

Net Income subject to normal tax and surtax = $1,800.00

Normal tax (3 percent of $9,000) = $270.00

Surtax on $9,000 = $2,236.00

Total tax on annual income = $2,506.00

Net income subject to normal tax—$9,000.00

Normal tax (3 percent of $9,000) = $270.00

Surtax on $9,000 = $2,236.00

Total tax on annual income = $2,506.00

Net income subject to normal tax—$9,000.00

Normal tax (3 percent of $9,000) = $270.00

Surtax on $9,000 = $2,236.00

Total tax on annual income = $2,506.00

The facts are the same as in example (1) (in paragraph (a) (2)) of this section. In the period from November 1, 1952, to December 31, 1952, the taxpayer had net income of $30,000. The taxpayer filed an application for permission to treat November 1, 1952, to December 31, 1952, as a taxable year under paragraph (c) of this section for a reduction of his tax on an amount computed on the basis of his actual net income for the 12-month period from January 1, 1952, to December 31, 1952. His tax is reduced to $2,618.18, computed as follows:

Net income for 12-month period—$11,090.00

Exemptions for normal tax and surtax = $1,000.00

Income subject to normal tax = $9,090.00

Normal tax (3 percent of $9,090) = $272.70

Surtax on $9,090 = $2,236.00

Total tax on annual income = $2,509.00

Net income for 12-month period—$11,090.00

Normal tax (3 percent of $9,090) = $272.70

Surtax on $9,090 = $2,236.00

Total tax on annual income = $2,509.00

Net income for 12-month period—$11,090.00

Normal tax (3 percent of $9,090) = $272.70

Surtax on $9,090 = $2,236.00

Total tax on annual income = $2,509.00

Net income for 12-month period—$30,000.00

Less: Exemptions for normal tax and surtax = $1,200.00

Net Income subject to normal tax and surtax = $28,800.00

Normal tax (3 percent of $9,090) = $272.70

Surtax on $9,090 = $2,236.00

Total tax on annual income = $2,509.00

Net income for 12-month period—$11,090.00

Amount of tax for 10-month period

[(49,904 × 12) ÷ 10] = 59,884.00

Amount of tax for 10-month period = $18,000

Subtracting: Credit provided in section 26 (a) for dividends received (85 percent of $15,300) = $12,944.00

Normal tax on $92,700.00 = $26,195.00

Surtax on $26,195.00 = $2,618.18

Total tax on annual basis = $28,813.18

Since the tax computed on the basis of the net income for the short period without placing such net income on an annual basis is $2,618.18, the tax

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computed by reference to the actual net income for the 12-month period, the tax for the short period under section 47 (c) (2) is $2,500.00.

Example (3). The facts are the same as in example (2) in paragraph (a) (3) of this section. The taxpayer desires to have its tax reduced under the provisions of section 47 (c) (2). During the 4-month period from September 1, 1952, to December 31, 1952, the taxpayer has received $16,000 net income, including $3,000 dividends from a domestic corporation, for which the credit provided in section 26(a) is applicable, and $1,000 interest on obligations of the United States described in section 26 (a). The net income for the 12-month period from January 1, 1952, to December 31, 1952, is, therefore, $88,000. 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 interest on United States obligations described in section 26 (a) amounts to $5,000. The normal tax and surtax for the short period is reduced under section 47 (c) (2) to $28,250.18, computed as follows:

**Net income for 12-month period**

Jan. 1, 1952, to Dec. 31, 1952... $86,000.00

Subtracting: Dividends received credit provided in section 26 (b) (85 percent of $15,000)... 12,750.00

Surtax net income... 73,250.00

Less: Credit provided in section 26 (a) for interest on United States obligations... 5,000.00

**Normal tax net income**... 68,250.00

**Total tax on annual income**... 31,390.00

**Net income for 8-month period Jan. 1, 1952, to Aug. 31, 1952...** $72,000.00

Amount of tax for 8-month period Jan. 1, 1952, to Aug. 31, 1952... (72,000.00 x $25,436.18)... 26,288.18

The amount of normal tax and surtax that would be due if the income for the short period were not placed on an annual basis is $58,636.00, as follows:

Net income for 8-month period... $72,000.00

Credit for dividends received (85 percent of $12,000)... 10,200.00

Surtax net income... 61,800.00

Less: Credit for interest on United States obligations... 4,000.00

**Normal tax net income**... 57,800.00

**Normal tax on $70,000.00**... 21,075.00

Surtax on $70,000.00... 11,655.00

**Total tax for period**... 32,730.00

Since the tax for the short period computed under section 47 (c) (2) by reference to the actual income for the 12-month period, or $28,250.18, is greater than the tax that would be due if the income for the short period were not placed on an annual basis, or $25,436.18, the tax for the short period is reduced to $28,250.18, the tax computed by reference to the income for the 12-month period.

(c) Application to compute tax under section 47 (c) (2) A taxpayer desiring the benefit of section 47 (c) (2) must file an application therefor. If at the time the return for the short period is filed the taxpayer is able to determine that the 12-month period ending with the close of the short period will be for full fiscal computations under section 47 (c) (2) then the tax on the return for the short period may be determined under the provisions of section 47 (c) (2). In such a case, an application for the benefits of section 47 (c) (2) must be made under the penalties of perjury. Such application shall set forth in such cases, and to such extent, and in such detail, as the Commissioner with the approval of the Secretary may by regulations prescribe, the items of gross income and the deductions and credits allowed under this section and such other information for the purpose of carrying out the provisions of this chapter as may be prescribed by such regulations.

(b) Husband and wife-(1) In general. A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the entire tax shall be paid on the aggregate income and the liability with respect to the income so paid shall be allocable to the husband or wife by the court in the case of a joint return made after the death of either of both, or to each one of the surviving spouse in the case of a joint return made before the death of either of both.

(2) Normal tax. A joint return may be made if either the husband or wife at any time during the taxable year is a nonresident alien.

(3) Different taxable years. No joint return shall be made if the husband and wife have different taxable years; except that if both have the same taxable year the same day and end on different days because of the death of one or of both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of his taxable year, nor if the taxable year of either spouse is a fractional part of a year under section 47 (a).

(4) Joint return after death. In the case of the death of one spouse or both spouses the joint return with respect to the decedent may be made only by his executor or administrator except that if the death of one spouse the joint return may be made by the surviving spouse with respect to both himself and the decedent if (A) no return for the taxable year has been made by the decedent, (B) no executor or administrator has been appointed, and (C) the executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse, the executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disannul such joint return by making, within one year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year of the decedent with respect to which the joint return was made, in which case the executor or administrator shall constitute his separate return.

(5) Determination of status. For the purpose of this section—

(A) The status as husband and wife of two individuals having taxable years beginning on the same day shall be determined—

(I) If both have the same taxable year—

(a) If the close of such taxable year

(b) If one dies before the close of the taxable year of the other—

(II) If both have different taxable years

(6) Application to compute tax under section 47 (c) (2) A taxpayer desiring the benefit of section 47 (c) (2) must file

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for such taxable year. A joint return filed by the husband and wife in such a case shall constitute the return of the husband and wife with respect to each. (A) Payments required before joint return can be made. A joint return can be made by the husband and wife in the case of a head of household electing the tax shall be computed from showing on the return the tax imposed by the collector as payable and (B) Time for making joint return. A joint return cannot be made under paragraph (1)—

(A) After the expiration of three years from the last day on which such separate return for such taxable year was filed, or (B) After such separate return was mailed by such party to the other without regard to this subsection.

(3) Regulations. The Commissioner with the approval of the Secretary shall prescribe regulations for the application of the rules of this subsection to cases where the gross income from sources other than wages on which the tax has been withheld at the source is more than $100 but not more than $500, and to cases where the gross income from all other sources other than wages on which the tax has been withheld at the source is more than $500. Such regulations shall provide (A) for the application of this subsection in the case of husband and wife, including provision whereby the return under this subsection may be permitted or required and what constitutes a joint return, (B) that the return for the purposes of this subsection, from showing on the return the tax imposed by this chapter. In such case the tax shall be computed by the collector under Supplement T without regard to the taxpayer's status as head of a household.

(2) Result of computation. After the collector has computed the tax, he shall mail to the taxpayer a notice stating the amount determined by him as payable and making demand therefor.

(3) Regulations. The Commissioner with the approval of the Secretary shall prescribe regulations for the application of the rules of this subsection to cases where the gross income from sources other than wages on which the tax has been withheld at the source is more than $100 but not more than $500, and to cases where the gross income from all other sources other than wages on which the tax has been withheld at the source is more than $500. Such regulations shall provide (A) for the application of this subsection in the case of husband and wife, including provision whereby the return under this subsection may be permitted or required and what constitutes a joint return, (B) that the return for the purposes of this subsection, from showing on the return the tax imposed by this chapter. In such case the tax shall be computed by the collector under Supplement T without regard to the taxpayer's status as head of a household.

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(2) Result of computation. After the collector has computed the tax, he shall mail to the taxpayer a notice stating the amount determined by him as payable and making demand therefor.

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(ii) For any taxable year where a joint return has been filed, separate returns may not be made by the spouses after the time for filing the return of either has expired. See, however, subparagraph (2) (v) of this paragraph for the right of the surviving spouse to file a joint return for a deceased spouse and thereby disaffirm a timely joint return made by the surviving spouse.

(iii) If a joint return is made, the gross income and the adjusted gross income of husband and wife on the joint return are computed in an aggregate amount and the deductions allowed and the net income are likewise computed on an aggregate basis. Deductions limited to a percentage of the adjusted gross income, such as the deduction for charitable contributions under section 25 (d) will be allowed with reference to such aggregate adjusted gross income. Similarly, in the case of a joint return, losses of husband and wife from sales or exchanges of capital assets are combined and "such combined losses are allowed under section 117 (d) (2) only to the extent of the combined gains of the spouses from such sales or exchanges, plus the net income (or adjustment if there is no net income) of the surviving spouse computed under Supplement T) or $1,000 whichever is smaller. The "net income" referred to in section 117 (d) (2) is the net income computed before reduction by one-half for the purposes of income splitting under section 12 (d) and is such net income computed without regard to gains and losses from sales or exchanges of capital assets. The separate return (a) in such a case, there are two taxpayers on a joint return, there is only one net income. The tax on the joint return shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several. A joint return may not be made if either the husband or wife at any time during the taxable year is a non-resident alien. For computation of tax on the basis of the splitting of income in the case of a joint return, see § 39.12—3. For tax in the case of a joint return with a wife electing to pay the tax under Supplement T, see §§ 39.400—1 and 39.401—1.

(3) Joint return after death. (1) Since in general a joint return may not be made with respect to a taxable year except as provided by section 51 (b) or by section 51 (g) in the case of the death of one or both spouses prior to the last day of such taxable year. Section 51 (b) provides that a joint return may be made for the decedent's spouse if the taxable years of such spouse begin on the same day and end on different days only because of the death of either or both. Thus, if a husband and wife make their returns on a calendar year basis, and the wife dies on August 1, 1952, a joint return may be made with respect to the calendar year 1952 of the husband and the calendar year of the wife beginning on January 1, 1952, and ending with her death on August 1, 1952. Similarly if husband and wife both make their returns on the basis of a fiscal year beginning on July 1 and the wife dies on October 1, 1952, a joint return may be made with respect to the fiscal year of the husband beginning on June 30, 1952, ending on June 30, 1953, and with respect to the taxable year of the wife beginning on July 1, 1952, and ending with her death on October 1, 1952. Section 51 (g) provides that a joint return may be made, under certain conditions, after separate returns have been filed even though the time prescribed by law for filing the return (for such year has expired. See § 39.51—1 (b) (2) A joint return made under section 51 (g) after the death of either spouse shall, with respect to the decedent, be made only by his executor or administrator. Thus, where no executor or administrator has been appointed, a joint return cannot be made under section 51 (g). For the purposes of the next two subsections, the deaths of two individuals as husband and wife, if one dies prior to the close of the taxable year of the other, shall be determined as of the time of such death.

(2) If a surviving spouse is making a joint return to be made for the taxable year in which the death of either or both spouses occurs is subject to two exceptions. The first exception is that if the surviving spouse remarries before the close of his taxable year, he may not make a joint return with the first spouse who died during the taxable year. In such a case, the surviving spouse may make a joint return with his new spouse provided that the other requirements of section 51 (b) are met. The second exception is that the surviving spouse may not make a joint return with the deceased spouse if the taxable year of either spouse is a fractional part of a year under section 47 (a) resulting from a change of accounting period. For example, if a husband and wife make their returns on the calendar year basis and the wife dies on March 1, 1952, and thereafter the husband receives permission to change his period to a fiscal year beginning July 1, 1952, no joint return may be made for the short taxable year ending June 30, 1952. Similarly, if a husband and wife make their return on a calendar year basis receive permission to change to a fiscal year beginning July 1, 1952, and the wife dies on June 30, 1952, no joint return may be made for the short taxable year ending June 30, 1952.

(3) If a surviving spouse makes the joint return provided for in subdivision (i) and thereafter an executor or administrator of the decedent is appointed, the executor or administrator may disaffirm such joint return. This disaffirmance, in order to be effective, must be made within one year after the last day prescribed for filing the return of the surviving spouse, and the disaffirmance is effective if the return during which the disaffirmance is made is the last return made by the surviving spouse with respect to which the decedent with respect to which the joint return was made. In the event of such proper disaffirmance the return made by the surviving spouse shall be treated as if the return, that is, the joint return made by him shall be treated as his separate return and the tax thereon shall be computed by excluding all the income of the decedent in the return of the deceased spouse. The separate return made by the execut-
tor or administrator shall constitute the return of the deceased spouse for the taxable year.

(vi) The time allowed the executor or administrator to disaffirm the joint return by the making of a separate return does not establish a due date for the return of the deceased spouse. Accordingly, the provisions of sections 291 and 294, relating to delinquents returns and delinquency in payment of tax, are applicable to returns filed by the executor in disaffirmance of the joint return.

(3) Joint return after filing separate returns—(1) In general. (a) Where an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under section 51 (b) and the time prescribed by law for filing the return for such taxable year has expired, such individual and his spouse may, under conditions hereinafter set forth, make a joint return for such taxable year. The joint return filed by such individual and his spouse shall constitute the return of the husband and wife for such year, and all payments, credits, refunds, or other re-

payments, credits, refunds, or other re-

turns, prior to the making of the separate return of either spouse, are to be taken into account in determining the extent to which the tax based on the joint return has been paid.

(b) For the purposes of this section, the determination whether an individual is married at any time during the taxable year shall be made in accordance with the provisions of section 51 (b) (g). See § 39.51-1.

(c) If the taxpayer and his spouse are divorced or legally separated at any time after the close of the taxable year for which separate returns are filed, such individuals shall be deemed to have made a joint return for such taxable year of the joint income, deduction, or credit of such spouse that would not be changed upon making a separate return for such taxable year, but without any extension of time granted to either spouse.

(d) If, after the expiration of 1 year from the date prescribed for the filing of such separate returns, there is a demand for any extension of time, the demand shall be deemed to have been made by the individual who has filed such separate return for such taxable year.

(2) Time for making joint return. A joint return may not be made under section 51 (g) with respect to a taxable year:

(a) After the expiration of 3 years from the last day prescribed by law for filing the returns of the individual and his spouse determined without regard to any extension of time granted to either spouse. Thus where an extension of time for filing returns has been granted by the Commissioner or his representative in accordance with section 59 (a), the extension shall be disregarded in determining the last day upon which a joint return may be filed after separate returns have been filed;

(b) After there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 62 or the notice, a petition with the Tax Court of the United States within the time prescribed in section 722 (a) that is, within 90 days (or 150 days if notice is addressed to the taxpayer outside the States of the Union and the District of Columbia) after the mailing of the notice, excluding Saturday, Sunday, or a public holiday in the District of Columbia as the ninetieth day;

(c) After either spouse has commenced a suit in any court for the recovery of any amount of tax for such taxable year;

(d) After either spouse has entered into a closing agreement under section 726 with respect to such taxable year, or after any civil or criminal case arising at the time of the making of such separate return, but without any extension of time granted to either spouse.

(3) Additional time for assessment. If a joint return is made under section 51 (g) and the tax is determined without regard to any extension of time granted to either spouse for filing the return or paying the tax, then the Joint return may be made under section 51 (g) with respect to a joint return made under section 51 (g) (ii) Payments required before joint returns can be filed. A joint return may not be made under section 51 (g) for a taxable year unless at or before the time of the filing of such joint return the following amounts are paid:

(a) All amounts shown as the tax by the spouse on his separate return for such taxable year, if, prior to such filing, a notice under section 722 (a) of such deficiency has been mailed.

(b) Any amount determined, at the time of the filing of the joint return, as a deficiency with respect to either spouse for such taxable year, if, prior to such filing, a notice under section 722 (a) of such deficiency has been mailed.

(c) The time for making joint return. A joint return may not be made under section 51 (g) with respect to a taxable year:

(a) After the expiration of 3 years from the last day prescribed by law for filing the returns of the individual and his spouse determined without regard to any extension of time granted to either spouse. Thus where an extension of time for filing returns has been granted by the Commissioner or his representative in accordance with section 59 (a), the extension shall be disregarded in determining the last day upon which a joint return may be filed after separate returns have been filed.

(b) After there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 62 or the notice, a petition with the Tax Court of the United States within the time prescribed in section 722 (a) that is, within 90 days (or 150 days if notice is addressed to the taxpayer outside the States of the Union and the District of Columbia) after the mailing of the notice, excluding Saturday, Sunday, or a public holiday in the District of Columbia as the ninetieth day;

(c) After either spouse has commenced a suit in any court for the recovery of any part of the tax for such taxable year;

(d) After either spouse has entered into a closing agreement under section 726 with respect to such taxable year, or after any civil or criminal case arising at the time of the making of such separate return, but without any extension of time granted to either spouse.

(2) Time for making joint return. A joint return may not be made under section 51 (g) with respect to a joint return made under section 51 (g) (ii) Payments required before joint returns can be filed. A joint return may not be made under section 51 (g) for a taxable year unless at or before the time of the filing of such joint return the following amounts are paid:

(a) All amounts shown as the tax by the spouse on his separate return for such taxable year, if, prior to such filing, a notice under section 722 (a) of such deficiency has been mailed.

(b) Any amount determined, at the time of the filing of the joint return, as a deficiency with respect to either spouse for such taxable year, if, prior to such filing, a notice under section 722 (a) of such deficiency has been mailed.

(c) The time for making joint return. A joint return may not be made under section 51 (g) with respect to a taxable year:

(a) After the expiration of 3 years from the last day prescribed by law for filing the returns of the individual and his spouse determined without regard to any extension of time granted to either spouse. Thus where an extension of time for filing returns has been granted by the Commissioner or his representative in accordance with section 59 (a), the extension shall be disregarded in determining the last day upon which a joint return may be filed after separate returns have been filed.
abuse from the United States for a period of at least 60 days before the date prescribed by law for making the return. When a return is made by an alien, it must be accompanied by the prescribed power of attorney, Form 935, except that an agent holding a valid and subsisting general power of attorney which he has received for the principal may be authorized to represent the principal in making, executing, and filing the income return, may submit a certified copy thereof in lieu of the authorization on Form 935.

The taxpayer agent, if any, will be 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 §39.217-1 and 39.217-2.

(3) The home or residential address of the taxpayer (including the street and number, if any) 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 home residential address is also given within the space provided.

(b) Use of optional return on Form 1040A. (1) A tax payer entitled to elect to pay the tax imposed by Supplement T (except a taxpayer making his return on a fiscal year basis) may elect to use Form 1040A as his return and provided his gross income is less than $6,000, consists entirely of remuneration for personal services performed by him as an employee, dividends, or interest, and his gross income from sources other than wages, as defined in section 1621 (a) does not exceed $100. A taxpayer who makes his return on a basis other than the cash receipts and disbursements basis may not use Form 1040A as his return. A taxpayer who has made payments of estimated tax for a taxable year may not use Form 1040A as his return for such year. In the case of married persons domiciled in a community-property State, Form 1040A may not be used as a return by either spouse unless the aggregate gross income of husband and wife meets the tests prescribed above for them to make a joint return. If they desire to file separate returns, Form 1040 is required.

(2) An election to make a return on Form 1040A shall be expressly executed by properly executing and filing such form, to which shall be attached all Forms W-2 received for the taxable year, with the district director of internal revenue on or before the due date of the taxpayer's return. Such Form 1040A, when filled out and executed and having attached thereto all Forms W-2 received with respect to wages paid in the taxable year, shall, when timely filed, constitute such individual's return for such year if he is eligible under section 51 (d) to use the optional Form 1040A.

(c) Joint return of husband and wife on Form 1040A. (1) If during the taxable year either husband or wife, or both, derive income from wages, as defined in section 1621 (a) and are furnished one or more Forms W-2, and the aggregate gross income of both spouses is less than $5,000, consists solely of remuneration for services performed as an employee, dividends, or interest, and includes a total of $100 or more from dividends, interest, and remuneration for personal services other than such wages, the spouse may file a joint return on Form 1040A and all Forms W-2 received by both spouses for the taxable year shall be attached thereto.

(2) The tax computed by the district director of internal revenue upon the basis of a joint return on Form 1040A shall be the lesser of the following amounts:

(i) A tax computed as though the return on Form 1040A constituted the separate returns of the spouses, and

(ii) A tax computed as though the return on Form 1040A constituted a joint return.

(3) If a joint return is made by husband and wife on Form 1040A, the liability for the tax shall be joint and several.

(d) Head of household. In the case of a head of a household electing to make his return on Form 1040A in accordance with the rules prescribed in this section, the tax shall be computed under Supplement T without regard to the status of the taxpayer as the head of a household.

§39.51-3 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 from personal services performed by him as an employee, dividends, or interest, and his gross income from sources other than wages, as defined in section 1621 (a) does not exceed $100. A minor taxpayer who makes his return on Form 1040A in accordance with the rules prescribed in this section, the tax shall be computed under Supplement T without regard to the status of the taxpayer as the head of a household.

§39.51-4 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 in the manner prescribed on the form for the return.

(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 51. If any person or persons actually prepare any other income return for another person, the signed form of verification on the return shall be executed by such person or persons preparing the return and attached to the return. The return is required to be verified on all such income returns required under the Internal Revenue Code except the following:

(1) Returns required under sections 149 and 144 (relating to withholding of tax at the source),

(2) Returns required to be made by departing aliens under section 145,

(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 338 (a), 339, and 3004 (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 as to the formation of foreign corporations).

Such verification is not required if the actual preparation of the return is 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 (as in the case of a clerk, stenographer, typist, 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 periodic audits of the accounts of the person for whom the return is prepared, the verification is required. If the return is a separate return of a married person, the verification is required, although the ordinarily 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, an internal revenue agent, or other officer or employee of the Internal Revenue Service actually prepares the return, the person for whom the return is made shall make in the return a brief statement to that effect, and it will not be necessary to make the verification required by this paragraph.

§39.51-5 Use of prescribed forms.

Copies of the prescribed return forms will so far as possible be furnished taxpayers by district directors of internal revenue. 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 district director of internal revenue in ample time to have their returns prepared, verified, and filed with the district director of internal revenue on or before the due date. Such a taxpayer should carefully prepare his return so 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 statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time the
§ 39.52 Statutory provisions; returns and payment of tax; corporation returns.

Sec. 59. Corporation returns—(a) Requirement. Every corporation subject to taxation under this chapter shall make a return, stating the gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and 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 as tax due on the basis of returns made by the corporations from which the business or property they have custody and control.

(b) Cross reference. For provisions relating to consolidated returns, see section 141. (Sec. 53 as amended by sec. 159 (1), Rev. Act 1948)

§ 39.52–1 Corporation returns. (a) Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. For returns of insurance companies, see §§ 39.201–1, 39.204–1, and 39.207–1, of foreign corporations, see section 235; and of affiliated corporations, see sections 141 and § 39.141–1. For returns of certain corporations, otherwise exempt from tax under section 101 (1) (5) (7) or (14) which are subject to the tax imposed by section 421 (a) (1) upon their Supplement U net income, see § 39.421–3. For returns of certain governmental colleges or universities which are subject to the tax imposed by section 421 (a) (1) upon their Supplement U net income, see § 39.421–3. For returns of certain governmental colleges or universities which are subject to the tax imposed by section 421 (a) (1) upon their Supplement U net income, see § 39.421–3.

(b) A corporation having an existence during any portion of a taxable year as required to make a return, or if a corporation was not in existence throughout an annual accounting period (either calendar year or fiscal year) the corporation is required to make returns for that fractional part of a year during which it was in existence. A corporation is not in existence after it ceases business and dissolves, retaining no assets, whether or not state law may thereafter be treated as continuing as a corporation for certain limited purposes connected with winding up its affairs, such as for the purpose of suing and being sued. If the corporation has valuable claims for which it is no longer liable, since they were incurred during this period, it has retained assets, and it continues in existence. A corporation does not go out of existence if it is merely turned over to receivers or trustees who continue to operate it. A corporation which has received a charter, but has never perfected its organization, which has paid its franchise tax and has no income from any source, may upon presentation of the facts to the district director of internal revenue be relieved from the necessity of making a return and thus remain an unorganized corporation. In the absence of a proper showing to the district director of internal revenue such a corporation will be required to make a return.

(2) Information returns by corporations contemplating dissolution or liquidation, see section 148 (d) For information returns by corporations of distributions in liquidation, see section 148 (e) For information returns by corporations relating to profits of the taxable year declared as dividends, see section 148 (b). For verification of returns made on prescribed forms, see §§ 39.51–4 and 39.51–5.

§ 39.52–2 Returns by receivers. Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, which have not transacted any business or property which would devolve upon the receiver, trustee, or assignee subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporation and is required to file returns for such corporations. If a receiver has full custody of and control over the business or property of a corporation, 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 the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. (See sections 274 and 293 and regulations contemplate dissolution or liquidation, see section 148 (e) For information returns by corporations relating to profits of the taxable year declared as dividends, see section 148 (b). For verification of returns made on prescribed forms, see §§ 39.51–4 and 39.51–5.

§ 39.52–3 Returns by assignees. In cases where receivers, trustees, or assignees are operating the property or business of corporations, the return shall be on Form 1120. In cases where receivers, trustees, or assignees are operating the property or business of corporations, the return shall be on Form 1120. In cases where receivers, trustees, or assignees are operating the property or business of corporations, the return shall be on Form 1120.

§ 39.52–4 Returns by persons acting for unorganized corporations. Returns (other than corporation returns) shall be made to the collector of the district in which the property of the person making the return is located or is having his principal place of business if the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Maryland.

Corporations. Returns of corporations shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation. Returns of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

For returns of a non-resident alien individual (except a bona fide resident of Puerto Rico during the entire taxable year) at the time prescribed in section 217.

(2) In the case of a return of a non-resident foreign corporation, at the time prescribed in section 235.

In the case of a return of a fiduciary of an estate or trust, or on or before the 15th day of the third full calendar month following the close of the taxable year. The rule is subject to several exceptions, in which the time for filing is as follows:

(1) In the case of a return of a non-resident individual (except a bona fide resident of Puerto Rico during the entire taxable year) at the time prescribed in section 217.

(2) In the case of a return of a non-resident foreign corporation, at the time prescribed in section 235.

(3) In the case of a final return of a decedent for a fractional part of a year, on or before the 15th day of the third full calendar month which began with the first day of such fractional part of the year.

(4) In the case of any return for a fractional part of a year, the district director may, upon a showing by the taxpayer of unusual circumstances, prescribe a later time for the filing of the return.

In the case of a return of a fiduciary of an estate or trust, or on or before the 15th day of the fourth month following the close of the taxable year.

(5) A corporation going into liquidation, filing any tax return, or paying any tax which has been imposed on the completion of such liquidation, prepare a return for that year covering its income for the part of the year during which it was engaged in business and may immediately file such return with the district director of internal revenue. See also section 148 (d) and (e).

(6) For provisions relating to certain cases in which the time for filing returns is postponed by reason of an individual serving in or in support of the military or naval forces of the United States in a foreign country, see section 304. See section 3035 and § 39.52–4 as to the time for filing income tax returns of China Trade Act corporations.

§ 39.52–2 Extension of time for filing returns. It is important that the taxpayer render on or before the due date of his return, or, if he does not file a return before the fifteenth day of the third month following the close of the fiscal year, it is possible for him to prepare. However, the Commissioner is authorized to

§ 39.52–2
grant a reasonable extension of time for filing returns under such rules and regulations as the Commissioner prescribes with the approval of the Secretary. Accordingly, authority for granting extensions of time for filing income tax returns is hereby delegated to the various district directors of internal revenue. Application for extensions of time for filing income tax returns should be addressed to the district director of internal revenue for the internal revenue district in which the taxpayer files his returns and must contain a full recital of the causes for the delay. Except 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) (1) and 39.53-3, 39.53-2, and 39.53-2.

§ 39.53-3 Extensions of time in the case of foreign organizations, certain domestic corporations, citizens of the United States residing or traveling abroad, and nontaxable returns of fiduciaries for estates or trusts. An extension of time for filing income tax returns is hereby granted up to and including the 15th day of the sixth month following the close of the taxable year in the case of:

(a) Taxpayers residing outside the United States; and

(b) Foreign corporations which maintain an office or place of business in the United States;

(c) Domestic corporations which transact their business and keep their records and books of account abroad;

(d) Domestic corporations which maintain a principal place of business within the United States; and

(e) American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States.

In all such cases a statement must be attached to the return showing that the person for whom the return is made is a person described in this subsection.

Taxpayers who take advantage of this extension of time shall be charged with interest on the amount of tax for the period of 6 percent per annum on the first installment of tax, if any, from the original due date until paid.

§ 39.53-4 Due date of return. The due date is the date on or before which a return is required to be filed in accordance with the provisions of the Internal Revenue Code, (including sections 3804 and 3805) and the regulations prescribed by the Secretary of the Treasury, and the date of 6 percent per annum on the first installment of tax, if any, from the original due date until paid.

§ 39.53-5 Place for filing individual returns. (a) Section 53 (b) (1) provides that individual returns shall be made to the district director of internal revenue for the district in which the individual or taxable estate is located.

§ 39.53 Statutory provisions; returns and payment of tax; records and special returns.

§ 39.54 Records and special returns.—(a) By taxpayer. Every person subject to the tax imposed by this chapter or for the collection thereof, shall keep such records, render such returns, and pay such tax as prescribed by law, or regulations, as the Commissioner prescribes, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, make such statements, and file such returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may, at any time prescribe. No such annual return need be filed under this subsection by any organization exempt from taxation under the provisions of section 101—

(1) Which is a religious organization exempt under section 101 (6); or

(2) Which is an educational organization exempt under section 101 (6). If such organization is operated, supervised, controlled by, or in connection with a religious organization described in paragraph (1) or (2), such organization may file an annual return under section 101 (6). If such organization is a corporation wholly owned by the United States or any agency or instrumentality thereof, or a wholly owned subsidiary of such corporation.

[Sec. 54 as amended by sec. 117, Rev. Act 1943]

§ 39.54-1 Records and income tax forms. (a) Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount subject to the tax, keep such records as are sufficient under the determination of the Commissioner to determine the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1.
In addition to such permanent books and records as are required by this para


the tax laws of the United States, as amended by Supplement U (sections 421 to 424, inclusive) every organization exempt from tax under section 101 but required by section 54 (d) to file an annual return shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts, and disbursements, and to the tax administration as is required by § 39.101-1. The books or records required by this paragraph shall be kept at all times available for inspection by internal revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(b) Income-tax forms shall be prescribed by the Commissioner and shall be executed and filed in accordance with regulations in this part and the instructions on the form or issued therewith.

(c) The provisions of section 54 shall be kept at all times available for inspection to such extent as shall be authorized and shall keep such permanent books of account or records as are required by § 39.101-1.

§ 39.55 Statutory provisions; returns and payment of tax; publicity of returns.

Sec. 55. Publicity of returns.—(a) Public record and inspection. (1) Returns made under this chapter upon which the tax has been determined by the Commissioner shall constitute public records but, except as hereinafter provided in this section, they shall be open to inspection only upon order of the President and under regulations prescribed by the Secretary and approved by the President.

(2) And all returns made under this chapter, subchapters A, B, D, and E of chapter 2, subchapter B of chapter 3, chapters 4, 7, 12, and 21, subchapter A of chapter 29, and chapter 30, public inspection shall be open to public examination and inspection to such extent as shall be authorized in rules and regulations promulgated by the President.

(3) Whenever a return is open to the inspection of the Commissioner, the record of such inspection shall be kept, upon request, to be furnished to such person under rules and regulations prescribed by the Commissioner with the approval of the President.

(b) Returns and payment of tax. The Commissioner may prescribe a reasonable fee for furnishing such copies.

(c) Inspection by States.—(1) State officers. The proper officers of any State may, upon the request of the governor thereof, have access to any return, or to any book or record kept by any person the amount of which is taxable under the income tax laws of such State, designated by such governor, and any return of such person, except as provided by law; and it shall be unlawful for any person to print or publish, either in whole or in part, any such return whatever not filed by law, or income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and it shall be unlawful to falsify any income return or copy thereof or any book containing any abstract or particulars thereof to be used as evidence in any such income return; and it shall be unlawful for any person to falsify any return or copy thereof or any book containing any abstract or particulars thereof to be used as evidence in any such income return; and it shall be unlawful for any person to falsify any return or copy thereof or any book containing any abstract or particulars thereof to be used as evidence in any such income return.

(d) State employees. Any, officer, employee, or agent of any State or political subdivision, who divulges (except as authorized in paragraph 2 of subsection (b), or when called upon to testify in any legal or administrative proceeding to which the State or political subdivision, or such State or local official, body, or corporation, as such, is a party) any information acquired by him through an inspection permitted him or another paragraph of subsection (b) to be lawful, or any other property or other person, on behalf of which such information was obtained, or in the process of obtaining, or in the inspection of, any income return or copy thereof or any book containing any abstract or particulars thereof to be used as evidence in any income return.

(e) Return inspection. All bona fide shareholders of record owning 1 percent or more of the outstanding stock of any corporation, on request from the Commissioner, shall be permitted to examine any income return or copy thereof or any book containing any abstract or particulars thereof to be used as evidence in any income return.

(f) Inspections authorized. The provisions of section 54 shall be kept at all times available for inspection to such extent as shall be authorized and shall keep such permanent books of account or records as are required by § 39.101-1.

(g) Cross reference. For penalties for disclosing information, see section 4047.

Sec. 55 as amended by sec. 597, Second Rev. Act 1940; sec. 554 (d) (1), Rev. Act 1911.

§ 39.55-1 Inspection of returns.

(a) Any properly authorized official, body, or commission, with the approval of the Secretary, or any properly authorized official, body, or commission, with the approval of the Commissioner, may, in the discretion of the Commissioner, or the person authorized to make the inspection, inspect any return or copy thereof at any time for the purpose of such administration. For the purposes of this section, the word "returns" shall include information returns, schedules, lists, and other written statements filed with the Commissioner.

(b) Requests for permission to inspect returns shall be made in writing to the Commissioner by the governor under the seal of his State, and must be addressed to the Commissioner of Internal Revenue, Audit Service Branch, Washington, D. C. The request shall (1) state the kind of returns it is desired to inspect, (2) the taxable year or years covered by the returns it is desired to inspect, (3) the name of the official, body, or commission, or the person under whose direction the inspection is to be made, (4) the name of the representative of such official, body, or commission, designated to make the inspection, (5) by specific reference, the State law which such
official, body, or commission is charged with administering and enforcing the law under which he, she, or it is charged, (6) the purpose for which the inspection is to be made, and (7) if the inspection is for the purpose of obtaining information to be furnished under oath or affirmation, the name of the official, body, or commission of any political subdivision of the State, lawfully charged with the administration of the tax laws of such political subdivision, if any, to whom or of which the information secured by the inspection is to be furnished, and (ii) the purpose for which the information is to be used by such official, body, or commission.

(c) In any case where inspection of the returns is authorized in accordance with the provisions of this section, the Commissioner may, in his discretion, permit inspection of other records and reports which contain information included or required by statute to be included in the return.

(d) For the purposes of returns, other than on behalf of States or political subdivisions thereof, and furnishing copies of returns so open to inspection, see Treasury Decision 4920, approved by the President August 28, 1939, and Treasury Decision 4948, approved September 20, 1939.

§ 39.56 Statutory provisions: Returns and payment of tax; Payment of tax.

Sec. 56. Payment of tax.—(a) Time of payment. The total amount of tax imposed by this chapter shall be paid on the fifteenth day of the fourth month following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the calendar year.

(b) Installment payments.—(1) Estates of decedents. In the case of the estate of a decedent, the amount of tax imposed by this chapter shall be paid on the basis of a fiscal year, except that in the case of the tax imposed upon an estate or trust the tax shall be paid on the fifteenth day of April following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the fourth month following the close of the fiscal year.

(2) Corporations. In the case of a corporation,

(A) Taxable years ending before December 31, 1954. The taxpayer may elect with respect to any taxable year ending before December 31, 1954, to pay the tax in two equal installments and in such case the amount of the tax paid by each installment shall be determined as follows:

<table>
<thead>
<tr>
<th>If the taxable year ends—</th>
<th>And each of the last 2 installments shall be the following percentage of the tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>On or after December 31, 1951</td>
<td>50%</td>
</tr>
<tr>
<td>On or after December 31, 1952</td>
<td>45%</td>
</tr>
<tr>
<td>On or after December 31, 1953</td>
<td>40%</td>
</tr>
<tr>
<td>On or after December 31, 1954</td>
<td>35%</td>
</tr>
</tbody>
</table>

(B) Taxable years ending on or after December 31, 1954. The taxpayer may elect with respect to any taxable year ending on or after December 31, 1954, to pay the tax in four equal installments and such case the amount of the tax paid by each installment shall be determined as follows:

<table>
<thead>
<tr>
<th>If the taxable year ends—</th>
<th>Each of the first 2 installments shall be the following percentage of the tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>On or after December 31, 1951</td>
<td>25%</td>
</tr>
<tr>
<td>On or after December 31, 1952</td>
<td>24%</td>
</tr>
<tr>
<td>On or after December 31, 1953</td>
<td>23%</td>
</tr>
<tr>
<td>On or after December 31, 1954</td>
<td>22%</td>
</tr>
</tbody>
</table>

(3) Dates for installment payments.—(A) Four installments. In any case in which the tax may be paid in four installments, the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the 15th day of the third month, the third installment shall be paid on the 15th day of the sixth month, and the fourth installment shall be paid on the 15th day of the ninth month, after such date.

(B) Two installments. In any case in which the tax may be paid in two installments, the tax paid on the date prescribed for the payment of the tax by the taxpayer, and the second installment shall be paid on the 15th day of the third month following such date.

(4) Requirement for payment. If any installment is not paid on or before the dates prescribed for the payment of the tax, the tax shall be paid on the due date.

(5) Payment of tax if not computed by taxpayer. Where under section 51 (f) a tax is imposed upon an estate or trust, the amount of tax shall 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, or on before the 15th day of the third month following the close of such fiscal year. See, however, paragraph (b) of this section with respect to estates and trusts and § 39.59–1 with respect to estimated taxes.

(6) For purposes of returns, other than on behalf of States or political subdivisions thereof, and furnishing copies of returns so open to inspection, see Treasury Decision 4920, approved by the President August 28, 1939, and Treasury Decision 4948, approved September 20, 1939.
...before the 15th day of the fourth month following the close of the fiscal year.

(c) Installments—payment thereof

(1) Estates of decedents. With respect to estates of decedents, the fiduciary may elect to pay the tax in four equal installments, instead of making the payment in a single payment, in which case the first installment shall be paid on or before the date prescribed for the payment of the tax as a single payment, the second installment shall be paid on or before the 15th day of the third month, the third installment on or before the 15th day of the sixth month, and the fourth installment on or before the 15th day of the ninth month, after such date.

(2) Corporations; taxable years ending before December 31, 1954. With respect to taxable years of corporations ending before December 31, 1954, the taxpayer may elect to pay the tax in four installments, and in such case the amount of the tax paid by each installment shall be as follows:

<table>
<thead>
<tr>
<th>If the taxable year ends—</th>
<th>Each of the first 2 installments shall be the 1st percent of the tax</th>
<th>Each of the last 2 installments shall be the 2nd percent of the tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>On or after—</td>
<td>And before—</td>
<td></td>
</tr>
<tr>
<td>Dec. 31, 1951</td>
<td>Dec. 31, 1952</td>
<td>35</td>
</tr>
<tr>
<td>Dec. 31, 1952</td>
<td>Dec. 31, 1953</td>
<td>40</td>
</tr>
<tr>
<td>Dec. 31, 1953</td>
<td>Dec. 31, 1954</td>
<td>45</td>
</tr>
</tbody>
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The first installment shall be paid on or before the date prescribed for the payment of the tax as a single payment, the second installment shall be paid on or before the 15th day of the third month, the third installment on or before the 15th day of the sixth month, and the fourth installment on or before the 15th day of the ninth month, after such date.

(3) Corporations; taxable year ending on or after December 31, 1954. With respect to taxable years of corporations ending on or after December 31, 1954, the taxpayer may elect to pay the tax in two equal installments, in which case the first installment shall be paid on or before the date prescribed for the payment of the tax as a single payment, the second installment on or before the 15th day of the third month after such date.

(4) In general. (i) If the taxpayer elects to pay the tax in installments, any installment may be paid, at the election of the taxpayer, prior to the date prescribed for its payment, if the installment is not paid at least 30 days before the date fixed for its payment either by the Internal Revenue Code or by the Commissioner in accordance with the terms of an extension, the whole amount of the tax unpaid shall be paid upon notice and demand from the district director of internal revenue.

(ii) In the case of taxpayers other than estates of decedents, and other than corporations, the installment of all or part of the tax not paid as required by paragraph (i) of this section shall be paid upon notice and demand from the district director of internal revenue.

§ 39.56-2 Extension of time for payment of the tax or part or installment thereof. (a) If it is shown to the satisfaction of the Commissioner or the district director that the payment of the amount determined as the tax by the taxpayer or any part of installment thereof upon the date or dates prescribed for the payment thereof will result in undue hardship to the taxpayer, the Commissioner (after August 1, 1953, and at the request of the taxpayer, may grant an extension of time for the payment for a period not to exceed six months from the date prescribed for the payment of such amount, part, or installment. However, 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 portion of 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 by him of property other than money upon the complete liquidation (as defined in section 115 (c)) of a corporation if the corporation, for its taxable year preceding the year in which such corporation complete liquidation (for 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. An extension will not be granted upon 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 unless the amount of the extension is granted.

(b) An application for an extension of time for the payment of such tax should be made on Form 1127 and must be accompanied or supported by evidence showing the undue hardship that would result if an extension was not granted. A statement of assets and liabilities of the taxpayer and an itemized statement showing all receipts and disbursements for each of the three years 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 district director of internal revenue, who, if the application is filed before September 1, 1953, will transmit it to the Commissioner with his recommendations as to the extension. It will be examined by the Commissioner with possibly within 30 days will be denied, granted, or tentatively granted, subject to certain conditions of which the taxpayer will be notified. An application for an extension of time for the payment of the tax or any part or installment thereof which is granted by the Commissioner must meet the term of the extension granted, and any amount not exceeding double the amount of the tax, or any part or installment thereof, on or before the date or dates prescribed for payment in any prior extension granted.

(c) As a condition to the granting of such an extension, the taxpayer will usually be required to furnish a bond on Form 1130 in an amount not exceeding double the amount of the tax or to furnish other security satisfactory to the Commissioner for the payment of the tax, or any part or installment thereof, on or before the date or dates prescribed for payment in any prior extension granted. The amount not exceeding double the amount of the tax, or any part or installment thereof, shall not be required if the application is accompanied by a statement of assets and liabilities satisfactory to the Commissioner and a surety bond Is required it shall be conditioned on the taxpayer paying in the extension, so that the amount determined as the tax by the taxpayer or any part of installment thereof upon the date prescribed for the payment thereof will be paid on or before the date prescribed for the payment thereof.

§ 39.56-3 When fractional part of cent may be disregarded. In the payment of taxes a fractional part of a cent may be disregarded unless it amounts to one-half cent or more, in which case it shall be considered as resulting in an undue hardship. It shall be increased to 1 cent. Fractional parts of a cent may be disregarded.

§ 39.56-4 Receipts for tax payments. Upon request a district director of internal revenue will give a receipt for each tax payment. In the case of payments made by check or money order the canceled check or the money order receipt is usually a sufficient receipt. In the case of payments made in person, the taxpayer should in every instance require the district director of internal revenue to furnish a receipt.

§ 39.57-1 Examination of return and determination of tax. As soon as practicable after the return is filed the Commissioner shall examine or have examined it and determine the correct amount of the tax.

§ 39.57-2 Examination of return and determination of tax by the Commissioner. As soon as practicable after the return is filed, the Commissioner shall examine and...
§ 39.58 (a) Statutory provisions; returns and payment of tax; declaration of estimated tax by individuals; requirement of declaration.

Example (1). H, a taxpayer making his return on the calendar year basis, is married and has two dependent children. Neither his wife nor his children have any source of income. His wife has been blind for several years. He is reasonably sure that she will not regain her sight in the future. H's wife has been, or expects to be, a resident of Mexico with his wife and one dependent child throughout 1952, makes his return on a calendar year basis. His family consists of his nonresident alien wife and their minor children. He is employed as an executive in El Paso, Texas, at a salary of $6,000 per annum and enters and leaves the United States at frequent intervals. He must pay tax. Neither husband nor wife has any reasonable expectation of any other income from United States sources. Since his wages derived from sources within the United States in 1952 can reasonably be expected to amount to more than $4,000 plus $2,400 (the aggregate of four exemptions, including one exemption for each child) his declaration of estimated tax must be filed for such resident of Mexico for 1952.

Example (2). P, a professional man engaged in the practice of his own business, has gross income of $4,000 from such profession for the two months of January and February. He has no other income. He expects that he will have no income during 1953 from any other source. Since P has gross income which can for 1952 reasonably be expected to exceed $3,000, it is not subject to withholding under the provisions of section 1623 is required to file a declaration of estimated tax if his gross income meets the requirements of section 58 (a) (1) of the Code (other than an alien resident of Puerto Rico for the entire taxable year) gross income means only gross income from sources within the United States. See sections 212 (a) and 220. As to what constitutes gross income from sources within the United States, see section 119 and the regulations thereunder. Thus, for example, a nonresident alien over the age of 65 years, living in Mexico with his wife and one dependent child throughout 1952, makes his return on a calendar year basis. He is a nonresident alien. He is employed as an executive in El Paso, Texas, at a salary of $6,000 per annum and enters and leaves the United States at frequent intervals. He must pay tax. Neither husband nor wife has any reasonable expectation of any other income from United States sources. Since his wages derived from sources within the United States in 1952 can reasonably be expected to amount to more than $4,000 plus $2,400 (the aggregate of four exemptions, including one exemption for each child) his declaration of estimated tax must be filed for such resident of Mexico for 1952.

Example (3). S has been regularly employed for many years prior to January 1, 1952, at which date his weekly wage was $50. S also owns stock in a corporation from which he has derived regularly for many years prior to 1952 annual dividends ranging from $120 to $160. In view of the fact that for 1952 S can reasonably be expected to receive gross income of $600 or more, which includes $600 of income from sources other than wages as defined in section 1621 (a), he is required to make a declaration of estimated tax for such taxable year and his gross income to be $600 or more.

Example (4). T, a married taxpayer, who makes his return on the calendar year basis, is employed at the beginning of 1952 at an annual salary of $7,500, which, on the basis of facts then existing, will, it is expected, not undergo any change throughout 1952. T has bought stock in a corporation which dividends ranging from $75 to $100 have been regularly paid during the years before 1952. T has two dependent children, one of whom has sources of income other than sources within the United States. T has also owns stock in a corporation which dividends ranging from $75 to $100 have been regularly paid during the years before 1952. T also contributes the major portion of the support of his mother whose only source of income is approximately $100 per year from a trust fund. Under these facts for the purpose of determining whether he is required to file a declaration, T may take into account only the expected income from employment for his mother, and one for the child expected to receive less than $200 gross income in 1952. Since his expected salary exceeds the sum of $4,600 plus $1,800 (three exemptions), $6,400, T is required to file a declaration of estimated tax for 1952. In computing his estimated tax as a separate declaration, T may take into account any exemption for his wife since she is reasonably expected to have gross income in 1952. If, however, a joint declaration is made and the tax is estimated on the basis of the aggregate net income, account may be taken of an exemption for the wife.
The declaration shall also contain such other information as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall contain or be verified by a written statement that it is made under the penalties of perjury.

§ 39.58 (b)–1 Form and contents of declaration of estimated tax—(a) In general. (1) The declaration of estimated tax shall be on Form 1040-ES. The form may be obtained from the district directors of internal revenue of the several districts. It shall be executed, verified, and filed in accordance with the regulations concerning the part and the instructions on the form issued therefor. For the purposes of making the declaration, the amount of gross income which the taxpayer can reasonably be expected to receive or accrue, as the case may be, depending upon the method of accounting upon the basis of which the net income is computed, and the amount of the estimated allowable deductions and credits to be taken into account in computing the amount of the estimated tax, shall be determined upon the basis of facts and circumstances existing as at the time prescribed for the filing of the declaration.

If, therefore, the taxpayer is employed at the date of filing his declaration at a given wage or salary, it should, in the absence of circumstances existing contrary thereto, be presumed by him for the purposes of the declaration that such employment will continue to the end of the taxable year at the wage or salary rate at the date of making the declaration. In the case of the recipient of income other than wages, the income which the taxpayer can reasonably be expected to receive or accrue, as the case may be, shall be determined by the taxpayer and filed with the district director of internal revenue on or before the prescribed date.

The excess of the amount estimated on Form 1040-ES shall be the estimated tax for such taxable year unless the taxpayer comes within the prescribed exceptions. A declaration made under section 400 in computing the estimated tax unless the taxpayer comes within the prescribed exceptions. A declaration made under section 400 in computing the estimated tax shall be the estimated tax of the taxpayer for the taxable year

(b) Joint declaration of husband and wife. (a) A husband and wife may make a joint declaration even though they are not living together. A joint declaration need not be made for any taxable year which includes the period comprised between the death of either the husband or wife and the filing of the joint declaration. The fact that no declaration form has been furnished to him. The taxpayer need not be supplied with the proper forms upon which the application therefor to the district director of internal revenue in ample time to have their declarations prepared, verified, and filed with the district director of internal revenue on or before the prescribed date. Each taxpayer should carefully prepare his declaration so as to set forth fully and clearly the data thereon contained.

If, by reason of continuous absence from the United States (including Puerto Rico) during the entire taxable year, if any, the taxpayer is unable to make the declaration, or if, by reason of continuous absence from the United States (including Puerto Rico) during the entire taxable year in case of a joint return, see § 39.58 (c)–3. A joint declaration shall contain the following:

(1) The amount estimated as the tax for the taxable year after the application of the credit for foreign tax, if any, but without regard to the credits under sections 32 and 38; and

(2) The amount estimated as the tax as the sum of the credits under such sections; and (3) The excess, if any, of the amount shown under (1) over the amount shown under (2), which excess shall be the estimated tax for such taxable year.

The estimated tax need not include an amount estimated as the tax on self-employment income imposed by section 420.

§ 39.58 (b)–2 Use of prescribed forms.

Copies of the prescribed declaration forms will so far as possible be furnished taxpayers by district directors of internal revenue, and the taxpayer may be compelled to make a declaration, however, by the fact that no declaration form has been furnished to him. The taxpayer need not be supplied with the proper forms upon which the application therefor to the district director of internal revenue in ample time to have their declarations prepared, verified, and filed with the district director of internal revenue on or before the prescribed date. Each taxpayer should carefully prepare his declaration so as to set forth fully and clearly the data thereon contained.

§ 39.58 (c)–1 Joint declarations by husband and wife. (a) A husband and wife may make a joint declaration even though they are not living together. A joint declaration need not be made for any taxable year which includes the period comprised between the death of either the husband or wife and the filing of the joint declaration. The fact that no declaration form has been furnished to him. The taxpayer need not be supplied with the proper forms upon which the application therefor to the district director of internal revenue in ample time to have their declarations prepared, verified, and filed with the district director of internal revenue on or before the prescribed date. Each taxpayer should carefully prepare his declaration so as to set forth fully and clearly the data thereon contained.

(b) A joint declaration of a husband and wife may be made by an agent if, by reason of continuous absence from the United States (including Puerto Rico) during the entire taxable year or by reason of continuous absence from the United States (including Puerto Rico) during the entire taxable year in case of a joint return, see § 39.58 (c)–3. A joint declaration shall contain the following:

(1) The amount estimated as the tax for the taxable year after the application of the credit for foreign tax, if any, but without regard to the credits under sections 32 and 38; and

(2) The amount estimated as the tax as the sum of the credits under such sections; and (3) The excess, if any, of the amount shown under (1) over the amount shown under (2), which excess shall be the estimated tax for such taxable year.

The estimated tax need not include an amount estimated as the tax on self-employment income imposed by section 420.

§ 39.58 (c)–2 Use of prescribed forms.
§ 39.51—2) shall be signed by both spouses. If signed by one spouse as agent for the other, authorization for such action must accompany the declaration. The spouse acting as agent for the other shall, with the principal, assume the responsibility for making the declaration and incur liability for the penalties provided for erroneous, false, or fraudulent declarations.

(c) If a joint declaration is made by husband and wife, the liability with respect to the estimated tax shall be joint and several. The fact that a joint declaration of estimated tax is made by them will not preclude a husband and his wife from filing separate returns. In case a joint declaration is made but a joint return is not made for the same taxable year, the payments made on account of the estimated tax for such year may be treated as payments on account of the tax liability of either the husband or the wife for the taxable year or may be divided between them in any manner they see fit.

(d) If a joint declaration is made by husband and wife and thereafter one spouse fails to make amendments thereto of the joint estimated tax on account of such joint declaration are required from the estate of the decedent. The surviving spouse, however, shall be liable for the payment of subsequent installments of the joint estimated tax unless an amended declaration settling forth the separate estimated tax for the taxable year is filed by such spouse. Such separate estimated tax shall be paid at the time and in the amounts determined under the rules prescribed in § 39.59—1. For the purposes of the amended declaration, the payments made pursuant to the joint declaration may be divided between the decedent and the surviving spouse in such proportion as the surviving spouse and the legal representative of the decedent may agree.

§ 39.58 (d) Statutory provisions; returns and payment of tax; declaration of estimated tax by individuals; time and place for filing.

Sec. 83. Declaration of estimated tax by individuals.

(a) Time and place for filing—(1) In general. The declaration required under subsection (a) shall be filed on or before March 15 of the taxable year, except that if the requirements of section 83 (a) are first met—
(A) after March 1 and before June 30 of the taxable year, the declaration shall be filed on or before June 15 of the taxable year;
(B) after June 1 and before September 1 of the taxable year, the declaration shall be filed on or before September 15 of the taxable year;
(C) after September 1 of the taxable year, the declaration shall be filed on or before January 15 of the succeeding taxable year.

(b) Amendment of declaration. An individual may make amendments of a declaration filed during the taxable year under this subsection without the consent of the Commissioner with the approval of the Secretary. If made, such amendments may be filed during the ninety days succeeding March 15 of the last month of any quarter of the taxable year subsequent to that in which the declaration was filed and such an amendment has been filed, except that in the case of an amendment filed after September 15 of the taxable year, it may be filed on or before January 15 of the succeeding taxable year. Declarations and amendments thereunder in the collector specified in section 83 (b) (1).

(c) Return as declaration or amendment. If on or before the preceding taxable year the taxpayer files a return, for the taxable year for which the declaration is made, and pays in full the amount computed on the return as payable, then, under regulations prescribed by the Commissioner with the approval of the Secretary.

(2) 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 this paragraph and shall make his declaration to the director of internal revenue at Baltimore, Md.

(3) If the tax shown on the return (reduced by the credits under sections 33 and 35) is greater than the estimated tax shown in a declaration previously made, or in the last amendment thereof, such return shall, for the purposes of this chapter, be considered as such declaration; and

September 15 of the taxable year, it may be filed on or before January 15 of the succeeding taxable year. Amended or revised declarations may be filed in the quarter in which the original declaration has been filed or in any subsequent quarter in which a prior or revised declaration is to be filed. Where an original declaration has been filed and a revised declaration is also made based upon a change in the number of exemptions to which the taxpayer may be entitled for the then current taxable year. An amended declaration may be filed jointly by husband and wife even though separate declarations have previously been filed. Such amended declaration shall be on Form 1040-ES. An amended or revised declaration may be filed on or before January 15 of the succeeding calendar year; in the case of a taxpayer on the calendar year basis, an amended declaration shall be filed after September 15 may be filed on or before January 15 of the succeeding calendar year; in the case of a taxpayer on the calendar year basis, an amended declaration shall be filed after September 15 may be filed on or before January 15 of the succeeding calendar year.

(2) The requirements with respect to the filing of the declaration are those prescribed in section 58 (a). The requirements with respect to the time for filing the declaration apply to such nonresident aliens as are required to make a declaration as well as to United States citizens and residents. In the case of any individual, whether in or not in a military or naval service of the United States in a combat zone, the provisions of section 3904 relative to the time for filing returns are also applicable with respect to the time for filing declarations. In the case of any such individual, however, if the time for filing the return for a taxable year is postponed under subsection (a) of the section, the time for filing of estimated tax for such taxable year is not required.

(b) Place for filing declaration. (1) The declaration of estimated tax and any amendments thereof shall be filed with the district director of internal revenue for the internal revenue district in which is located the legal residence or principal place of business of the person making the declaration, or if he has no legal residence or principal place of business in the United States, then with the district director of internal revenue at Baltimore, Md. Any amended declaration shall be filed with the district director of internal revenue for the internal revenue district in which the original declaration was filed.

(2) 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 this paragraph and shall make his declaration to the district director of internal revenue at Baltimore, Md.

(3) A declaration required by section 417 shall, for the purposes of this chapter, be considered as such declaration; and
ate, in the case of a taxpayer that the taxpayer render on or before the 15th day of the first month following the close of the taxable year is permitted by section 58 (d) (2)

Hence, for example, an individual taxpayer on the calendar year basis who, subsequent to September 1, 1952, first meets the requirements of section 58 (a) (relating to the requirements with respect to the filing of section 58 (a) after which necessitate the filing of such declaration in 1952, may satisfy the requirements as to the filing of such declaration by filing his return for 1952 on or before January 15, 1953, and paying in full at the time of such filing the tax shown thereon to be payable.

(2) Likewise, if a taxpayer files on or before September 15th a timely declaration for such year and subsequent thereto, on or on or before January 15th of the succeeding taxable year (or corresponding date in the case of a taxpayer on the fiscal year basis) files his return for such year, and pays at the time of filing the tax shown by the return to be payable, such return shall be treated as an amended declaration timely filed.

(3) For the purposes of section 58 (d) (3) a taxpayer may file his return, Form 1040, on or before the 15th day of the first month following the close of the taxable year, and the declaration which has been furnished Form W-2 by his employer. In such case the taxpayer shall compute, as accurately as possible, his wages for such year and the tax withheld thereon, and pay the tax shown by the return to be payable, such return shall be considered as an amended declaration timely filed.

Sec. 55. Declaration of estimated tax by individuals; extension of time.

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

(b) Signatures presumed correct. The fact that an individual’s name is signed to a filed declaration shall be prima facie evidence for all purposes that the declaration was actually signed by him.

(c) Publicity of declaration. For the purposes of section 85 (relating to publicity of returns), a declaration of estimated tax shall be held and considered a return under this chapter.

Sec. 56. Declaration of estimated tax by individuals. * * *

(a) Extension of time. The Commissioner may grant a reasonable extension of time for filing declarations and paying the estimated tax, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

Sec. 56 (c) as added by sec. 5 (a), Current Tax Payment Act 1943; amended by sec. 13 (a), Individual Income Tax Act 1944.

§ 39.58 (e)–1 Extension of time for filing declarations. (a) It is important that the taxpayer render on or before the due date a declaration of estimated tax as accurate as the facts and circumstances then existing or reasonably to be anticipated permit. However, the Commissioner is authorized to grant reasonable extensions of time for filing declarations under such rules and regulations as he shall prescribe with the approval of the Secretary. Accordingly, authorities for granting extensions of time for filing declarations is hereby delegated to the various district directors of internal revenue. Applications for extensions of time for filing declarations shall be addressed to the district director of internal revenue for the internal revenue district in which the taxpayer files his income tax returns, and must contain a full recital of the causes for the delay. Except in the case of taxpayers who are abroad, no extension for filing declarations may be granted for more than six months.

(b) An extension of time for filing the declaration of estimated tax otherwise due on or before the 15th day of the third month of the taxable year is hereby granted to and in the case of the sixth month of the taxable year in the case of United States citizens outside continental United States, Hawaii, and Puerto Rico on the 15th day of the third month of the succeeding fiscal year.

(c) An extension of time for filing the declaration of estimated tax automatically extends the time for paying the estimated tax (without interest) for the same period.

§ 39.58 (f)–(h) Statutory provisions; returns and payment of tax; declaration of estimated tax by individuals; persons under disability; signatures presumed correct; publicity of declaration.

Sec. 58. Declaration of estimated tax by individuals.

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

(b) Signatures presumed correct. The fact that an individual’s name is signed to a filed declaration shall be prima facie evidence for all purposes that the declaration was actually signed by him.

(c) Publicity of declaration. For the purposes of section 55 (relating to publicity of returns), a declaration of estimated tax shall be held and considered a return under this chapter.

Sec. 58 (f) to (h) as added by sec. 5 (a), Current Tax Payment Act 1943.

§ 39.58 (h)–1 Publicity of returns. The declaration of estimated tax constitutes, within the meaning of section 55, a return. Hence, the rules provided under that section with respect to publicity of returns are equally applicable to declarations of estimated tax. See section 55 and § 39.58–1.

§ 39.59 Statutory provisions; returns and payment of tax; payment of estimated tax.

Data of filing declaration

(i) On or before March 15, 1953. In general. The estimated tax shall be paid as follows:

(1) If the declaration is filed on or before March 15 of the taxable year, the estimated tax shall be paid in four equal installments. The first installment shall be paid at the time of the filing of the declaration, the second and third on June 15 and September 15, respectively, of the taxable year, and the fourth on January 15 of the succeeding taxable year.

(2) If the declaration is filed after March 15 and not after June 15 of the taxable year, and is not required by section 58 (d) to be filed on or before March 15 of the taxable year, the estimated tax shall be paid in three equal installments. The first installment shall be paid at the time of the filing of the declaration, the second and third on June 15 and January 15 of the succeeding taxable year.

(3) If the declaration is filed after June 15 and not after September 15 of the taxable year, and is not required by section 58 (d) to be filed on or before June 15 of the taxable year, the estimated tax shall be paid in two equal installments. The first installment shall be paid at the time of the filing of all installments of estimated tax which would have been payable on or before such date if the declaration had been filed within the time prescribed in section 58 (d), and the remaining installments shall be paid at the times at which, and in the amounts in which, they would have been payable if the declaration had been so filed.

(b) Amendments of declaration. If any amendment of a declaration is filed, the remaining installments, if any, shall be ratably reduced in proportion to the number of months by which the amendment is made after September 15 of the taxable year, any increase in the estimated tax by reason of such amendment, and if any installment is made after March 15 of the taxable year, the tax shall be determined for such number of months at the time of making such amendment.

(c) Installments paid in advance. At the election of the individual, any supplement of the estimated tax may be paid prior to the date prescribed for its payment.

(d) Payment as part of tax for taxable year. Payment of the estimated tax, or any installment thereof, shall be considered payment on account of the tax for the taxable year. Amounts so credited shall be limited to the amount paid.

Sec. 59 as amended by sec. 5 (a), Current Tax Payment Act 1943; sec. 13 (a), Individual Income Tax Act 1944.

§ 39.59–1 Payment of estimated tax—

(a) In general. (1) Section 59 (a) provides the following rules governing the payment of the estimated tax for calendar years:

Sec. 59. Payment of estimated tax—(a) In general. The estimated tax shall be paid as follows:

(1) If the declaration is filed on or before March 15 of the taxable year, the estimated tax shall be paid in four equal installments. The first installment shall be paid at the time of the filing of the declaration, the second and third on June 15 and September 15, respectively, of the taxable year, and the fourth on January 15 of the succeeding taxable year.

(2) If the declaration is filed after March 15 and not after June 15 of the taxable year, and is not required by section 58 (d) to be filed on or before March 15 of the taxable year, the estimated tax shall be paid in three equal installments. The first installment shall be paid at the time of the filing of the declaration, the second and third on June 15 and January 15 of the succeeding taxable year.

(3) If the declaration is filed after June 15 and not after September 15 of the taxable year, and is not required by section 58 (d) to be filed on or before June 15 of the taxable year, the estimated tax shall be paid in two equal installments. The first installment shall be paid at the time of the filing of all installments of estimated tax which would have been payable on or before such date if the declaration had been filed within the time prescribed in section 58 (d), and the remaining installments shall be paid at the times at which, and in the amounts in which, they would have been payable if the declaration had been so filed.

(b) Amendments of declaration. If any amendment of a declaration is filed, the remaining installments, if any, shall be ratably reduced in proportion to the number of months by which the amendment is made after September 15 of the taxable year, any increase in the estimated tax by reason of such amendment, and if any installment is made after March 15 of the taxable year, the tax shall be determined for such number of months at the time of making such amendment.

(c) Installments paid in advance. At the election of the individual, any supplement of the estimated tax may be paid prior to the date prescribed for its payment.

(d) Payment as part of tax for taxable year. Payment of the estimated tax, or any installment thereof, shall be considered payment on account of the tax for the taxable year. Amounts so credited shall be limited to the amount paid.

§ 39.59–1 Payment of estimated tax—

(a) In general. (1) Section 59 (a) provides the following rules governing the payment of the estimated tax for calendar years:

Sec. 59 as amended by sec. 5 (a), Current Tax Payment Act 1943; sec. 13 (a), Individual Income Tax Act 1944.
In three equal installments—one at time of filing declaration, one or before September 15, and one or before January 15 of the succeeding taxable year.

In two equal installments—one at time of filing declaration, and the other on or before January 15 of the succeeding taxable year.

In full at time of filing declaration.

(2) If, for example, due to the nature and amount of his gross income and has then existing marital status for 1952, the taxpayer is not required to file his declaration as of March 15, but is required to file on or before June 15, 1952, the case comes within the scope of subdivision (ii) of subparagraph (1) of this paragraph and the estimated tax is payable in full at the time of filing the declaration or, in the alternative, in three equal installments, one on the date of filing, one on or before September 15, 1952, and the third installment on or before January 15, 1953.

(3) Notwithstanding the rules set forth in subparagraph (1) of this paragraph relating to the time for payment of the estimated tax, section 59 provides that if in any case a declaration is filed after the period prescribed in section 58 (d) (including a case in which such filing is due to an extension of time granted for filing the declaration) the estimated tax shall be paid at the time of filing of such declaration, in any case where, in the absence of the declaration, there shall be paid at such time all installments of the estimated tax which would have been payable on or before such date of filing if the declaration had been timely filed in accordance with the provisions of section 58 (d) and the remaining installments shall be paid at the times and in the amounts in which they would have been payable if the declaration had been so filed. Thus, for example, A, a married man who makes his return on the calendar year basis, taxable year 1952, filed his return prior to September 15, 1952. In such case, A should have filed a declaration on or before March 15, 1953, and at the time of filing his declaration he was defficient in the payment of three installments of his estimated tax for the taxable year 1952. Hence, upon his filing the declaration on September 15, 1952, three-fourths of the estimated tax shown thereon must be paid.

(iii) In the case of a taxpayer on the fiscal year basis, that is, the taxable year ends after June 15, 1952, and a fiscal year basis is within the scope of section 59, then the estimated tax shall be paid as required at the time of filing the declaration, one or before September 15, and one or before January 15 of the succeeding taxable year.

(ii) After June 15 and before September 15 and not required to be filed on or before January 15 of the succeeding taxable year, there shall be substituted for the date prescribed for such return, the 15th day of the first month of the succeeding taxable year, and the penalties incurred. As to what constitutes income from farming within the meaning of this paragraph, see § 39.60—(a)

(b) Farmers. In the case of an individual whose estimated gross income from farming is at least two-thirds of his total gross income from all sources for the taxable year, special provisions are made with respect to the filing of the declaration, the payment of the tax, and the penalties incurred. As to what constitutes income from farming for its payment, the Secretary, after consultation with the Commissioner, may prescribe for its payment, the Secretary, after consultation with the Commissioner, may prescribe in any case in which the estimated tax is not paid in full at such time. In the case of a farmer on the fiscal year basis, the declaration may be filed on or before the 15th day of the succeeding fiscal year and the estimated tax shall be payable in full at such time. In the case of a farmer on the calendar year basis, the estimated tax shall be payable in full at such time.

(c) Short taxable years. (1) In the case of a short taxable year for which a declaration is required to be filed the estimated tax shall be paid in four equal installments, one at time of filing the declaration, one on or before June 15, the estimated tax shall be paid in four equal installments, one at time of filing the declaration, one or before September 15, and one or before January 15 of the succeeding taxable year.

(2) In the case of a short taxable year for which a declaration is required to be filed the estimated tax shall be paid in four equal installments, one at time of filing the declaration, one on or before September 15, and one or before January 15 of the succeeding taxable year.

(3) In the case of a short taxable year for which a declaration is required to be filed the estimated tax shall be paid in four equal installments, one at time of filing the declaration, one on or before September 15, and one or before January 15 of the succeeding taxable year.

(4) In the case of a short taxable year for which a declaration is required to be filed the estimated tax shall be paid in four equal installments, one at time of filing the declaration, one on or before September 15, and one or before January 15 of the succeeding taxable year.

(5) In the case of a short taxable year for which a declaration is required to be filed the estimated tax shall be paid in four equal installments, one at time of filing the declaration, one on or before September 15, and one or before January 15 of the succeeding taxable year.

§ 39.60  Farmers—(a) General rule. In the case of an individual whose estimated gross income from farming for a short taxable year is at least two-thirds of his total estimated gross income from farming for a short taxable year, in lieu of the time prescribed in section 59 (d), the declaration for the taxable year may be made at any time on or before January 15 of the succeeding taxable year; and if such an individual files a return on or before January 15 of the succeeding taxable year, and pays in full the amount computed on the return as payable, such return shall have the same effect as that prescribed in section 59 (d) (ii) in lieu of a return filed on or before January 15.

(b) Application to short taxable years. The application of sections 58 (d) and of subsection (a) of this section, to taxable years of less than twelve months shall be as prescribed in regulations prescribed by the Commissioner with the approval of the Secretary.
§ 39.60–2 Short taxable years—(a) Requirement of declaration. No declaration may be made for a period of more than one month. A separate declaration for a fractional part of a year is, therefore, required where, for example, there is a change, with the approval of the Commissioner, in the basis of the taxpayer from an annual taxable year to another taxable year. The periods to be covered by such separate declarations in the several cases are those set forth in section 47. No declaration, however, is required for a taxable year of less than three months.

If the short taxable year is a period:

(1) Of at least three months but less than six months and the requirements of section 58 (a) are first met after the 1st day of the third month, or

(2) Of at least six months but less than nine months and the requirements of section 58 (a) are first met after the 1st day of the sixth month, or

(3) Of nine months or more and the requirements of section 58 (a) are first met after the 1st day of the ninth month, no declaration is required. In the case of a declaration filed subsequent to the date of death, as to requirement for amended declaration if death of one spouse occurs after filing joint declaration, see § 39.58 (c)–1.

(b) Income placed on annual basis. For the purpose of determining whether the anticipated income for a short taxable year necessitates the filing of a declaration, such income shall be placed on an annual basis in the manner prescribed in section 47 (c) (1). Thus, for example, a taxpayer who changes from a calendar year basis to a fiscal year basis beginning July 1, 1952, will have a short taxable year beginning January 1, 1952, and ending June 30, 1952. If his anticipated gross income for such short taxable year consists solely of wages (as defined in section 1621 (a)), the amount of $3,000, his total gross income and his gross income from such wages for the purpose of determining whether a declaration is required is $6,000, the amount obtained by placing anticipated income of $3,000 upon an annual basis. Hence, assuming such taxpayer is single and has no dependents, he is required to file a declaration of estimated tax for the short taxable year since his anticipated gross income from wages when placed upon an annual basis is in excess of $8,100 ($6,000 + $2,100). Therefore, earnings from wages received during the required period of such short taxable year may satisfy the requirements as to the filing of such declaration by filing his return and paying the tax on or before the 15th day of the following month after the close of such fiscal year.

Miscellaneous Provisions

§ 39.61–64 Statutory provisions; miscellaneous provisions; laws made applicable; rules and regulations; publication of statistics; definitions.

Sec. 61. Laws made applicable. All administrative rules or any part thereof may be made generally applicable, including the law relating to the assessment of taxes, so far as applicable, shall be extended to and made a part of this chapter.

Sec. 62. Rules and regulations. The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter.

Sec. 63. Publication of statistics. The Commissioner, with the approval of the Secretary, shall prepare and publish annually reports and statistics relating to the operation of the income, war-profits and excess-profits tax laws, including classification of taxpayers and income, the amounts allowed as deductions, exemptions, and credits, and other facts deemed pertinent and valuable.

Sec. 64. Definitions. For definitions of a general character, see section 5107.

Supplement A—Rates of Tax

§ 30.101 Statutory provisions; exemptions from tax on corporations; in general.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (b) and in supplement A, corporations organized to exempt shall be exempt from taxation under this chapter.

Sec. 11. Denial of tax deductions and exemptions (Internal Security Act of 1953).

(b) No organization shall be entitled to exemption from Federal income tax under section 101 of the Internal Revenue Code, for any taxable year if at any time during such taxable year (1) such organization is registered under section 7, or (2) there is in effect a final order of the Board [the Subversive Activities Control Board] regulating such organization to register under section 7.

§ 39.101–1 Proof of exemption; annual returns—(a) Proof of exemption in general. An organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish its right to exemption, it is necessary that every organization claiming exemption file with the district director of internal revenue for the internal revenue district in which is located the principal place of business or principal office of the organization an application form as set forth below. An organization claiming exemption under section 101 (1) (a), (b), or (c) (3) (16) (10) (15) or (16) shall file the form of application appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following forms may be obtained from any district director of internal revenue: For organizations claiming exemption under sections 101 (1) (a), (b), or (c) (3) (16) (10) (15) or (16) Form 1026; under section 101 (1) (a), (b), or (c) (3) (16) (10) (15) or (16) Form 1024; under section 101 (9) Form 1025; under section 101 (10) (14) or (16) Form 1026; under section 101 (14) or (16) Form 1026A; under section 101 (16) Form 1027; and under section 101 (12) Form 1028. All other organizations claiming exemption, including bona fide credit unions, shall file an application for exemption showing the character of the organization, the purpose for which it was organized, 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 form or application shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the purposes which except the operation 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. Each such form or application shall contain or be verified by a written declaration that it is made under the penalties of perjury.
(b) Additional proof by particular classes of organizations. (1) Organizations mentioned below shall submit with and as a part of their applications the following information:

(i) Mutual insurance companies shall submit copies of the policies or certificates of membership;

(ii) In the case of holding companies claiming exemption under section 101 (14) if the organization for which this section has not been specifically notified in writing by the Commissioner 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 this section is held.

(2) In addition to the information specifically called for by this section the Commissioner may require any additional information deemed necessary for the proper determination of whether a particular organization is exempt under section 101, when due and in the interest of an efficient administration of the internal revenue laws, and when the information is required in the cases of particular types of organizations prescribe the form in which the proof of exemption shall be furnished, and the manner in which the same shall be filed.

(c) Duties of district director with respect to proof of exemption. The district director of internal revenue, upon receipt of the application and other papers constituting the proof of exemption of an organization claiming exemption from tax under section 101, will forward completed documents to the Commissioner for decision as to whether the organization is exempt.

(d) “Private shareholder or individual” defined. The words “private shareholder or individual” in section 101 refer to persons having a personal and private interest in the activities of the organization.

(e) Requirement of annual returns. Every organization exempt from tax under section 101 shall, notwithstanding the amount or source of its income or receipts and irrespective of whether it is chartered by, affiliated with, or operated and controlled by it, any or all of the amounts or sources of its income or receipts, and disbursements and the amounts of and the receipts and disbursements and such other information as may be prescribed by the Commissioner in the instructions or regulations of the organization which are exempt from tax under section 101 (6) shall be filed annually on Form 990-A (as is required from tax under section 101 (18)). Where the organization has no such established accounting period, such returns shall be on the basis of the calendar year. Religious and apostolic organizations which are exempt from tax under section 101 (18) shall annually file the return of income required under §39.101 (18)–1 on the same Form 1099 as is required from the parent or holding company Form 990. With respect to proof and establishment of right to exemption from tax which must accompany Form 990 or Form 990-A in the case of a local organization, see paragraphs (a) and (b) of this section.

(f) Group returns. A central, parent, or like organization (referred to in this section as central organization) although required to file a separate annual return, may file an annual return (as is required from tax under section 101 (18)) for two or more of the local organizations, chapters, or the like (referred to in this section as “local organizations” which are chartered by, affiliated with, or operated and controlled by, or affiliated or associated with, such central organization at the close of its annual accounting period, subject to the general supervision of, and examination by, the central organization, and exempt from tax under section 101 (18) shall annually file an annual return for itself under section 101 (6) in lieu of the filing of a separate return by each of the local organizations included in the group return. The annual return shall be made and filed, with the central organization, by each of the local organizations included in the group return. The group return shall include only those local organizations which in which writing have authorized the central organization to act for them in the group return, and which have filed, with the central organization, their statements, containing the information required by such return made under the penalties of perjury, specifically stating their items of gross income, receipts, and disbursements, and such other information relating to them which is required to be stated in the group return, and such authorizations and statements shall be permanently retained by the central organization. There shall be attached to the group return and made and filed under the penalties of perjury a schedule showing the name and address of each of the local organizations and the total amount thereof included in such return, and a schedule showing the name and address of each of the local organizations and the total amount thereof not included in the group return. The group return shall be on the basis of the central organization’s accounting period of the central organization. Where such central organization has no established annual accounting period, such return shall be on the basis of the calendar year. The same income, receipts, and disbursements of a local organization shall not be included in more than one group return. The group return shall be filed in accordance with these regulations and the instructions on Form 990 or Form 990-A issued therewith, and shall be considered the return of each of the local organizations included therein.

(2) Date for filing annual returns. The annual returns of information on Forms 990 and 990-A shall be filed on or before the fifteen day of the fifth full calendar month following the close of the period for which the return is required to be filed.

(i) Organizations not required to file annual returns. (1) Annual returns on Forms 990 and 990-A are not required to be filed by (a) any organization which has established its right to such exemption before the filing of the group return, see paragraphs (a) and (b) of this section.

(ii) It is organized and operated exclusively for religious purposes;

(iii) It is an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; or

(iv) It is a charitable organization, or an organization for the prevention of cruelty to children or animals, which is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or which is primarily supported by contributions of the general public.

(2) If Form 990 need not be filed by a fraternal benefit society, order, or association, which has established its exemption under section 101, and in lieu of the filing of a separate return by each and every organization exempt from tax under section 101 (6), if it is a corporation wholly owned by the United States or any State or political subdivision thereof, or is a wholly-owned subsidiary of such a corporation.

(3) If the organization is primarily supported by contributions of the general public on Form 990 need not be filed by a fraternal benefit society, order, or association, which has established its exemption under section 101, and in lieu of the filing of a separate return by each and every organization exempt from tax under section 101 (6), if it is a corporation wholly owned by the United States or any State or political subdivision thereof, or is a wholly-owned subsidiary of such a corporation.

§ 39 101–1
Section 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (b), and in supplement U, the following organizations shall be exempt from taxation under this chapter—

(1) Labor, agricultural, or horticultural organizations;

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt from tax under section 54 if they are required to file returns on Form 990 or Form 990-A if they are required to file such returns.

(2) An organization described in section 54.101 (1) (a)—

(a) Feeder organizations.

(b) An organization described in section 54.101 (1) (a) entitled to exemption from income tax under paragraphs (9) or (11) of section 54.101 (1) —

(c) Labor, agricultural, or horticultural organizations.

An organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him to inquire further into its status and ascertain whether or not it is exempt from tax. An organization which is required to file returns on Form 990 or Form 990-A shall immediately notify the district director of the Internal Revenue Service for the internal revenue district in which it is located its principal office of any changes in its character, operations, or purposes for which it was originally created.

(3) An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54.101 (2) (f) or (14) which are subject to tax on Supplement U net income, are also required to file returns on Form 990-T. See § 39.421-3 for requirements with respect to such returns.

§ 39.101-1 Limitations on exemptions—(a) In general. Under section 101 (1) (6) (f) or (14) which are subject to tax on Supplement U net income, or are required to file returns on Form 990-T. See § 39.421-3 for requirements with respect to such returns.

§ 39.101-2 Limitations on exemptions—(a) In general. Under section 101 (1) (6) (f) or (14) which are subject to tax on Supplement U net income, or are required to file returns on Form 990-T. See § 39.421-3 for requirements with respect to such returns.

§ 39.101-3 Statistical returns; exemptions from tax on corporations; mutual savings banks; fraternal benefit societies, orders, or associations.

§ 39.101 (1) Statistical provisions; exemptions from tax on corporations; mutual savings banks; fraternal benefit societies, orders, or associations.

§ 39.101-3 (2) (3) Exemptions from tax on corporations; mutual savings banks; fraternal benefit societies, orders, or associations.
members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members or their dependents;

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section if the gross income of all of its profits is payable to one or more organizations exempt under this section from taxation.

Notwithstanding paragraph (12) (B) and supplement U, an organization described in this section (other than Federal credit unions which are exempt under section 101 (15) without capital stock, organized and operated for mutual purposes and without profit), are exempt from tax under section 101 (4) Corporations or associations without capital stock organized before September 1, 1951, and operated for mutual purposes and without profit for the purpose of providing reserve funds for and insurance of shares or deposits in:

(a) Domestic building and loan associations as defined in section 3797 (a) (19).
(b) Cooperative banks without capital stock organized and operated for mutual purposes and without profit, or
(c) Mutual savings banks not having capital stock represented by shares, are exempt from tax under section 101 (4).

§ 39.101 (4) Statutory provisions; exemptions from tax on corporations; credit unions, etc.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from taxation under this chapter—

(1) Corporations organized and operated for mutual purposes and without profit, or
(2) That all funds not required for the payment of dividends upon or for the retirement of preferred stock shall be used by the corporation for the care and improvement of the cemetery property.

§ 39.101 (6) Statutory provisions; exemptions from tax on corporations; religious, charitable, etc. organizations.

Sec. 1 Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, an organization described in this section (other than Federal credit unions which are exempt under section 101 (15) without capital stock, organized and operated for mutual purposes and without profit), are exempt from tax under section 101 (4) Corporations or associations without capital stock organized before September 1, 1951, and operated for mutual purposes and without profit for the purpose of providing reserve funds for and insurance of shares or deposits in:

(a) Domestic building and loan associations as defined in section 3797 (a) (19).
(b) Cooperative banks without capital stock organized and operated for mutual purposes and without profit, or
(c) Mutual savings banks not having capital stock represented by shares, are exempt from tax under section 101 (4).

§ 39.101 (5) Statutory provisions; exemptions from tax on corporations; cemetery companies.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and supplement U, an organization described in this section (other than Federal credit unions which are exempt under section 101 (15) without capital stock, organized and operated for mutual purposes and without profit), are exempt from tax under section 101 (4).

§ 39.101 (6) Religious, charitable, scientific, literary, and educational organizations and community chests.

(a) In order to be exempt under section 101 (6) the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;
(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and
(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

(b) Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations which are exempt under section 101 (6) and which have been organized for the benefit of the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive volun-
tary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

(c) An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement of the commonwealth or political subdivision of the capacity 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 give lectures on subjects useful to the individual and beneficial to the community, even though an association of either class has commercial improvement features. An organization formed, or availed of, to disseminate controversial or partisan propaganda is not an educational organization within the meaning of the Code. However, if the organization is not formed, or availed of, to disseminate controversial or partisan propaganda, or otherwise attempting, to influence legislation forms no substantial part of its activities, its principal purpose and substantially all of its activities have a nonpartisan, noncontroversial, and educational nature.

(d) Since an organization exempt under section 101 (6) must be organized and operated exclusively for one or more of the specified purposes, an organization organized or operated for the primary purpose of carrying on a trade or business for profit is not exempt thereunder. The organization must be not exempt under section 101 (6) even though it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization.

§ 39.381-1

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section of the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

Notwithstanding paragraphs (12) (B) and supplement U, an organization described in this section (other than in the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

[Sec. 101 as amended by sec. 201 (b), Rev. Act 1950; sec. 314 (b), Rev. Act 1951]

§ 39.101 (c)-1 Civic leagues and local associations of employees. Civic leagues entitled to exemption under section 101 (6) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations described within section 101 (6). Certain local associations of employees are also expressly entitled to exemption under section 101 (6). The Internal Revenue Code prescribes as exempptions the conditions under which the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, or (b) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. See § 39.101 (c)-1 with reference to the meaning of "charitable" and "educational" and also to the meaning of "local" as used in section 101.

§ 39.101 (b) Statutory provisions; exemptions from tax on corporations; social clubs.

Sec. 101. Exemptions from tax on corporations.

Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from taxation under this chapter—

(1) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofit purposes, no part of the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. See § 39.101 (c)-1 and the meaning of "local" as used in section 101.

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section of the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

[Sec. 101 as amended by sec. 201 (b), Rev. Act 1950; sec. 314 (b), Rev. Act 1951]
timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

§ 39.101 (10) Statutory provisions; exemptions from tax on corporations; mutual life insurance associations and mutual or cooperative companies.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from taxation under this chapter.* * *

(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, and organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses; * * *

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations of a purely local character, mutual or cooperative telephone companies, or like organizations exempt under this section from taxation. For the purposes of this paragraph the term "trade or business" shall not include the rental of an organization of its real property (including personal property leased with the real property).

Notwithstanding paragraph (12) (B) and in supplement U, an organization described in this section (other than in the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

§ 39.101 (11) Mutual insurance companies or associations. An insurance company is exempt from taxation under chapter 1 of the Internal Revenue Code if it is a mutual company or association (other than life or marine) or an insurer or reciprocal writer, and if the amount of its earnings during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000.

§ 39.101 (12) Statutory provisions; exemptions from tax on corporations; cooperative farmers' fruit growers' etc., associations.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from taxation under this chapter.* * *

(12) (A) Farmers' fruit growers' or like associations, and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over to them at less than the actual cost, plus necessary expenses. Exemption shall not be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

Notwithstanding paragraph (12) (B) and in supplement U, an organization described in

§ 39.101 (10)
this section (other than in the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law applicable to organizations exempt from income taxes.

[Sec. 101 as amended by sec. 301 (b), Rev. Act 1950; sec. 314 (a) (6), Rev. Act 1951]

§ 39.101 (12)–1 Farmers' cooperative marketing and purchasing associations; requirements for, exemptions from, and use of section 101 (12) (A) (a) (1) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning over the proceeds of the sales of such products, less necessary operating expenses, on a cooperative basis in the manner prescribed by the association, to purchasing associations exempt under section 101 (12) (A) will be required to show that the association is eligible for exemption under the provisions of this Act. An association which purchases supplies and equipment through the association. Any ownership of stock by others than actual producers must be satisfactorily explained in the association's application for exemption. The term "necessary expenses" will be defined and the methods of determining the fairness of the expenses will be explained in the association's application for exemption.

(b) The provisions of paragraph (a) of this section relating to a reserve or surplus dividend, or a dividend, or the sale of products on a cooperative basis in the manner prescribed by the association, to purchasing associations exempt under section 101 (12) (A) will be required to show that the association is eligible for exemption under the provisions of this Act. An association which purchases supplies and equipment through the association. Any ownership of stock by others than actual producers must be satisfactorily explained in the association's application for exemption. The term "necessary expenses" will be defined and the methods of determining the fairness of the expenses will be explained in the association's application for exemption.

(c) In order to be exempt under either paragraph (a) or (b) of this section, the 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) of this section. An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the Internal Revenue Code. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under section 101 (12) and thus an association to be eligible for exemption must not be organized but actually operated in the manner and for the purposes specified in section 101 (12) (A).

(d) Cooperative organizations engaged in occupations dissimilar to those of farmers, fruit growers, and the like, such as marketing building materials, are not exempt. See § 39.101 (12)–4 Tax treatment of farmers' cooperative marketing and purchasing associations exempt under section 101 (12) (A) (a) In general. (1) Section 101 (12) (B) is applicable to farmers' fruit growers' or like associations organized and operated on a cooperative basis in the manner prescribed in section 101 (12) (A). Although such an association is subject to both normal and surtax, as in the case of corporations generally, certain special rules for the computation of net income are provided in section 101 (12) (B) and § 39.101 (12)–3. (2) Rules governing the manner in which amounts allocated as patronage dividends, refunds, or rebates are to be taken into account in computing the net income of such an association are set forth in § 39.101 (12)–4. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, rebates, or refunds, see § 39.22 (a)–23.

(b) Meaning of terms. For purposes of §§ 39.101 (12)–2 to 39.101 (12)–4, inclusive, §§ 39.148 (O)–1, and 39.22 (a)–23, the following terms shall have the meaning ascribed below:

§ 39.101 (12)–2...
Cooperative association. The term "cooperative association" includes any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons, except that the term does not include any cooperative or nonprofit corporation (including any cooperative or nonprofit corporation engaged in grain or elevator operations) exempt from taxation under section 101 (10) or (11) or any corporation subject to a tax imposed by Supplement G relating to insurance companies.

Patron. The term "patron" includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association, and whether an individual, a trust, estate, partnership, company corporation, or cooperative association.

Allocation. The term "allocation" includes distributions made by a cooperative association to a patron in cash, merchandise, capital stock, revolving fund certificates, retain certificates, letters of advice, or other similar documents, or on other similar basis for the account of any such patron. For a patron, a mere credit to the account of a patron on the books of the cooperative associations, without disclosure to the patron, is not an allocation.

Patronage dividends, rebates, and refunds. The term "patronage dividend, rebate, or refund" includes any amount allocated by a cooperative association, to the account of a patron on the basis of the business done with or for such patron. The following are not patronage dividends, rebates, or refunds:

(a) Amounts distributed in redemption of capital stock, or in redemption or satisfaction of certificates of indebtedness, revolving fund certificates, retain certificates, letters of advice, or other similar documents.
(b) Amounts allocated as patronage dividends, rebates, or refunds.
(c) Amounts allocated on the basis of the business done with or for such patron in cash, merchandise, capital stock, revolving fund certificates, retain certificates, letters of advice, or of other similar nature, advances to patrons, and allocations to such products.

Manner of taxation of cooperative associations subject to section 101 (12). Manner of taxation of cooperative associations subject to section 101 (12).—

§ 39.101 (12)–3 Manner of taxation of cooperative associations subject to section 101 (12).

The term "earnings" includes the excess of its receipts over the sum of its expenses and its pre- vious allocations to individuals for W in an additional 3 cents per unit and shares of the capital stock of A having an aggregate face value calculated at the rate of 2 cents per unit.

The amount of patronage dividends, rebates, or refunds allocated to Y for 1953—

Example (2). Cooperative B, a marketing association operating on a pooling basis, receives the products of patron X on March 5, 1952, pays X $2.00, and the market price of the product when received, and issues to him a certificate having no face value but which entitles X to the close of the pool to the proceeds derived from the sale of his products less the previous payment of $1.00 and the expenses and other charges attributable to such products. On May 15, 1955, Cooperative B, having sold the products in the pool, having deducted the previous payments for such products, the determinations of the expenses and other charges of the pool, redeems the participation certificate of X in cash for 10 cents per unit. The allocation made by Cooperative B during 1955, amounting to 10 cents per unit, is a patronage dividend, rebate, or refund. Neither the payment to X in 1952 nor the redemption of the participation certificate of X in cash for 10 cents per unit is a patronage dividend, rebate, or refund. The amount of patronage dividends, rebates, or refunds allocated to Y for 1953 is $2.00, the aggregate of the cash distribution of $1.00, and the face amount, $1.00, of the revolving fund certificate.

Example (3). Cooperative C, a purchasing association, obtains supplies for patron Y on May 1, 1953, and returns therefor $100. On February 1, 1954, Cooperative C, having determined the excess of its receipts over its costs and expenses, allocates to Y a 10 cents per unit for such product. On May 15, 1955, Cooperative C, having determined the excess of its receipts over its costs and expenses, allocates to Y the aggregate of the cash distribution of $1.00, and the face amount, $1.00, of the revolving fund certificate.

Example (4). Cooperative D, a service association, sells the products of members on a fee basis. It receives the products of patron Z under an agreement not to sell his products with those of other members, to sell his products, and to deliver to him the proceeds of the sale. Patron Z makes payments to Cooperative D during 1952 aggregating $75 for service rendered him by Cooperative D during the year ending June 30, 1953. Cooperative D, having determined the excess of its receipts over its costs and expenses, allocates to Z the aggregate of the cash distribution of $2.00. Such amounts include the remaining dividends, rebate, or refund allocated by Cooperative D during 1955.
It may have utilized such method for accounting purposes for taxable years beginning prior to January 1, 1952.

(3) The following provisions shall be applicable in computing, under section 122, the net operating loss deduction provided in section 28 (e). No net operating loss carry-back or carry-over shall be allowed from a taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101 (12). In the case of a taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101 (12) and of a taxable year beginning after December 31, 1951, the amount of the net operating loss carry-back or carry-over from such year shall not be reduced by reference to the income of any taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101 (12) However, in determining preceding taxable years and succeeding taxable years under section 128 (b) a taxable year beginning after December 31, 1951, for which the cooperative association was exempt from tax under section 101 (12) shall be taken into account and shall be considered to be a "preceding taxable year" or "succeeding taxable year," as the case may be.

(4) The adjustments to the cost or other basis provided in sections 113 (b) and §§ 39.113 (b) (1) (1) (1) (2) (3) (4) are, inapplicable, and applicable for the entire period since the acquisition of the property. Thus, proper adjustment to basis must be made under section 113 (b) (1) (B) for depreciation, obsolescence, amortization and depletion for all taxable years beginning prior to January 1, 1952, although the cooperative association was exempt from tax under section 101 (12) for such years. However, the provisions of section 114 (b) (relating to percentage and discovery depletion) are applicable only for such years during which the association was not exempt from tax under section 101 (12) and such provision is applicable only to the taxable year in which the adjustment is made. The amendment is computed. For further rules as to the method of accounting upon the basis of which the adjustment is made and for further rules as to the method of accounting upon the basis of which the adjustment is made, see § 39.27 (b) (2).

(5) In the case of a mortgage acquired at a premium where the principal of such mortgage is payable in installments, the premium must be made for all taxable years (whether or not the association was exempt from tax under section 101 (12) during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payment specified in the mortgage of such association. For the purpose of this adjustment, the term "premium" includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage includes the cost including buying commissions, attorneys' fees or brokerage fees, but such value does not include amounts paid for advertising, legal, accounting, or other services.

(6) The cooperative association may select either of the alternative methods for treating bad debts provided in § 39.23 (d) (1) (a) in the return for its first taxable year beginning prior to January 1, 1952, and the method selected shall be subject to the approval of the Commissioner upon examination of the return. Any change in the method so selected shall be made only with the consent of the Commissioner. There is allowable as a deduction from income not derived from patronage income relevant to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, from the sale or exchange of capital assets, constitutes income not derived from patronage. Business done with the United States shall constitute income not derived from patronage. In that order that the deduction for income not derived from patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable. Thus, if capital gains are realized from the sale or exchange of capital assets held for a period of more than one taxable year income realized from such gains must be allocated, in proportion insofar as is practicable, to the patrons of the taxable years during which the asset was owned by the association, and to the patrons of business done by such patrons during such taxable years.

§ 39.101 (12)–4 Patronage dividends, rebates, or refunds: treatment as to cooperative associations entitled to tax treatment under section 122 (a) General rule. Patronage dividends, rebates, or refunds, allocated by a cooperative association entitled to tax treatment under section 101 (12) (b) to a patron shall be taken into account in computing the gross income of such association for the taxable year, as an increase in its other cost of goods sold in the case of an association marketing...
products for patrons, or as a reduction in its gross receipts, in the case of an association purchasing supplies and equipment or performing services for patrons, as the case may be.

(1) The allocation is made in fulfillment and satisfaction of a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated, and

(2) The allocation is made on or before the 15th day of the month following the taxable year in which the amounts allocated were received by the cooperative association.

For the purpose of subparagraph (1) of this paragraph, amounts allocated by a cooperative association entitled to tax treatment under section 101 (12) (B) will be deemed allocated in fulfillment and satisfaction of a valid enforceable obligation, if made pursuant to provisions of the by-laws, articles of incorporation, or other contract, whereby the association is obligated to make such allocation after the retention of "reasonable reserves" and after payment of dividends on capital stock or other proprietary capital interests. Notwithstanding the provisions of subparagraphs (1) and (2) of this paragraph, amounts allocated as patronage dividends, rebates, or refunds to patrons of 1952, 1953, or 1954, for any such corporation because it has capital stock, if the dividend, rate of such stock is less than the amount of business done by such patrons during the taxable year or years in which the retained amounts were received by the cooperative association.

(b) Illustrations

Example (1), E, a cooperative association entitled to tax treatment under section 101 (12) (B), organized without capital stock, is engaged in the business of marketing products for its patrons on a non-pool basis.

The by-laws of cooperative E provide that there shall be allocated to patrons as patronage dividends within a reasonable time following the close of the year all of the gross returns from sales, less expenses of operation for the year and amounts retained as "reasonable reserves" necessary to the operation of cooperative E. At the close of the taxable year, 1952, it is determined that from the gross returns from sales less operating expenses and all taxes for such year, $5,000 is to be retained as reserves. The remaining $10,000 is allocated in "retain certificates" bearing no interest and redeemable in the discretion of the Board of Directors of cooperative E.

There may be added to the cost of goods sold by cooperative E for 1952, $200,000 ($100,000 in cash, $100,000 in retain certificates), the total amount allocated as patronage dividends, rebates or refunds in fulfillment and satisfaction of the by-laws, on March 1, 1953, before the 15th day of the month following the determination of such amounts, and $5,000, the amount retained as reserves apportioned on the books, but not allocated as patronage dividends, rebates, or refunds.

Example (2). The facts are the same as Example 1, it additionally appearing that at the close of 1953 it is determined by Cooperative E to allocate as cash patronage dividends, rebates, or refunds to patrons of 1952, 1953, and 1954, for any such corporation because it has capital stock, if the dividend, rate of such stock is less than the amount of business done by such patrons during the taxable year or years in which the retained amounts were received by the cooperative association.

§ 39.101 (13) Statutory provisions; exemptions from tax on corporations; corporations organized to finance crop operations.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from tax under this chapter:—

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount, or any part thereof, to an organization which itself is exempt from the tax imposed by this chapter;—

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

Notwithstanding paragraph (12) (B) and supplement U, an organization described in this section (other than the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

§ 39.101 (14) Corporations organized to hold title to property for exempt organizations.

(a) A corporation otherwise exempt from tax under section 101 (14) is taxable upon its Supplement U net income if the income is payable to an organization which is itself subject to the tax imposed by Supplement U or if the income is payable to a church or to a convention or association of churches. See sections 421 to 424, inclusive, and the regulations thereunder.

Since a corporation to be exempt under section 101 (14) must not engage in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business net income as defined in section 423 (a) other than Supplement U rental income described in section 423.

An organization exempt under section 101 (14) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization.

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which is itself exempt from tax under chapter 1 of the Internal Revenue Code.

§ 39.101 (15)—(18) Statutory provisions; exemptions from tax on corporations; instrumentalities of the United States; charitable associations; teachers' retirement fund associations; religious or apostolic organizations.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from taxation under 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 association 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) no part of their gross income consists of amounts collected from members and amounts contributed to the association by the employer of the members for the sole purpose of making such payments and meeting expenses;

(17) Teachers' or employee retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts assessed upon the teaching salaries of members, and income in respect of investment;

(18) Religious or apostolic associations or corporations, if such associations or corporations 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 includes, at the time of filing his return, in his gross income his entire pro-rata share, whether distributed or not, of the net income of the association or corporation for the taxable year of the association or corporation ending with or including the taxable year of his member; Any amount so included in the gross income of a member shall be treated as a dividend received.

(b) Every association or corporation claiming exemption as a religious or apostolic association or corporation under the provisions of section 101 (18) and this section shall make for each taxable year a return on Form 1065 stating specifically the items of its gross income and deductions, and its net income, and there shall be attached to the return as a part thereof a statement showing the name and address of each member of the association or corporation and the amount of his distributive share of the net income of the association or corporation for the taxable year of any member if different from the taxable year of the association or corporation, the distributive share of the net income of the association or corporation for the taxable year of any member for his taxable year shall be based upon the net income of the association or corporation for the taxable year of the association or corporation ending with or including the taxable year of such member.

§ 39.101 (19) Statutory provisions; exemptions from tax on corporations; employee benefit associations.

Sec. 101. Exemptions from tax on corporations. Except as provided in paragraph (12) (B) and in supplement U, the following organizations shall be exempt from taxation under this chapter:

(19) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members or their designated beneficiaries, if (A) admission to membership in such association or corporation is limited to employees of the United States Government, and (B) no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under this section from taxation.

For the purposes of this paragraph the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

Notwithstanding paragraph (12) (B) and supplement U, the provisions of this section (other than in the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

§ 39.101 (18)—1 Religious or apostolic associations or corporations. (a) Religious or apostolic associations or corporations are exempt from taxation under chapter 1 of the Internal Revenue Code if they have a common treasury or community treasury, even though

Sec. 102. Surtax on corporations improperly accumulating surplus.—(a) Imposition of surtax. Such a tax shall be by the amount paid for any corporation (other than a personal holding company) for the taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company) for the taxable year ending with or including the taxable year of such corporation if the corporation, in such year or in any other corporation, through the medium of permitting earnings or profits to accumulate, improperly accumulates a surplus that, if it were distributed, would be taxable; and if it is, formed and offered of the purpose of preventing the imposition of the surtax upon shareholders, if (A) any corporation, through the medium of permitting earnings or profits to accumulate, improperly accumulates a surplus that, if it were distributed, a surtax equal to the sum of:

3% per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

3% per centum of the undistributed section 102 net income in excess of $100,000.

(b) Prima facie evidence. The fact that any corporation is a mere holding or investment company shall be prima facie evidence of a purpose to avoid surtax upon shareholders.

(c) Evidence determinative of purpose. The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business of the corporation shall be prima facie evidence of a purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shows that it is not for such purpose.

(d) Definitions. As used in this chapter—

Section 102 net income. The term "section 102 net income" means the net income, computed without the benefit of the capital losses (other than those of a carry-over provided in section 117 (e) from a taxable year which begins after December 31, 1940), and computed without the net operating loss deduction provided in section 23 (c), minus the taxes imposed by this chapter.

(A) Taxes. Federal income, war-profits, and excess-profits taxes (other than the tax imposed by Subchapter B of Chapter 2 for a taxable year beginning after December 31, 1940) paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

(B) Disallowed charitable, etc., contributions. Contributions, gifts payment of which is made within the taxable year, not allowed as a deduction under section 170 (b) (1) (A) (ii), or section 172, or section 173 (a), or section 23 (e) (2) (C) (ii), if the use of donees described in section 23 (o), for the purposes therein specified. For the purpose of this section, the proceeds of any contribution or gift shall be considered as made within the taxable year if and only if it is considered for the purposes of section 23 (q) as made within such year.

(C) Disallowed losses. Losses from sales or exchanges of capital assets which are disallowed as a deduction by section 117 (d).

(D) Long-term capital gains. The excess of the net long-term capital gain for the taxable year over the net short-term capital losses for such year, minus the taxes imposed by this chapter.

The tax attributable to such excess shall be an amount equal to the difference between (1) the taxes attributable to such excess (except the tax imposed by this section) for such year and (ii) such taxes computed for such year without including such excess in net income.

(2) Undistributed section 102 net income. The term "undistributed section 102 net income" means the section 102 net income minus the basic capital credit provided in section 27 (b), but the capital credit under section 27 (b) (1) shall be made without its reduction by the amount of the credit provided in section 29 (a), re-
§ 39.102-1 Taxation of corporation formed or utilized for avoidance of surtax. (a) Section 102 imposes (in addition to other taxes imposed by chapter 1 of the Internal Revenue Code) a graduated income tax or surtax upon any domestic or foreign corporation formed or availed of to avoid the imposition of the individual surtax upon its shareholders or to induce the shareholders of any existing corporation through the medium of permitting earnings or profits to accumulate instead of dividing or distributing them. Resident alien shareholders or nonresident personal holding companies, as defined in sections 501 and 631, and foreign personal holding companies, as defined in Supplement P (see section 331) are excepted from taxation under section 102. The surtax imposed by section 102 applies whether the avoidance was accomplished through the formation or use of only one corporation or a chain of corporations. For example, if the capital 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 preventing the imposition of the individual surtax upon the individual shareholders of the N Corporation. (b) A foreign corporation, whether resident or nonresident, formed or availed of for the purpose specified in section 102 is subject to the tax imposed thereby if it derives income from sources within 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 (b) or section 211 (c) would be subject to the surtax with respect to distributions of the corporation which if made would constitute income from sources within the United States (see section 119) or (2) foreign corporations if any beneficial interest therein is owned directly or indirectly by any shareholder specified in (1) or (2). On the other hand, the tax imposed by section 102 will not apply even toward a foreign corporation, whether resident or nonresident derived income from sources within the United States, if all of its shareholders are nonresident alien individuals who, by the application of section 211 (a) would not be subject to surtax with respect to distributions of the corporation if made. (c) For the computation of the surtax, see § 39.102-4.

§ 39.102-2 Purpose to avoid surtax; evidence; burden of proof; definition of holding or investment company. (a) The Commissioner's determination that a corporation was formed or availed of for the purpose of avoiding the individual surtax is subject to the burden of proof by competent evidence. The existence or non-existence of the purpose may be indicated by circumstances other than the evidence specified in the Internal Revenue Code, and whether or not such purpose was present depends upon the particular circumstances of each case. In other words, a corporation is subject to taxation under section 102 if it is formed or availed of for the purpose of preventing the imposition of the surtax upon shareholders through the medium of permitting earnings or profits to accumulate, even though the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits; and the evidence shall be such as was such an accumulation is not absolutely conclusive against it if, by clear and convincing evidence, the taxpayer satisfies the Commissioner that the corporation was not formed or availed of for the purpose of avoiding the individual surtax. All the other circumstances which might be construed as evidence of the purpose cannot be outlined, but among other things the following will be considered: (1) Dealings between the corporation and its shareholders, such as withdrawals by the shareholders as personal loans or the expenditure of funds by the corporation for the personal benefit of the shareholders, and (2) the investment of earnings or profits in the corporation. The nature of the business; the financial condition of the corporation at the close of the taxable year, the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the business if the purpose is not to prevent the imposition of the surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated to serve no purpose other than the avoidance of the surtax. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in such a manner as to reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the corporation.

(b) The business of a corporation is not merely that which it has previously carried on, but includes in general 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 one corporation is a mere holding or investment company, then the Internal Revenue Code places further weight to the presumption of correctness already arising from the Commissioner's determination by expressly providing an additional presumption of the existence of a purpose to avoid surtax upon shareholders, while the other corporations or personal holding companies are subject to the surtax with respect to distributions of the corporation if made in excess of the reasonable needs of the business, then the Code adds still more weight to the Commissioner's determination by providing that irrespective of the nature of the corporation, whether it is a mere holding or investment company, the existence of such an accumulation is determinative of the purpose to avoid surtax upon shareholders unless the taxpayer proves the contrary by such a clear preponderance of all the evidence that the absence of such a purpose is unmistakable.

(c) A corporation having practically no activities except holding property, and collecting the income therefrom or investing therein, shall be considered a holding company within the meaning of section 102 if the activities are undertaken for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the business if the purpose is not to prevent the imposition of the surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated to serve no purpose other than the avoidance of the surtax. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in such a manner as to reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the corporation.

§ 39.102-3 Unreasonable accumulation of profits. (a) An accumulation of earnings or profits (including the undistributed earnings or profits of prior years) is unreasonable if it is not needed or is not reasonably required for the purposes of the business. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in such a manner as to reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the corporation.

(b) The business of a corporation is not merely that which it has previously carried on, but includes in general 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 one corporation is a mere holding or investment company, then the Internal Revenue Code places further weight to the presumption of correctness already arising from the Commissioner's determination by expressly providing an additional presumption of the existence of a purpose to avoid surtax upon shareholders, while the other corporations or personal holding companies are subject to the surtax with respect to distributions of the corporation if made in excess of the reasonable needs of the business, then the Code adds still more weight to the Commissioner's determination by providing that irrespective of the nature of the corporation, whether it is a mere holding or investment company, the existence of such an accumulation is determinative of the purpose to avoid surtax upon shareholders unless the taxpayer proves the contrary by such a clear preponderance of all the evidence that the absence of such a purpose is unmistakable.

(c) A corporation having practically no activities except holding property, and collecting the income therefrom or investing therein, shall be considered a holding company within the meaning of section 102 if the activities are undertaken for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the business if the purpose is not to prevent the imposition of the surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated to serve no purpose other than the avoidance of the surtax. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in such a manner as to reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonable needs of the corporation.
§ 39.102–4 Computation of undistributed section 102 net income. (a) In ascertaining the tax basis for corporations subject to the provisions of section 102, the "section 102 net income" is first computed. For this purpose, whenever in the case of a domestic corporation by subtracting from the corporate net income (as defined in sections 21 and 204) computed without the benefit of deductions enumerated in subparagraphs (1), (2), (3) and (4) of this paragraph, or any other deductions. See section 233. In the case of a taxable year of less than twelve months, the net income for 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 multiplied by the annual basis under the provisions of section 47 (c).

(b) 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 22 (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 District of Columbia or of the possessions of the United States.

(c) In determining "section 102 net income," section 117 (b) (2) in the case of coal, shall have no application. See § 39.117 (c)–1 (c).

(d) The "undistributed section 102 net income" is computed by subtracting from the "section 102 net income" the amount of the basic surtax credit provided in section 27 (b). In computing the basic surtax 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 for section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

§ 39.102–104 Statutory provisions; tax on citizens and corporations of certain foreign countries; banks and trust companies.

Sec. 103. Rates of tax on citizens and corporations of certain foreign countries. Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President, in his discretion, and the rates of tax imposed by sections 11, 12, 13, 14, 201 (a), 204 (a), 207, 211 (a), 212, 230 (a), 231, 232, 233, 234, 235, 236, and 237, as the case may be, in no case shall this section operate to exceed an amount of 20 per centum of the net long-term capital gain for such year in net income, for each taxable year thereafter, be doubled in the case of each citizen or corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by section 103. (See Rev. Act 130, 211 (a), 231 (a), 232, and 233, as the case may be.) In no case shall this section operate to exceed in any such case of a foreign corporation, whether resident or nonresident, which files or causes to be filed a return, the "section 102 net income" means the net income includable within the income tax imposed and determined for such year and the rates of tax imposed by such sections (computed without regard to this section) to an amount in excess of 20 per centum of the net income of the taxpayer. Whereupon 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 as amended by sec. 103 (b) (1), 172 (c), Rev. Act 1942; sec. 6 (b) (3), Individual Income Tax Act 1944.

Sec. 105. Banks and trust companies.—(a) As used in this section, "bank" means a bank or trust company incorporated and doing business under the laws of the United States, or a national bank, or a bank, foreign corporation, whether resident or nonresident, which files or causes to be filed a return. The "undistributed section 102 net income" means the net income includable within the income tax imposed and determined for such year and the rates of tax imposed by such sections (computed without regard to this section) to an amount in excess of 20 per centum of the net income of the taxpayer. Whereupon 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. See sections 102 as amended by sec. 103 (b) (1), 172 (c), Rev. Act 1942; sec. 6 (b) (3), Individual Income Tax Act 1944.

Sec. 106. Mutual savings banks, building and loan associations, and cooperative banks. (a) Mutual savings banks, building and loan associations, and cooperative banks not having capital stock represented by shares are subject to both normal tax and surtax as in the case of other corporations. Such institutions are, however, not subject to the alternative tax as computed under section 104 (b) (1) (c) of the Federal Reserve Act, 38 Stat. 203 (U. S. C. Title 12, section 2482), as amended, and which is subject to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

(b) Rate of tax. Banks shall be subject to tax under section 13 or section 14 (b), and under section 15.

Sec. 107. Mutual savings banks, building and loan associations, and cooperative banks. (a) Mutual savings banks, building and loan associations, and cooperative banks not having capital stock represented by shares are subject to both normal tax and surtax as in the case of other corporations. Such institutions are, however, not subject to the alternative tax as computed under section 104 (b) (1) (c) of the Federal Reserve Act, 38 Stat. 203 (U. S. C. Title 12, section 2482), as amended, and which is subject to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

§ 39.104–2
§ 39.105 Statutory provisions; sale of oil or gas properties.

Sec. 105. Claims against United States involving acquisition of property. In the case of amounts (other than interest) received by a taxpayer from the United States with respect to an interest in the United States involving the acquisition of property and remaining unpaid for more than fifteen years, the portion of the tax imposed by section 12 attributable to such receipt shall not exceed 30 per centum of the selling price of such property or interest.

§ 39.105–1 Surtax on sale of oil or gas properties. (a) If the taxpayer, by prospecting and locating claims or by exploring or discovering undeveloped claims, has demonstrated the economic 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 interest thereon shall not exceed 30 percent of the selling price. Shares of stock in a corporation owning oil or gas property do not constitute an interest in such property. To determine the application of section 105 to a particular case, the taxpayer should first compute the surtax imposed by section 12 upon his entire surtax net income, including the net income from such property or interest thereon, without regard to section 105. The proportion of the surtax, so computed, indicated by the ratio which the amount which is from the sale of the property or interest thereon, computed as prescribed in this section, bears to his total surtax net income is the portion of the surtax attributable to such sale. Such proportion shall be reduced to that amount.

(b) In determining the portion of the net income attributable to the sale of such oil or gas property or interest thereon, the taxpayer shall allocate to 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 general expenses, losses, and deductions which cannot properly be otherwise charged against the cash sale of such property or interest therein, less the deduction therefor, computed as prescribed in this section, bears to his total net income is the portion of the surtax attributable to the gross income 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 general expenses, losses, and deductions which cannot properly be otherwise charged against the cash sale of such property or interest therein, less the deduction therefor.

(c) Any deduction, loss, or other expense which under section 1251, bears to his total gross income is the portion of the surtax attributable to the gross income 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 general expenses, losses, and deductions which cannot properly be otherwise charged against the cash sale of such property or interest therein.

(d) Back pay—(1) In general. If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 per centum of the gross income of the individual for such taxable year, the amount of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the taxes attributable to such part of the period preceding the close of the taxable year but not more than thirty-six calendar months.

(2) Definition of back pay. 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.

(3) Determination of back pay. For the purposes of this section the amount of back pay received or accrued by an individual shall be determined by the Commissioner with the approval of the Secretary.
ployer and which would have been paid prior to the taxable year except for the intervention of one of the following events: (a) bankruptcy or receivership of the employer; (ii) dispute as to the liability of the employer to pay such remuneration, which is determined after the amount of contested compensation is determined; (iii) if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or (iv) any other event determined to be similar in nature under regulations prescribed by the Commissioner. [Secs. 119, 208 (d) (5), Social Security Act Amendments 1959]

The method of allocating compensation for personal services to the calendar months in which falls any of the calendar months included within 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 period of service, may be illustrated by the following examples, in each of which the taxpayer makes his return on the cash receipts and disbursements basis:

Example (1). On November 1, 1952, A, an individual who makes his income tax returns on a calendar year basis, receives $12,000, the entire compensation for the current calendar year, for services rendered during a 40-month period beginning on June 1, 1949, and ending on September 30, 1952. For the purpose of determining the aggregate of the taxes attributable to the $12,000 compensation, it had been received in equal portions in each of the calendar months included within the period of service which preceded the date such compensation is received or accrued, and multiplied by the number of such calendar months included within the period of service, which precedes the date such compensation is received (in this case the entire period of service), is less than the tax attributable to such compensation in the taxable year 1953.

Example (2). Assumes the same facts as in example (1) except that the tax returns on the basis of the fiscal year July 1 to June 30. The $6,000 is allocated as follows: $1,000 to the taxable year ending June 30, 1949, $12,000 each to the taxable years ending June 30, 1950, June 30, 1951, and June 30, 1952, and $3,000 to the taxable year ending June 30, 1953 (the current taxable year).

Example (3). Assumes the same facts as in example (1) except that the tax returns on the basis of the fiscal year July 1 to June 30. The $4,000 is allocated as follows: $1,000 to the taxable year ending June 30, 1949, $12,000 each to the taxable years ending June 30, 1950, June 30, 1951, and June 30, 1952, and $3,000 to the taxable year ending June 30, 1953 (the current taxable year).
$34,000 payment must be allocated to the rent taxable year). Using the method
within the entire period of service. Accord-
allocated to the 40 calendar months included
in the current taxable year)., $24,000 to
$12,000 to $34,000 payment is allocated to
the date such payment is received (March
1952,
1951,
1950,
1949, and completes them on December 31,
1951. On December 31, 1951, he receives
$69,000 in full compensation therefor.
In his return for the calendar year
1951, he allocates $1,000 to each of the 60
calendar months included within the
period of service and determines his
income tax under the provisions of
section 107 (a). He also commences the
performance of personal services for B on
January 1, 1949, and completes them on
December 31, 1952. On December
31, 1952, he receives $48,000 in full com-
mand is to be disregarded unless
it amounts to more than half a month,
in which case it is to be con-
sidered as a month. (c) The first step in determining
whether the limitation in section 107 (b)
relative to the amount of tax is appli-
cable is the computation of the amount
of tax in the current taxable year attrib-
utable to the gross income received or
accrued in such year from the artistic
work or invention. The tax attribut-
able to such income is the difference be-
tween the tax for such taxable year com-
puted with the inclusion in gross income
of the gross income from the artistic work
or invention and the tax for such year
computed in accordance with paragraph
(b) of this section. The tax attributable to the gross income from the artistic
work or invention is the sum of the taxes
attributable to gross income from the
artistic work or invention in each of the
calendar months in which falls any of the
calendar months (not exceeding 36 calendar
months) included within the part of the
period of work which precedes the close of
the current taxable year, and multiplied by the
fraction of one month in any such month.
(d) The tax for the current taxable
year shall be for such year, computed
without including in gross income the
income from the artistic work or inven-
tion, plus whichever of the fol-
lowering examples:
Example (1). On October 1, 1952, A,
individual, who makes his returns on a cal-
endar year basis and on the basis of cash
receipts and disbursements, receives $30,000
in full payment for a musical composition,
the work on which was commenced by A on
July 10, 1948, and completed on January
29, 1953. Although the period of work cov-
ered 56 calendar months, allocations may
be made to only the last 36 calendar months
included within the part of the period of work
which precedes the close of 1953 (the current
taxable year). Therefore, $18,000 (before
allocated by 36) must be allocated to each of
the 36 calendar months preceding January
1, 1953. Accordingly, $12,000 is allocated to
1950, $12,000 to 1951, and $12,000 to 1952 (the current
taxable year).
§ 39.107-3 Back pay attributable to prior taxable years. (a) Section 107 (d) (2) defines “back pay” and section 107 (d) (3) defines “back pay in gross income for any taxable year to which back pay is attributable.” (b) An event will be considered similar in nature to the events specified in section 107 (d) (2) (A) i) ii) and iii) only if the circumstances are unusual if they are of the type specified therein if they operate to defer payment or the renumeration for the services performed, and if payment for such circumstances, would have been made prior to the taxable year in which it was paid or accrued. If the services were paid $12,000 remuneration paid in the current year in accordance with the usual practice or custom of the employer even though received in respect of services performed in a prior year or years, additional compensation or any amount which is not includable in gross income under chapter 1 of the Internal Revenue Code. The term “back pay” also embraces retroactive wage or salary increases received or accrued in respect of services performed by an employee for his employer in a prior taxable year which have been ordered, recommended, or approved, and may be disallowed by the Federal or State agency such as, not limited to, the Wage Stabilization, the Labor Stabilization Board, and boards authorized by the Railway Labor Act (45 U. S. C. 151 et seq.) or collective bargaining agreements, parties to the and State courts; payments made as a result of alleged violations of sections 6 and 7 of the Labor Standards Act of 1938 (29 U. S. C. 206, 207) and made retroactive to any period prior to the taxable year and payments which are received or accrued during the taxable year arising out of an alleged violation by an employer of any State or Federal law relating to labor standards or practices, such payments received to effectuate the policies of the National Labor Relations Act (29 U. S. C. 151 et seq.) and any such back pay is attributable and, if such back pay is attributable and, if such back pay is attributable to each of such taxable years, the following rules will be applicable: (1) Back pay, as defined under section 107 (d) (2) (A), shall be deemed to be attributable to a particular taxable year in the amount and to the extent that it would have been paid in such year except for the intervention of one of the circumstances in accordance with the applicable rule prescribed in subparagraph (1) (2), or (3) of this paragraph. (2) Back pay, as defined under section 107 (d) (2) (B), shall be deemed to be attributable to a particular taxable year in the amount and to the extent that it would have been paid in such year had he included in gross income. The tax for the current taxable year is smaller than the tax which he would have paid for the taxable year in which such back pay is attributable and, if such back pay is attributable in gross income. (3) Back pay, as defined under section 107 (d) (2) (C), shall be deemed to be attributable to a particular taxable year in the amount and to the extent that it represents payments in respect of the alleged violation described in section 107 (d) (2) (C) which occurred in such year or which continued during any part of such year. (4) In those cases where a computation has been made by, or under the direction of, a Federal or State agency (including any Federal or State court) under which the back pay is awarded, which indicates that particular portions of such back pay are attributable to certain definite periods of time, such computation shall be accepted as the appropriate apportionment for the purposes of this section. (5) Where no computation has been made as provided in subparagraph (4) of this paragraph, and where the apportionment cannot be accurately made upon consideration of all the attendant circumstances in accordance with the applicable rule prescribed in subparagraph (1) (2), or (3) of this paragraph, then in proper cases the back pay shall be apportioned to each of the taxable years within which fall one or more calendar months included within the entire period for which such back pay has been received or accrued in equal portions in each of such calendar months. For the purposes of this section, a fractional part of a month is to be disregarded unless it amounts to more than half a month, in which case it is to be considered as a month. (6) In determining whether section 107 (d) (2) (B) is applicable, the percentage which the back pay is of taxable income of the taxpayer for the current taxable year must be ascertained. It must exceed 35 percent of such gross income. (7) The amount of the tax attributable to back pay is the difference between the tax for the taxable year computed with the inclusion of such back pay in gross income and the tax for such taxable year computed without including such back pay in gross income. The amount of the tax attributable to back pay in each taxable year is the difference between the tax for such taxable year computed with the inclusion in gross income of the portion of back pay attributable to such taxable year and the tax for such taxable year computed without including any such part of back pay. If the taxable year is the smaller of (1) the tax computed with the inclusion in gross income of the entire back pay received or accrued in the taxable year, or (2) the tax computed without including any such back pay in gross income for the taxable year, plus the aggregate of the increase in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for each taxable year to which such portion is respectively attributable. (g) This section may be illustrated by the following example in which the taxpayer makes his returns on the cash receipts and disbursements basis, and in which it is assumed that he is entitled to use and uses for the taxable years 1952, 1949, and 1948, the alternative tax provided in Supplement T.

Example. In 1952, a single individual with no dependents who makes his income tax returns on the calendar year basis receives $2,000, which amount constitutes his adjusted gross income. Of this amount, $1,000 constitutes back pay. His tax for the calendar year 1952 on $2,000 would be $720. On the receipts and disbursements basis his tax would be $518. That part of the tax for 1952 attributable to back pay is therefore 302 ($720 minus 518) which is attributed to the year 1949. During such year he had received $1,000. For such year the tax attributable to such back pay in gross income of the portion of such back pay for which no income tax was levied. The tax for the taxable year is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000. For such year the tax attributable to such back pay is $1,000.
the portion of back pay attributable to such year would be $80 ($246 minus $166). The remainder of the back pay, $460, is attributable to the calendar year 1953. During such year he had received $1,206. For such year the amount of tax is $82 and the amount of tax which he would have paid for such year if he had received $1,206 instead of $1,206 would be $84 ($141 minus $82). The aggregate of the increases in the tax for the calendar years 1949 and 1948 would be $141. The increase in the tax for such year would be $141 if he had received $1,206 instead of $1,206. The tax for the calendar year 1952 is the smaller of $518 plus $149. The tax for the calendar year 1952 is the smaller of $518 plus $149.

(b) The provisions of section 107 and of this section shall be applied without regard to, and shall not affect, the tax on self-employment income imposed by section 409.

§ 39.108 Statutory provisions; fiscal year taxpayers.

Section 108, fiscal year taxpayers. (a) To
(b) [applicable only to taxable years beginning before January 1, 1953]

(1) Definition of calendar month. For the purposes of this section, a calendar month only part of which falls within a taxable year (1) shall be deemed as taxable year if less than 15 days of such month are included in such taxable year, and (2) shall be included as a calendar month if 15 days of such month are included in such taxable year but if more than 14 days of such month fall within the taxable year.

(2) Taxable years of individuals beginning in 1953 and ending in 1954. In the case of a taxable year of a taxpayer, other than a corporation, beginning before January 1, 1954, and ending after December 31, 1953, the tax imposed by sections 11 and 12, section 400, or section 421 (a) (2), shall be an amount equal to the sum of:

(1) That portion of a tentative tax, computed under the provisions of sections 11 and 12, section 400, or section 421 (a) (2), applicable to years beginning on January 1, 1953, which the number of calendar months in such taxable year prior to January 1, 1954, bears to the total number of calendar months in such taxable year, plus

(2) That portion of a tentative tax, computed under the provisions of sections 11 and 12, section 400, or section 421 (a) (2), applicable to years beginning on January 1, 1954, as if such provisions were applicable to such taxable year, which the number of calendar months in such taxable year prior to December 31, 1953, bears to the total number of calendar months in such taxable year.

(2) Taxable years of corporations beginning before April 1, 1954, and ending after March 31, 1954. In the case of a taxable year of a corporation beginning before April 1, 1954, and ending after March 31, 1954, the tax imposed by sections 11 and 15, or section 421 (a) (1), shall be an amount equal to the sum of:

(1) That portion of a tentative tax, computed under the provisions of sections 11 and 15, or section 421 (a) (1), applicable to years beginning on January 1, 1953, which the number of days in such taxable year prior to April 1, 1954, bears to the total number of days in such taxable year, plus

(2) That portion of a tentative tax, computed under the provisions of sections 11 and 15, or section 421 (a) (1), applicable to years beginning on April 1, 1954, as if such provisions were applicable to such taxable year, which the number of days in such taxable year after March 31, 1954, bears to the total number of days in such taxable year.

(c) Short taxable years. The provisions of section 108 (j) apply to a taxable year beginning in 1953 and ending in 1954, whether or not such taxable year is one of less than 12 months. In the case of a taxpayer who is subject to the provisions of section 108 (j) and who because of a change in accounting period has a taxable year of less than 12 months, the net income shall be placed on an annual basis if a change in accounting period of less than 15 days of such month is made in such taxable year and such taxable year is an annual basis after March 31, 1954.

(d) Alternative tax under section 117 (c). In any case in which a taxpayer subject to the provisions of section 108 has an excess of net long-term capital gains over net short-term capital losses, the alternative tax under section 117 (c) shall be an amount equal to the sum of the proper portions of the tentative tax determined under section 108 (j) by computing each such tentative tax pursuant to the alternative tax computation provided in section 117 (c), regardless of whether the alternative tax basis is larger or smaller than the tentative tax computed without regard to section 117 (c).

(e) Certain joint returns. If a joint return of a husband and wife is filed under the provisions of section 51 (b) (3), if the husband and wife have different taxable years solely because of the death of either spouse, and if the taxable year of the surviving spouse covered by such joint return is a period which begins in 1953 and ends in 1954, the number of calendar months to be taken into account in determining the proper portions of the tentative tax under section 108 (j) (1) and (2) shall be the number of calendar months before January 1, 1954, in the taxable year of the surviving spouse, the number of calendar months after December 31, 1953, in the taxable year of the surviving spouse, and the total number of calendar months in the taxable year of the surviving spouse.

(1) Credits against tax. In the case of a taxpayer subject to the provisions of section 108 (j) any credit against the alternative tax computed under the provisions of sections 11 and 15, or section 421 (a) (1), shall be an amount equal to the sum of:

(1) That portion of a tentative tax, computed under the provisions of sections 11 and 15, or section 421 (a) (1), applicable to years beginning on January 1, 1953, which the number of calendar months in such taxable year prior to January 1, 1954, bears to the total number of calendar months in such taxable year, plus

(2) That portion of a tentative tax, computed under the provisions of sections 11 and 15, or section 421 (a) (1), applicable to years beginning on April 1, 1954, as if such provisions were applicable to such taxable year, which the number of days in such taxable year after March 31, 1954, bears to the total number of days in such taxable year.

* * *

Rules and regulations
normal tax, surtax, and Supplement U net income are determined, for the purpose of the tentative tax computation under section 108 (k) (1) with the allowance of the 27-percent credit provided in section 26 (h) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108 (k) (2) with the allowance of the 30-percent credit provided in section 26 (h) applicable to a taxable year beginning on April 1, 1954.

(4) Corporations receiving dividends on preferred stock of public utility. In the case of any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26 (h) is allowable to the distributing corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108 (k) (1) with the allowance of the 62-percent credit provided in section 26 (h) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108 (k) (2) with the allowance of the 59-percent credit provided in section 26 (h) applicable to a taxable year beginning on April 1, 1954.

(d) Short taxable years. The provisions of section 108 (k) apply to a taxable year beginning before April 1, 1954, and ending after March 31, 1954, in the case of any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26 (h) is allowable to the distributing corporation, the amount of the normal-tax net income and the amount of the corporation surtax net income for the first tentative tax computation differ from such amounts for the second tentative tax computation. See subparagraphs (2), (3) and (4) of this paragraph.

(2) Western Hemisphere trade corporations. In the case of a Western Hemisphere trade corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108 (k) (1) with the allowance of the 27-percent credit provided in section 26 (h) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108 (k) (2) with the allowance of the 30-percent credit provided in section 26 (h) applicable to a taxable year beginning on April 1, 1954.

(3) Public utilities paying dividends on preferred stock. In the case of a public utility corporation, its normal-tax net dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26 (h) is allowable, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108 (k) (1) with the allowance of the 27-percent credit provided in section 26 (h) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108 (k) (2) with the allowance of the 30-percent credit provided in section 26 (h) applicable to a taxable year beginning on April 1, 1954.

The tentative normal taxes under section 108 (k) (1) and (2) of a corporation are computed at the rates of 16 percent and 25 percent, respectively, upon its normal-tax net income or upon its Supplement U net income, in the case of a corporation subject to tax under Supplement U. The tentative surtaxes under section 108 (k) (1) and (2) of a corporation are computed upon its corporation surtax net income or Supplement U net income, as the case may be, in excess of $25,000 at the rate of 23 percent. See, however, section 15 (c) and §39.15-2 as to the circumstances under which the $25,000 exemption from surtax may be disqualified, in whole or in part, in the computation under section 108 (k) (1) of the tentative surtax under section 15 for a taxable year beginning before July 1, 1953.

(2) Computation of normal-tax net income and corporation surtax net income in special cases. In general. In computing the tentative tax under section 108 (k) (1) and (2) the amount of the net income and the amount of the adjusted net income of the corporation are not recomputed and remain unchanged. However, the credits provided in section 26 (b) (1) and (2) may differ in computing the several tentative taxes. Thus, in the case of a Western Hemisphere trade corporation, or a public utility corporation which has paid dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26 (h) is allowable, the corporation has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26 (h) is allowable to the distributing corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108 (k) (1) with the allowance of the 62-percent credit provided in section 26 (h) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108 (k) (2) with the allowance of the 59-percent credit provided in section 26 (h) applicable to a taxable year beginning on April 1, 1954.

(c) Classes of corporations excluded from operation of section 108 (k). The provisions of section 108 (k) do not apply to an insurance company subject to Supplement G, a regulated investment company subject to Supplement Q, or a foreign corporation not engaged in trade or business within the United States other than such a corporation subject to Supplement U.

(d) Example. The provisions of section 108 (k) apply to a taxable year beginning before April 1, 1954, and ending after March 31, 1954, in the case of a taxpayer which is subject to the provisions of section 108 (k) and which because of a change in accounting period has a taxable year of less than 12 months, the net income shall be placed on an annual basis under the provisions of section 47 (c) (1) for the purpose of both tentative tax computations under section 108 (k) or shall be computed on a taxable year basis under section 108 (k) (2) for the purpose of both tentative tax computations. Regardless of the method adopted, the amounts of the tentative normal tax and surtax so computed shall be properly reduced under section 47 (c) in order to determine the tentative taxes under section 108 (k) (2) in the case of a taxpayer which is subject to the provisions of section 108 (k) and which because of any reason other than a change in accounting period has a taxable year of less than 12 months, the net income for the purpose of section 108 (k) shall not be placed on an annual basis under section 47 (c) (1) and shall not be computed under the exception in section 47 (c) (2).

(e) Alternative tax under section 117. In any case in which a taxpayer subject to the provisions of section 108 (k) (2) with an excess of net long-term capital gains over net short-term capital losses, the alternative tax under section 117 (c) shall be an amount equal to the sum of the proper portions of the tentative taxes determined under section 108 (k), by computing each such tentative tax pursuant to the provisions of section 47 (c) (2) and then adding the tax computed under section 47 (c) (2).

(f) Credits against tax. In the case of a taxpayer subject to the provisions of section 108 (k) any credit against the tax otherwise imposed by sections 13, 15, and 421 (a) (1) such as the credit for taxes paid to a foreign country or possession of the United States under section 121, shall be deducted from, and computing the tax otherwise imposed by section 47 (c) (2) to be based upon, the tax computed under section 108 (k).

(g) Example. This section may be illustrated by the following example:

Example. The A Corporation, a domestic corporation (which is neither a public utility corporation subject to Supplement Q, nor a foreign corporation, nor engaged in trade or business within the United States), is a Western Hemisphere trade corporation referred to in section 26 (b) (1) and, which is not subject to tax under Supplement U, makes its income tax returns on the basis of the calendar year. For the calendar year 1954, the A Corporation has net income of $100,000, which does not include any interest on United States obligations or dividends from foreign corporations. The net income includes cash dividends received from a domestic corporation other than a public utility corporation, allowable as a credit under section 26 (h) (1). In the amount of $10,000, and cash dividends received from a domestic public utility corporation on its preferred stock (with respect to which the credit is allowable to the public utility under section 26 (h) (2)) in the amount of $5,000. The normal tax and surtax of the A Corporation for the calendar year 1954 are $25,215.32 and $19,078.63, respectively, computed as follows:

§ 39.108-2
§ 39.109. Statutory provisions; Western Hemisphere trade corporations.

§ 39.110 Statutory provisions; Western Hemisphere trade corporations. 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 in the West Indies, or in Newfoundland and which satisfies the following conditions:

(a) If 95 per cent 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 within the United States and the tax return a statement showing that its entire business was authorized under State law.

(b) If 90 per cent or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

[Sec. 110 as added by sec. 346, Rev. Act 1951]

§ 39.110–1 Mutual savings banks conducting life insurance business—(a) Scope of application. Section 110 is applicable in the case of a mutual savings bank not having capital stock represented by shares, authorized under State law to engage in the business of issuing life insurance contracts, and which conducts a life insurance business in a separate department the accounts of which are maintained separately from the accounts of the department of the mutual savings bank, there shall be levied, collected, and paid, in lieu of the taxes imposed by sections 101 and 18, on the life insurance business of the mutual savings bank, without regard to any item of gross income or deductions not properly allocable to such department, at the rates and in the manner provided in Supplement G with respect to life insurance companies.

(b) Limitations of section. The provisions of subsection (a) shall be applicable only if the life insurance business (other than to save, or any net amount thereof derived from such trade or business.}

§ 39.110–2 Computation of tax. In the case of a mutual savings bank conducting a life insurance business to which section 110 is applicable, the tax upon such bank consists of the sum of the following:

(1) [Computations of its net earnings]
§ 39.111 Statutory provisions; determination of amount of, and recognition of, gain or loss.

Sec. 111. Determination of amount of, and recognition of, gain or loss—(a) Computation of gain or loss. The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) (1) to the extent that the basis for the purposes of this chapter shall be determined under the provisions of section 112.

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

§ 39.111-1 Computation of gain or loss. (a) Exception as otherwise provided, the Internal Revenue Code regards as income or as loss, as the case may be, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent. The amount realized from the sale or other disposition of property is the sum of any 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 considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 111, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 113 (b) and §§ 39.113 (b) (1)–1 to 39.113 (b) (4)–1, inclusive (i.e., the cost or other basis provided by section 113 (a), adjusted for receipts, expenses, allowances, and other items chargeable against and applicable to such cost or other basis).

The amount which remains after the adjusted basis has been restored to the taxpayer the adjusted basis of the property, a loss is sustained in the amount of the insufficiency. The basis may be different depending upon whether gain or loss is being computed, loss is more formal than substantial. As to losses, the Internal Revenue Code provides that such differences shall not be deemed controlling, and that gain or loss shall be computed in the manner prescribed under the provisions of section 112.

§ 39.112 (a) Statutory provisions; recognition of gain or loss; general rule.

§ 39.112 (a)–1 Sales or exchanges. (a) The extent to which the amount of gain or loss, determined under section 111, from the sale or exchange of property is recognized is governed by the provisions of section 112. The general rule is that the entire amount of such gain or loss is to be recognized.

(b) Exceptions to the general rule are made by section 112 (b) (1) to (5) inclusive, section 112 (b) (10) and section 112 (d) in the case of certain specifically described exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property received, differences which are more formal than substantial. As to losses, the Internal Revenue Code provides that such differences shall not be deemed controlling, and that gain or loss shall be computed in the manner prescribed under the provisions of section 112.

§ 39.112 (e)–1 (d) 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 strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Internal Revenue Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose and uniformity of such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

(e) To constitute an exchange within the meaning of section 112 (b) (1) to (5), inclusive, section 112 (b) (10) and section 112 (d) the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

(f) See section 112 (b) (6) and (7) with respect to nonrecognition of gain or loss upon the receipt of property distributed in complete liquidation of a corporation under certain prescribed circumstances. See sections 112 (b) (8) and 371 with respect to nonrecognition of gain or loss upon exchanges and distributions 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 4, 1939 (46 U. S. C. 1100 (e)), with respect to nonrecognition of gain in case of the transfer of an obsolete vessel to the Maritime Commission under the provisions of such section. See section 112 (b) (11) with respect to nonrecognition...
of gain upon the distribution of stock (other than preferred) in a corporation is a property of a like kind to be held for productive use in trade or business; or for investment.

§ 39.112 (a)–2 Use of term “assumption of liabilities.” When used in the regulations prescribed under sections 112 and 113, the term “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, any other liabilities of the property of the taxpayer acquired by another party to the exchange where the liability is assumed by another party to the exchange.

§ 39.112 (b) (1) Statutory provisions; recognition of gain or loss; exchanges solely in kind, property held for productive use or investment.

Sec. 112. Recognition of gain or loss.

(b) Exchanges solely in kind—(1) Property held for productive use or investment. No gain or loss shall be recognized if property held for productive use in trade or business or for investment (other than preferred) in a corporation is exchanged solely for property of a like kind.

(2) 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.

(3) Stock for stock of same corporation. A transfer is not within the provisions of section 112 (b) if as part of the consideration the other party to the exchange assumes a liability of the transferor, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

(d) Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing September 1, 1965, for Trea-

ury bonds maturing June 15, 1965, or (2) a real estate mortgage for consolidated farm loan bonds.

§ 39.112 (b) (2) Statutory provisions; recognition of gain or loss; exchanges solely in kind, stock for stock of same corporation.

Sec. 112. Recognition of gain or loss.

(b) Exchanges solely in kind.

(2) Stock for stock of same corporation. The fact that any real estate involved is unimproved real estate or for property of a different kind or class.

(3) Stock for stock on reorganization. A transfer is not within the provisions of section 112 (b) (2) if as part of the consideration the other party to the exchange assumes a liability of the taxpayer, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

(d) Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing September 1, 1965, for Treasury bonds maturing June 15, 1965, or (2) a real estate mortgage for consolidated farm loan bonds.

§ 39.112 (b) (2) Statutory provisions; recognition of gain or loss; exchanges solely in kind, stock for stock of same corporation.

Sec. 112. Recognition of gain or loss.

(b) Exchanges solely in kind.

(2) 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.

(3) Stock for stock on reorganization. No gain or loss shall be recognized if stock or securities received are analogous to those transferred, but any gain or loss shall be recognized if stock or securities received are not analogous to those transferred.

(4) Stock for stock of same corporation. A transfer is not within the provisions of section 112 (b) (2) if as part of the consideration the other party to the exchange assumes a liability of the transferor, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

(d) Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing September 1, 1965, for Trea-

ury bonds maturing June 15, 1965, or (2) a real estate mortgage for consolidated farm loan bonds.

§ 39.112 (b) (2) Statutory provisions; recognition of gain or loss; exchanges solely in kind, stock for stock of same corporation.

Sec. 112. Recognition of gain or loss.

(b) Exchanges solely in kind.

(2) Stock for stock of same corporation. The fact that any real estate involved is unimproved real estate or for property of a different kind or class.

(3) Stock for stock on reorganization. A transfer is not within the provisions of section 112 (b) (2) if as part of the consideration the other party to the exchange assumes a liability of the taxpayer, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

(d) Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing September 1, 1965, for Treasury bonds maturing June 15, 1965, or (2) a real estate mortgage for consolidated farm loan bonds.

§ 39.112 (b) (2) Statutory provisions; recognition of gain or loss; exchanges solely in kind, stock for stock of same corporation.
fewers 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 transferee whose indebtedness is assumed.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. A and B are individuals, each of whom owns 1,000 shares of the common stock of the X Corporation, to which they transfer property above described for the entire capital stock of the X Corporation and the assumption by the X Corporation of A's purchase money mortgage. The X Corporation's capital stock is divided as follows: $50,000 to A and $100,000 to B. Nevertheless, for the purposes of determining whether the transferees 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 A. Accordingly, under the facts as stated, the proportions required by section 112 (b) (5) exist.

Section 112. Recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

(a) Exchanges solely in kind. Property received by corporation on complete liquidation of another. No gain or loss shall be recognized upon the receipt of property described in paragraph (1) of this subsection, if the property was received in taxable status of the corporation by which the stock or securities and other property or property or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received in the exchange.

(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.

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(a) Exchanges solely in kind. Property received by corporation on complete liquidation of another. No gain or loss shall be recognized upon the receipt of property described in paragraph (1) of this subsection, if the property was received in taxable status of the corporation by which the stock or securities and other property or property or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received in the exchange.

(b) Provisions; recognition of gain or loss; exchanges solely in kind, property received by corporation on complete liquidation of another.
§ 39.112 (b) 61-2

holders.

percentage of such class owned at the

the recipient corporation shall at

liquidation and have continued so to be

the meaning of the Internal Revenue

distribution in complete liquidation within

the property (both tangible and in-

merely for the purpose of winding up its

the corporation;

In accordance with a plan of liquidation.

corporation in complete cancellation or

ing of section 112

1935.

any distribution received under the plan.

completion of the transfer of all the

the recipient corporation does not con-

percentage of any class of stock than the

Liquidations

Liquidity

§ 39.112 (b) (6)-2

RULES AND REGULATIONS

Liquidation and have continued so to be

at all times until the receipt of the prop-

ers that the recipient corporation shall at

no time, on or after the date of the adop-

tion of the plan and until the receipt of

property, be the owner of a greater
cancellation of stock than the
time of the receipt of the property. If

the recipient corporation does not con-
tinue qualified occurs at any time prior to

the completion of the transfer of all the

property for the nonrecog-

sion of gain or loss do not apply to

any distribution received under the plan.

(c) 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, 1955.

(d) To constitute a distribution in complete liquidation within the meaning of section 112 (b) (6) the distribution must be made by the liquidating corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation or (2) one of a series of distributions in complete can-
cellation or redemption of all its stock in accordance with a plan of liquidation. It is essential that a status of liquidation exist at the time the first distribution is made under the plan and that such status continue to the date of dissolution of the corporation. A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its share-
holders. A liquidation may be completed prior to the actual dissolution of the liquidating corporation; provided that the windup of the liquidating corporation is completed before the date of liquidation of the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible) (Sec. § 39.30A).

(e) If a transaction constitutes a distribution in complete liquidation within the meaning of the Internal Revenue Code and satisfies the requirements of section 112 (b) (6) it is not material that it is otherwise described under the local law. If a liquidating corporation distributes all of its property in complete liquidation and if pursuant to the plan for such complete liquidation a corporation owning the specified amount of stock in the liquidating corporation receives property constituting amounts distributed in complete liquidation within the meaning of the Code and also receives other property attributable to shares not owned by it, the transfer of the property to the recipient corporation shall not be con-
treated, by reason of the receipt of such other property, as not being a distribu-
tion (or one of a series of distributions) in complete cancellation or redemption of all of the liquidating corporation within the meaning of section 112 (b) (6) even though for purposes of those provisions in section 112 relating to reorganizations the amount re-
cived by the recipient corporation in ex-
cess of its ratable share is regarded as acquired upon the issuance of its stock or securities in a tax-free exchange as described in section 112 (b) (4) and the cancellation or redemption of the stock not owned by the recipient corporation is treated as occurring as a result of a tax-free exchange described in section 112 (b) (4).

(f) The application of these rules may be illustrated by the following example:

Example. On July 1, 1952, the M Corporation had outstanding capital stock consist-
ing of 3,000 shares of common stock, par value $100 a share, and 1,000 shares of pre-
ferred stock, par value $100 a share, which preferred stock was limited and preferred as to dividends and voting rights. On July 1, 1952, and thereafter until the date of dissolution of the M Corporation, the O Corporation owned 2,500 shares of the com-
mon stock of the M Corporation. By a statutory merger consummated on August 1, 1952, pursuant to a plan adopted on July 1, 1952, the M Corporation was merged into the O Corporation, the O Cor-
poration retaining ownership of the stock which was received by the holders of the stock of the M Corporation not owned by the O Corporation for their stock in the O Corporation. The receipt by the O Cor-
poration of the properties of the M Corporation is a distribution received by the O Corporation in complete liquidation of the M Corporation within the meaning of section 112 (b) (6), and no gain or loss is recognized as a result of the receipt of the properties.

§ 39.112 (b) (6)-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 owns the specified amount of stock in the liquidating corporation and which continues qualified with respect to the distributions in liquidation for such taxable year, then no gain or loss shall be recognized with respect to the distributions received by the recipient corporation. In such case no transfer or satisfaction is re-
quired of the recipient corporation under section 112 (b) (6).

§ 39.112 (b) (6)-3 Liquidations covering more than one taxable year. If the plan of liquidation is consummated by a series of distributions not covering a period of more than one taxable year, the nonrecognition of gain or loss with respect to the distributions in liquidations shall be subject to the require-
ments of § 39.112 (b) (6)-1, be subject to the following requirements:

(1) In order for the distribution in liquidation to be brought within the ex-
ception provided by 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 period within which the transfer of the property of the liquidating corporation to the recipient corporation is to be completed. The trans-
fer of all the property under the liquidation must be completed within the taxable year during which is made the first of the series of distributions under the plan.

(2) For each of the taxable years which falls wholly or partly within the three years from the close of the taxable year during which is made the first of the series of distributions under the plan, the recipient cor-
poration shall, at the time of filing its return, file with the district director of internal revenue for transmittal to the Commissioner a waiver of the statutory limitations on assessment. Such waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period for assessment of all profits 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 last taxable year in 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 other terms with respect to assessment as the Commissioner may require. Each waiver must be authorized by the Commissioner to be necessary to insure the assessment and collection of the exact tax liability for each year within which the transfer of property under the plan shall have occurred.

(3) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient cor-
poration 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 provi-
sions unequivocally assuring prompt payment of the excess of income and profits taxes (plus penalties, if any, and interest) as computed by the Com-
misssioner without regard to the provi-
sions of sections 112 (b) (6) and 113 (a) (15) over such taxes computed with respect to such property. As to 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, etc. Any bond required under section 112 (b) (6) shall have such surety or sureties as the Commissioner may require. How-
ever, see 6 U. S. C. 15, providing that where a bond is required and liquidations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. 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 executed in triplicate so that the Commissioner, the taxpayer, and the surety or the deposit-
ary may each have a copy.

(b) Pending the completion of the liq-
duation, if there is a compliance with subparagaphs (1) and (2) of para-
graphs (a) and § 39.112 (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 receipt of the distribu-
tions in liquidation. In such deter-
mation, the basis of the property or properties received by the recipient cor-

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corporation shall be determined in accordance with section 112 (a) (15) (See § 39.112 (a) (15)–1.) However, if the transfer of the property is not completed within the three-year period allowed by section 112 (b) (6) or if the corporation is not qualified with respect to the ownership of stock of the liquidating corporation as required by that section, gain or loss shall be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (5) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 39.112 (b) (6)–4 Distributions in liquidation as affecting minority interests. Upon the liquidation of a corporation in pursuance of a plan of complete liquidation, the gain or loss of minority shareholders shall be determined without regard to section 112 (b) (6) since it does not apply to distributions in liquidation received by minority shareholders.

§ 39.112 (b) (6)–5 Records to be kept and information to be filed with return. (a) Permanent records in substantial form shall be maintained by the corporation for 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 the 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) For the taxable 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 shall file with its return 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, or pursuant to, the plan.

(2) A list of the 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 (shown 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.

§ 39.112 (b) (7) Statutory provisions; recognition of gain or loss; exchanges solely in kind; election to recognition of gain in certain corporate liquidations.

Sec. 112. Recognition of gain or loss. The act of distribution of property under a plan of liquidation of a domestic corporation as required by section 112 (a) (15) of this title is not a taxable event for federal income tax purposes unless it is made in contravention of regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. The gain or loss realized by a corporation from the exchange of its property for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 39.112 (b) (7)–1 Corporate liquidation in calendar month in 1952—(a) In general. Section 112 (b) (7) provides a special rule, in the case of certain specifically described complete liquidations of corporate assets unrealized earnings and profits to the date on which the transfer of all the property under the liquidation is completed; and

(1) There shall be recognized, and taxed as short-term or long-term capital gain or loss, the portion of the gain or loss on the distribution of the property which is attributable to appreciation in the value of certain corporate assets unrealized earnings and profits to the date on which the transfer of all the property under the liquidation is completed; and

(b) Type of liquidation. (1) The liquidation must be in pursuance of a plan of liquidation adopted under section 112 (b) (7). The determination of who is a qualified electing shareholder is to be made under section 112 (b) (7) (C) and § 39.112 (b) (7)–2. For the basis of property received in such liquidations, see section 113 (a) (15).

(2) A list of all the properties received by a shareholder (other than an excluded corporation) which at the time of the adoption of such plan of liquidation, and may be exchanged for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

(3) A statement as to its ownership of all classes of stock of the liquidating corporation (shown 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.

§ 39.112 (b) (7)–2. Recognition of gain or loss; exchanges solely in kind; election to recognition of gain in certain corporate liquidations.

Sec. 112. Recognition of gain or loss. The act of distribution of property under a plan of liquidation of a domestic corporation as required by section 112 (a) (15) of this title is not a taxable event for federal income tax purposes unless it is made in contravention of regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. The gain or loss realized by a corporation from the exchange of its property for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 39.112 (b) (7)–3. Recognition of gain or loss; exchanges solely in kind; election to recognition of gain in certain corporate liquidations.

Sec. 112. Recognition of gain or loss. The act of distribution of property under a plan of liquidation of a domestic corporation as required by section 112 (a) (15) of this title is not a taxable event for federal income tax purposes unless it is made in contravention of regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. The gain or loss realized by a corporation from the exchange of its property for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 39.112 (b) (7)–4. Recognition of gain or loss; exchanges solely in kind; election to recognition of gain in certain corporate liquidations.

Sec. 112. Recognition of gain or loss. The act of distribution of property under a plan of liquidation of a domestic corporation as required by section 112 (a) (15) of this title is not a taxable event for federal income tax purposes unless it is made in contravention of regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. The gain or loss realized by a corporation from the exchange of its property for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 39.112 (b) (7)–5. Recognition of gain or loss; exchanges solely in kind; election to recognition of gain in certain corporate liquidations.

Sec. 112. Recognition of gain or loss. The act of distribution of property under a plan of liquidation of a domestic corporation as required by section 112 (a) (15) of this title is not a taxable event for federal income tax purposes unless it is made in contravention of regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. The gain or loss realized by a corporation from the exchange of its property for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 39.112 (b) (7)–6. Recognition of gain or loss; exchanges solely in kind; election to recognition of gain in certain corporate liquidations.

Sec. 112. Recognition of gain or loss. The act of distribution of property under a plan of liquidation of a domestic corporation as required by section 112 (a) (15) of this title is not a taxable event for federal income tax purposes unless it is made in contravention of regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. The gain or loss realized by a corporation from the exchange of its property for money, or of stock or securities acquired in exchange for money, or of assets received in a liquidating corporation as affecting minority interests, may be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of sections 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.
Example. The X Corporation has outstanding 100 shares of its common stock on July 1, 1952, at the time of the adoption of a plan of liquidation within the provisions of section 112 (b) (7), each entitled to one vote upon the adoption of such plan of liquidation. At that time ten of such shares are owned by the Y Corporation, two each by the Z Corporation, and one each by A, B, C, D, and E, individuals. There are also outstanding at such time 40 shares of preferred stock, not entitled to vote on liquidation, one share being owned by F, an individual, and the remaining 39 shares of preferred stock by the X Corporation, being a corporate shareholder and the owner of 60 percent of the voting stock, may not be a qualified electing shareholder under section 39.112 (b) (7). In order for any other corporate shareholder to be a qualified electing shareholder, it is necessary that the X Corporation and the Y Corporation, whose written elections to be governed by section 112 (b) (7). If this is done, the F shareholder may make an election to the treatment of gain realized upon the cancellation or redemption of such stock. If he has filed a like election. Similarly, in the case of individual shareholders, some combination of four of the individual holders of the common stock must have filed their written elections, before any individual shareholder may be considered a qualified electing shareholder, but if this is done, W will also be a qualified electing shareholder if he has filed a like election.

(d) An election to be governed by the provisions of section 112 (b) (7) relates to the treatment of gain realized upon the cancellation or redemption of stock upon liquidation and can therefore be made only by or on behalf of a person by whom gains, if any, will be realized. Thus, the shareholder who may make such election must be the actual owner of such stock and not a mere record holder, such as a nominee.

(e) A shareholder is entitled to make an election relative to the gain only on common stock owned by him at the time of the adoption of the plan of liquidation. The election is personal to the shareholder making it and does not follow such stock into the hands of a transferee.

§ 39.112 (b) (7)–3 Making and filing of written elections. An election to be governed by section 112 (b) (7) shall be made on Form 870 (revised), in accordance with the instructions printed thereon and with this section. The original and one copy shall be filed by the shareholder by mailing to the liquidating corporation with the Commissioner of Internal Revenue, Washington 25, D. C., attention of the Audit Service Branch, Audit Division, within 60 days after the adoption of the plan of liquidation. An election shall be considered as timely filed if it is placed in the mail on or before midnight of the 30th day after the adoption of the plan of liquidation, as shown by the postmark on the envelope containing the written election or as shown by other available evidence of the mailing date. Another copy shall be attached to the shareholder's income tax return for his taxable year in which the transfer of all the property under the liquidation occurs.

§ 39.112 (b) (7)–4 Treatment of recognized gain. (a) Computation of gain. As in the case of shareholders generally, for the purpose of computing gain, amounts received by qualified electing shareholders are treated as in full payment for each share of such stock. If section 115 (c), and gain from the receipt of such amounts is determined as provided in section 111. Gain or loss must be computed separately on each share of stock owned by a qualified electing shareholder at the time of the adoption of the plan of liquidation. The limited recognition as a special dividend of such gain is made only to the extent that the gain on such shares of stock upon which the gain was realized and not to net gain computed by setting off losses realized on any shares other than those which are considered a qualified electing shareholder under section 39.112 (b) (7) (M)–2.

(b) Recognition of gain. Pursuant to section 112 (b) (7) only so much of the gain on each share of stock owned by a qualified electing shareholder, if any, realized upon the cancellation or redemption of such stock under the provisions of the adoption of the plan of liquidation is recognized as does not exceed the greater of the following:

(1) Such share’s ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, computed as of the last day of the month of liquidation, without diminution by reason of distributions made during such month, and including in such computation all items of income and expense accrued up to the date on which the transfer of all the property under the liquidation is completed.

(2) Such share’s ratable share of the sum of the amount of money received by such shareholder on shares of the same class and the fair market value of all the stock or securities so received which were acquired by the liquidating corporation after August 15, 1950. The mere replacement after August 15, 1950, of lost or destroyed certificates or instruments acquired on or before August 15, 1950, or the mere conversion of certificates or instruments into certificates or instruments of larger or smaller denominations will not constitute an acquisition within the meaning of the phrase “acquired after August 15, 1950.” Nor will such an acquisition result from the issuance after August 15, 1950, of certificates of stock in connection with a subscription made and accepted on or before August 15, 1950.

(c) Treatment of recognized gain. (1) In the case of a qualified electing shareholder other than a corporation that part of the recognized gain on a share of stock owned at the time of the adoption of the plan of liquidation which is not in excess of the shareholder’s ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, determined as provided in section 112 (b) (7) (E) (1) is treated and taxed to him as a dividend. It retains its character as a dividend for all tax purposes. The remainder of the gain which is recognized and taxed to him as a short-term or long-term capital gain, as the case may be. In the case of a qualified electing shareholder which is a corporation, the entire amount of the gain which is recognized and taxed to the corporation is treated and taxed as a short-term or long-term capital gain, as the case may be.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example.

Example. The X Corporation has only one class of stock outstanding, owned in equal amounts by three shareholders. The basis of the stock owned by each of the shareholders is $50, with 1,000 shares owned by A, 1,000 by B, and 1,000 by C. The X Corporation enters into an agreement to liquidate on December 31, 1952.

A holds 1,000 shares purchased in 1940, basis $50, fair market value $100, purchased as an investment. The $50,000 of undistributed earnings and profits, to which A is entitled, is $17,000. Assuming all other conditions are met, A’s ratable share of the earnings and profits is $17,000, and A’s gain is zero.
to the requirements of section 112 (b) (7). One of such shareholders is an indi-
vidual and two are corporations and all are quali-
cfied electing shareholders. The corpo-
ration has distributed the earnings and profits accumu-
lated after February 28, 1913 (computed as provided in section 112 (b) (7)), of its assets consisting of property (other than stock or securities acquired after August 15, 1920, and money) with a fair market value of $650, cash in stock and secur-
ities acquired after August 15, 1950, with a fair market value of $90, all of which as-
ets are distributed to the shareholders in complete liquidation of the corporation, as provided in section 112 (b) (7). Each shareholder, therefore, receives, in cash and property, $135 and his gain is $85. In the case of each shareholder, the gain is recognized since such amount represents the sum of the cash received by him and the fair market value of the stock and securities received by which were acquired by the X Corporation after August 15, 1950, and is greater than its ratable share of the earnings and profits ($30). In the case of the corporate shareholders this amount is treated as capital gain. In the case of the individual shareholders, however, the amount of the shareholder's ratable share of the earnings and profits, is taxable, to him as a dividend, of $20, being the difference between the shareholder's ratable share of the earnings and profits and the sum of the cash and securities received by him, is recognized and treated as a short-term or long-term capital gain, as the case may be. The remainder of each shareholder's gain, $60, is not recognized.

If the basis of each shareholder's stock had been $100, instead of $50, the corporate shareholders would be taxed on only $35 as capital gain and the individual share-
holders on $30 as a dividend but only on $15 as a capital gain, since the total amount-taxable is limited by the amount of gain real-
ized by the shareholder upon the cancella-
tion or redemption of his stock.

§ 39.112 (b) (7)–5 Records to be kept and information to be filed with return.

(a) Permanent records in substantial form shall be kept by every qualified electing shareholder receiving distributions in complete liquidation of a domest-
ic corporation. Such shareholder shall file with his return for his taxable year an accounting of the gain realized by him upon the shares of stock owned by him at the time of the adoption of the plan of liquidation, including:

(1) A statement of his stock ownership in the liquidating corporation as of the date of the distribution, showing the number of shares of each class owned on such date and the cost or other basis of each such share;

(2) A list of all the property including money received upon the distribution, showing the fair market value of each item of such property other than money on the date distributed and stating what items, if any, consist of stock or securities acquired by the liquidating corporation after August 15, 1950;

(3) A statement of the ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, computed without 
discount for any depreciation which may be made during the month of liquidation; and

§ 39.112 (b) (7)–4 A copy of such shareholder's written election to be governed by the provisions of section 112 (b) (7). (See § 39.112 (b) (7)–3.)

(b) For information to be filed by the liquidating corporation, see section 168 (e).

§ 39.112 (b) (8)–(9) Statutory prov-
sions; recognition of gain or loss; exchanges solely in kind; exchanges and distributions in obedi-
tance to orders of Securities and Exchange Commission. In the case of any exchange or distribution described in section 771, no gain or loss shall be recognized to the extent specified in such section with respect to such exchange or distribution.

§ 39.112 (b) (9)–1 Loss not recognized on cer-
tain railroad reorganizations. Sec. 112. Recognition of gain or loss.

(b) Exchanges solely in kind.

(b) (9)–1 A transfer resulting in a loss and has no significance.

(b) (10)–1 Transfer of property of insolvent corporation in corporate reorganization or receivership proceeding.

§ 39.112 (b) (10)–1 Transfer of prop-
erty of insolvent corporation in corporate reorganization or receivership proceeding—(a) Exchange solely for securities or property. (1) Section 112 (b) (10) provides for the nonrecognition of gain or loss upon any such exchanges made in connection with the reorganization of an insolvent corporation. For the purpose of this section the term "reorganization" is defined in such section with respect to such exchange or distribution.

(2) Section 112 (b) (10) does not apply to exchanges of property of an insolvent corporation in connection with an exchange of property in a receivership proceeding or a voluntary or involuntary bankruptcy proceeding under the National Bankruptcy Act, as amended.

(3) Section 112 (b) (10) does not apply to transfers of property in a receivership proceeding under section 777 (b) of the National Bankruptcy Act, as amended, or to transfers of property in a bankruptcy proceeding under Chapter X of the National Bankruptcy Act, as amended.

(4) A transfer consisting of other property or money (see section 112 (b) (9)) is to be strictly limited to a trans-
ferral of the property, or to the transferee upon any intermediate transfer.

(b) Section 112 (b) (9) applies only to a transfer resulting in a loss and has no application if the transfer thereto described results in a gain.

§ 39.112 (b) (10)–2 Statutory prov-
sions; recognition of gain or loss; exchanges solely in kind; transfers of property on reorganization of corporations in certain reorganization and bankruptcy proceedings.

(b) Exchanges solely in kind. (10) Gain or loss not recognized on reorganization of corporations in certain reorganization and bankruptcy proceedings. No gain or less shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 771) is transferred, in a taxable year of such corporation beginning after December 31, 1933, to another corporation having jurisdiction of such corporation—

(a) In a receivership, foreclosure, or similar proceeding, or

(b) In a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended.

(2) The transferor corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

(3) The application of section 112 (b) (10) is to be strictly limited to a trans-
formation of the character set forth in such section. Hence, the section is inapplica-
table unless there is a bona fide plan of reorganization approved by the court having jurisdiction of the proceeding.

§ 39.112 (b) (10)–1 Transfer of prop-
erty of insolvent corporation in corporate reorganization or receivership proceeding—(a) Exchange solely for securities or property. (1) Section 112 (b) (10) provides for the nonrecognition of gain or loss upon any such exchanges made in connection with the reorganization of an insolvent corporation. For the purpose of this section the term "reorganization" is defined in such section with respect to such exchange or distribution.

(2) Section 112 (b) (10) does not apply to transfers of property of an insolvent corporation in connection with an exchange of property in a receivership proceeding or a voluntary or involuntary bankruptcy proceeding under the National Bankruptcy Act, as amended.

(3) Section 112 (b) (10) does not apply to transfers of property in a receivership proceeding under section 777 (b) of the National Bankruptcy Act, as amended, or to transfers of property in a bankruptcy proceeding under Chapter X of the National Bankruptcy Act, as amended.

(4) A transfer consisting of other property or money (see section 112 (b) (9)) is to be strictly limited to a trans-
ferral of the property, or to the transferee upon any intermediate transfer.

(b) Section 112 (b) (9) applies only to a transfer resulting in a loss and has no application if the transfer thereto described results in a gain.

§ 39.112 (b) (10)–2 Statutory prov-
sions; recognition of gain or loss; exchanges solely in kind; transfers of property on reorganization of corporations in certain reorganization and bankruptcy proceedings.

(b) Exchanges solely in kind. (10) Gain or loss not recognized on reorganization of corporations in certain reorganization and bankruptcy proceedings. No gain or less shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 771) is transferred, in a taxable year of such corporation beginning after December 31, 1933, to another corporation having jurisdiction of such corporation—

(a) In a receivership, foreclosure, or similar proceeding, or

(b) In a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended.

(2) The transferor corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

(3) The application of section 112 (b) (10) is to be strictly limited to a trans-
formation of the character set forth in such section. Hence, the section is inapplica-
table unless there is a bona fide plan of reorganization approved by the court having jurisdiction of the proceeding.
and the transfer of the property of the insolvent corporation is made pursuant to such plan. It is unnecessary to show a transfer of the property of the insolvent corporation, it is sufficient if the transfer is an integral step in the consummation of the reorganization plan approved by the shareholders of the corporation. This section has no application to a reorganization consummated by adjustment of the capital or debt structure of the insolvent corporation, so arranged as to transfer of its assets to another corporation.

(4) As used in section 112 (b) (10) the term "reorganization" is not controlled by the definition of "reorganization" contained in section 112 (g). However, certain basic requirements, implicit in the statute, which are essential to a reorganization under section 112 (g) are likewise essential to qualify a transaction as a reorganization under section 112 (b) (10).

(5) A short-term purchase money note is not a security within the meaning of section 112 (b) (10) and the transfer of the property of the insolvent corporation for cash and deferred payment obligations of the transferee evidenced by short-term notes is a sale and not an exchange.

(b) Exchange for stock or securities and other property or money. (1) If an exchange would be within the provisions of section 112 (b) (10) if it were not for the fact that the consideration for the transfer of the property of the insolvent corporation consists not only of stock or securities but also of other property or money, then, as provided in section 112 (d) (1) if the other 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. Property is distributed within the meaning of this section if it is paid over or distributed to shareholders or creditors who have by appropriate legal steps obtained effective command of the property of the corporation. If the other property or money received 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 as a gain from the disposition of section 112 (g) (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 either case no loss from the exchange will be recognized (see section 112 (e)).

(2) For the proper treatment of a transaction involving an assumption of liabilities under so much of section 112 (d) or (e) as relates to section 112 (b) (10) see section 112 (c) (11) and (d).

\[ \text{§ 39.112 (b) (10) - Records to be kept and information to be filed.} \]

(a) Each corporation a party to a section 112 (b) (10) reorganization shall keep a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the exchange, including:

(1) A certified copy of the plan of reorganization approved by the court in the proceeding, together with a statement showing in full the purposes thereof and in detail the changes therein, if any, or pursuant, to the plan;

(2) A complete statement of the cost or other basis of all property, including all stock or securities, transferred incident to the plan;

(3) A statement of the amount of stock or securities and other property or money received in the exchange, including a statement of all distributions or other disposition thereof. 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 exchange;

(d) A statement of the amount and nature of any liabilities assumed upon the exchange.

The information required by this section shall be filed as a part of the corporation's return for its taxable year within which the reorganization occurred.

(b) Permanent records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange in connection with a corporate reorganization showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received (including any liabilities assumed or assumed in part) in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

\[ \text{§ 39.112 (b) (11) Statutory provisions; recognition of gain or loss; exchanges solely in kind, distribution of stock not in liquidation.} \]

(b) In a reorganization, stock (other than preferred stock) in another corporation which is a party to the reorganization, without the surrender by such shareholder of stock, no gain to the distributees from the receipt of stock shall be recognized unless it appears that (A) any corporation which is a party to such reorganization was not in the active conduct of a trade or business after such reorganization, or (B) the corporation whose stock is distributed was used principally as a device for the distribution of earnings to the shareholders of any corporation a party to the reorganization.

Sec. 112. Recognition of gain or loss. (11) Exchanges solely in kind. ** ** **

(11) Distribution of stock not in liquidation. If there is distributed, in pursuance of a plan of reorganization, to a shareholder of a corporation which is a party to the reorganization, stock (other than preferred stock) in another corporation which is a party to the reorganization, without the surrender by such shareholder of stock, no gain to the distributees from the receipt of stock shall be recognized unless it appears that (A) any corporation which is a party to such reorganization was not in the active conduct of a trade or business after such reorganization, or (B) the corporation whose stock is distributed was used principally as a device for the distribution of earnings to the shareholders of any corporation a party to the reorganization.

(11) Involves cases in which one corporation, in a reorganization as defined in section 112 (g) (1) or (2) or (B) or (C) the corporation whose stock is distributed was used principally as a device for the distribution of earnings to the shareholders of any corporation a party to the reorganization.

(11) Involves cases in which one corporation, in a reorganization as defined in section 112 (g) (1) or (2) or (B) or (C) the corporation whose stock is distributed was used principally as a device for the distribution of earnings to the shareholders of any corporation a party to the reorganization.

(11) Involves cases in which one corporation, in a reorganization as defined in section 112 (g) (1) or (2) or (B) or (C) the corporation whose stock is distributed was used principally as a device for the distribution of earnings to the shareholders of any corporation a party to the reorganization.
the corporation whose stock is distributed is not used principally as a device for the distribution of earnings and profits to shareholders of any corporation a party to the reorganization. The underlying assumption of section 112 (b) (11) and of the rules applicable to reorganizations is that the reorganization and distribution of stock must result in a continuation of the old business activities undisturbed (as distinguished from any desire to effect changes in the interests of the shareholders therein).

(b) A corporation shall be considered to have distributed property to the shareholders of any corporation if and only if it distributes to one or more persons to a corporation for its stock or securities, within the meaning of section 112 (b) (6) there is received by the taxpayer in the additional 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 (c)).

(b) The application of this section may be illustrated by the following example:

Example. A, who is not a dealer in real estate, in 1952 exchanges real estate, which he purchased (for investment) in 1945 for $50,000, for stock in a real estate (for productive use in trade or business) which has a fair market value of $60,000, and he receives in addition thereto $8,000. If the gain from the transaction is $8,000, but is recognized only to the extent of the cash received of $2,000.

(c) 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) and (2) As to the proper treatment of such consideration for the purposes of so much of section 112 (c) as relates to section 112 (b) (3), see § 39.112 (g)–4, and so much of section 112 (c) as relates to section 112 (b) (5), see section 112 (c) (d).

(d) See section 113 (a) (6) for the basis for determining the gain or loss from the subsequent sale of the property received in exchange for such exchanged as described in this section.

(e) As to the receipt of other property or money on an exchange of stock or securities in connection with a section 112 (g) reorganization, see § 39.112 (10)–4; or in connection with a section 112 (b) (10) reorganization, see § 39.112 (10)–1. As to distributions in pursuance of a plan of reorganization which have the effect of a taxable dividend, see § 39.112 (g)–4, in the case of a section 112 (g) reorganization, or § 39.112 (10)–1, in the case of a section 112 (b) (10) reorganization.

§ 39.112 (d)–(e) Statutory provisions; recognition of gain or loss; gain of exchange not solely in kind.

§ 39.112 (d)–(e) Statutory provisions; recognition of gain or loss; gain of exchange not solely in kind.
(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 does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

§ 39.112 (d) as amended by sec. 121 (d) (3), Rev. Act 1943

(e) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (b) (1) to (6), inclusive, or (10), within the provisions of subsection (1) of this section if it were not for the fact that the property received in exchange consists not only of property permitted to be exchanged, therefrom shall be recognized to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain. If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(f) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (b) (1) to (6), inclusive, or (10), within the provisions of subsection (1) of this section if it were not for the fact that the property received in exchange consists not only of property permitted to be exchanged, therefrom shall be recognized to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain. If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(g) Nonrecognition of gain.

If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(h) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (b) (1) to (6), inclusive, or (10), within the provisions of subsection (1) of this section if it were not for the fact that the property received in exchange consists not only of property permitted to be exchanged, therefrom shall be recognized to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain. If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(i) Nonrecognition of gain.

If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(j) Nonrecognition of gain.

If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(k) Nonrecognition of gain.

If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.

§ 39.112 (d) (1), (2), Rev. Act 1943

(l) Nonrecognition of gain.

If the taxpayer is entitled to nonrecognition of gain under subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer, the amount so recognized shall be limited to the extent that the amount realized upon such conversion is excelled by the fair market value of such property so received and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph:

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The amount so recognized shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a), (b), the amount realized upon such conversion which otherwise would have been recognized shall be the amount realized upon such conversion which otherwise would have been recognized and in such manner as the Secretary may by regulations prescribe.
(2) All of the details in connection with an involuntary conversion of property at a gain, (including those relating to the replacement of the converted property, the time when the replacement was made, the amount of such gain recognized only to the extent provided in subparagraph (1) of this paragraph shall be made by including such gain in gross income for the year in which such gain is recognized. If the replacement of the converted property is not made, or if the replacement is made after the close of the first taxable year in which any part of the gain upon the conversion is realized, any deficiency, for any taxable year ending after the close of the last taxable year in which a part of such gain is realized, which is attributable to such gain may be assessed, at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of section 272 (f) or 275 or the provisions of any law or rule of law which would otherwise prevent such assessment.

(3) If the taxpayer makes an election under section 112 (f) (3) the gain upon the conversion shall be recognized to the extent that the amount realized upon such conversion exceeds the cost of the converted property or stock, which is attributable to such gain, regardless of whether such amount is realized in one or more taxable years.

(4) The proceeds of an involuntary conversion of real estate are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(5) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(6) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(7) If, in a condemnation proceeding the Government retains out of the award, sufficient funds to satisfy special assessments levied against the remaining portion of the lot or parcel of real estate affected for benefits accruing in connection with the condemnation, the amount so retained shall be deducted from the gross award in determining the amount of the net award.

§ 39.112 (g) Statutory provisions; recognition of gain or loss; definition of reorganization.

Sec. 112. Recognition of gain or loss. * * *

(g) Definition of reorganization. As used in this section (other than subsection (b) (10) and subsection (I) and in section 113 (other than subsection (a) (23))—

The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another cor-
corporation, but in determining whether the exchange of stock is 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, and an ordinary dividend is to be treated as an ordinary dividend, and the mere purchase of one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred, for voting stock 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 make the transaction outside the purposes and assumptions of the reorganization provisions. Section 112 (g) (1) (C) does not prevent consideration of the effect of other liabilities in the general character of 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.

(e) A "recapitalization," and therefore a reorganization, takes place if, for example:

(1) A corporation with $200,000 par value of bonds outstanding, instead of paying them off in cash, exchanges them by issuing preferred shares to the bondholders;

(2) There is surrendered to a corporation for cancellation 25 percent of its properties for stock in exchange for no par value common stock;

(3) A corporation issues preferred stock, previously authorized but unsold, for outstanding common stock;

(4) An exchange is made of a corporation's outstanding preferred stock, bearing certain priorities with reference 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 having no such rights.

(f) The term "a party to a reorganization" includes, in addition to a corporation which performs the specific act constituting the reorganization and described and defined in section 112 (g) (1) only a corporation specified in section 112 (g) (2) Both corporations are parties to the reorganization if statutory authority Corporation A is merged into Corporation B; and all three 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, the transfer, or series of transactions, embraced in a plan of reorganization for all of the capital stock of Corporation G. Only Corporations H and J are parties to the reorganization if it consists of the acquisition by Corporation H in exchange for a part of its voting stock of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of Corporation J, even though in such transaction, H is from Corporation K.

(g) The term "plan of reorganization" has reference to a consummated transaction specifically described as a reorganization under section 112 (g). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 112 (g) (1) but is to be limited to that reorganization of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in section 112 (g) (1). Moreover, a transaction, in a plan of reorganization, must not only come within the specific language of section 112 (g) (1) but, the readjustments involved in the exchanges or distributions affected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation and not for the purpose of giving the taxpayer other property or money, or of stock or securities of another corporation a party to the reorganization, in pursuance of the plan of reorganization.

§ 39.112 (g)–3 Exchanges solely of stock or securities, or property, solely for stock or securities, in pursuance of plan of reorganization. No taxable income is received, nor is a deductible loss sustained, if the shareholders in a corporation a party to a reorganization transactions exchange stock or securities solely for 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 of such other corporation, in pursuance of the 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 voting stock and at least 80 percent of the total number of shares of all other classes of the stock of Corporation G;

(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 § 39.112 (g) (2) of substantially all the properties of Corporation J;

(e) The transfer by Corporation K of all or a part of its assets to Corporation L, if immediately after the transfer Corporation K or its stockholders, or both, has control over Corporation L ("control" for the purposes of this petition being defined in section 112 (h) as the ownership by Corporation K or its stockholders, or both, of the stock of Corporation L 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 all 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 mere change in the identity, form, or place of organization of a corporation, however effected.

§ 39.112 (g)–4 Exchanges in reorganization for stock or securities and other property or money. (a) If in an exchange a taxpayer transfers to a 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

(1) As provided in section 112 (e) (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 received; or

(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)).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example A. In connection with a reorganization, in 1952, exchanges a share of stock in the X Corporation (a party to the reorganization) at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $10 in cash. The transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $30 would not be recognized.

(c) 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 taxable dividend, then, as provided in section 112 (e) (2) (1), there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized on the exchange as is in excess of the distributee's ratable share of the income distributed during the taxable year.

(d) The application of paragraph (c) of this section may be illustrated by the following example:

Example. The X Corporation has a capital stock worth $150,000 and a surplus of $59,000 accumulated prior to February 23, 1913. The Y Corporation, in 1913, transfers all of its assets to the X Corporation in pursuance of a plan for the issuance of all of the stock of the Y Corporation and the payment of $50,000 thereof to the stockholders of the X Corporation, A, who owns one share of stock in the X Corporation, for which he in 1910 paid $100, receives a share of stock in the Y Corporation worth $100 and the sum of $50 in cash in addition. A gain of $59 is recognized to A.

(e) If, in pursuance of a plan of reorganization, property is exchanged by a taxpayer apart from a party to the reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, as provided in section 112 (d) (1) if the other 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 the other property or money received 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), 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, but in other cases no loss from the exchange will be recognized (see section 112 (e))

(f) 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 (e) as relates to section 112 (b) (3). For the proper treatment of an assumption of liabilities under section 112 (e) (3) and so much of section 112 (e) as relates to section 112 (b) (3), see section 112 (e).

§ 39.112 (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 a holder 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, is not taxable as a dividend.

§ 39.112 (g)–5
§ 39.112 (g)–(j) 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 appear upon the official records of the corporation which is a party to the reorganization. Each corporation party to the 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 certified copy of the plan of reorganization, together with a statement under oath showing in full the information to be furnished in the exchange, and

(2) A complete statement of the cost or other basis of all stock or securities transferred in the exchange.

§ 39.112 (h)–(j) Statutory provisions; recognition of gain or loss; definition of control.

Sec. 112. Recognition of gain or loss. * * *

(a) Definition of Control. As used in this section the term "control" means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or of the number of all shares of stock of the corporation.

Sec. 112 (b)–(1) Control of corporation. Section 112 (b) (5) and section 112 (g) (1) "Control" in reference to the phrase "control of the corporation," as used in section 112 (b) (5) and section 112 (g) (1) is provided specifically that this definition is limited to the meaning of the term "control" as that term is used in section 112 (b) (5).

(b) Reorganization with, or transfer of property to or from, a foreign corporation. In determining whether the transfer of property for stock or securities or other property or money received from the exchange, including a statement of all distributions and other disposition made thereof. The amount of each kind of stock or securities and other property or money received from the exchange, in connection with a corporate reorganization shall be considered or recognized as part of the consideration property for stock or securities and other property or money received upon the exchange. If the reorganization is not considered as a corporation in determining the extent to which gain is recognized from the exchange or distribution. If the reorganization or the transfer is not carried out in accordance with the plan submitted, the Commissioner’s approval will not render the transaction tax free.

§ 39.112 (j)–(k) Statutory provisions; recognition of gain or loss; cross reference; assumption of liability.

Sec. 112. Recognition of gain or loss. * * *

(a) Installment obligations. For nonrecognition of gain or loss in the case of installment obligations, see section 44 (d).

(b) Assumption of Liability not recognized. Where upon an exchange the taxpayer receives as part of the consideration property or money which would be permitted by subsection (b) (4), (5), or (10) of this section to be received without the recognition of gain or loss, the amount of the liability so acquired or the taxpayer, such assumption or acquisition shall be considered as "other property or money" received by the taxpayer within the meaning of subsection (d), (d), or (e) of this section and shall not prevent the exchange from being within the provisions of subsection (b) (4), (5), or (10); except that if, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer with respect to the assumption or acquisition was a purpose to avoid Federal income or excess-profits taxes, such assumption or acquisition (in the amount of the liability) shall be considered as money received by the taxpayer for purposes of this section, be considered as money received by the taxpayer for purposes of this section.
Section 112 (k) assumes that the transaction
would, but for the purpose of deter-
miming the amount of gain to be recog-
nized upon the exchange in which the lia-
bilities are assumed, be treated as
money received by the taxpayer upon the
exchange. In any suit or proceeding
which brings into question the tax-
saver's status as the Commissioner de-
termines that the taxpayer's purpose with
respect thereto was a purpose to avoid Fed-
eral income tax on the exchange or was not
a bona fide business purpose, the tax-
saver contends such determination
by litigation, the taxpayer must sustain such
burden by the clear preponderance
of the evidence. Thus, the taxpayer
must prove his case by such a clear pre-
ponderance of all the evidence that a
purpose to avoid Federal In-
come tax on the exchange, or the pre-
ence of a bona fide business purpose, is
unmistakable.

Section 112 (l) Statutory provisions;
recognition of gain or loss; exchanges by
security holders in connection with cer-
tain corporate reorganizations.

(a) Exchanges by security holders in con-
nection with certain corporate reor-
ganizations—(1) General rule. No gain or
loss shall be recognized upon the ex-
change of the type described in sec-
tion 112 (b) (4) (5) or (10); and

(b) Application of general rule. The
application of paragraph (a) of this sec-
tion 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 mar-
ket value of $8,000, cash in the amount of
$3,000, and the assumption by the corporation
of indebtedness of $5,000. No gain is $8,000, computed as
follows:

Stock received........................................................................ $8,000
Cash received........................................................................ 3,000
Liabilities assumed by transferee........................................... 5,000
Total consideration received................................................... 16,000
Less: Adjusted basis of property transferred.................................. 10,000
Gain realized........................................................................... 6,000

Assuming that the transaction falls within
section 112 (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 each $8,500 gain will be recog-
nized as does not exceed the "other
property or money" received. Since section
112 (b) (5) provides that the liabilities shall
not constitute "other property or money" for
this purpose, the only "other property or
money" received is the $3,000 cash, and the $5,000 realized gain will be recog-
nized only to the extent of $3,000.

(c) Exceptions and limitations. The benefits of section 112 (c)
do not extend to any exchange involving an
assumption of liabilities unless it appears that
the principal purpose of the taxpayer with
respect to such assumption was a pur-
pose to avoid Federal income tax on the
exchange, or if such purpose was not
a bona fide business purpose, in
such cases, the amount of the liabilities
assumed shall, for the purpose of deter-

Section 112 (l) provides that no gain or
loss shall be recognized upon a
exchange consisting of the relinquishment or ex-
tinguishment of stock or securities of an insolvent
company in connection with a reorganiza-
tion described in section 112 (b) (10) or so much of
section 112 (d) (3) as relates to section 112 (b) (10).

(1) Exchange occurring in taxable years
beginning prior to January 1, 1943.

(2) Exchange occurring in taxable years
beginning prior to January 1, 1943.

(3) Exchange occurring in taxable years
beginning prior to January 1, 1943.

(4) Exchange occurring in taxable years
beginning prior to January 1, 1943.

(5) Exchange occurring in taxable years
beginning prior to January 1, 1943.

(6) Exchange occurring in taxable years
beginning prior to January 1, 1943.
§ 39.112 (m) Statutory provisions; recognition of gain or loss; gain from sale or exchange to effectuate policies of Federal Communications Commission. Sec. 113, Recognition of gain or loss. * * *

(m) Gain from sale or exchange to effectuate policies of Federal Communications Commission. If the sale or exchange of property in a corporation is certified by the Federal Communications Commission to be necessary or appropriate to effectuate the policies of the Commission with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, to the extent that it is treated as an involuntary conversion of such property within the meaning of subsection (f) of section 112, be treated as gain or loss from such an exchange subject to the provisions of section 112 (f) of this section, in accordance with the regulations prescribed by the Commissioner with the approval of the Secretary. Any election made by the taxpayer on account of the proceeds of an involuntary conversion of such property shall be binding for the taxable year and all subsequent taxable years.

§ 39.112 (m)–3 Nature and effect of election—(a) Alternative elections. (1) A taxpayer entitled to the benefits of section 112 (m) in respect of a sale or exchange of property may elect—

(i) To treat such sale or exchange as an involuntary conversion under the provisions of section 112 (f), and in addition elect to reduce the basis of the property, in accordance with the regulations prescribed in § 39.112 (m)–3, by all or part of the gain that would otherwise be recognized under section 112 (f), or

(ii) To reduce the basis of the property, in accordance with the regulations prescribed in § 39.112 (m)–3, by all or part of the gain realized upon the sale or exchange.

(b) Application of section 112 (f) and 113 (a) (9) (1) If the taxpayer elects, under paragraph (a) (1) or (ii) of this section, to treat the sale or exchange as an involuntary conversion, the provisions of sections 112 (f) and 113 (a) (9) as made applicable by paragraph (a) (9) together with the regulations prescribed under such sections, shall be applicable to determine the amount of recognized gain and the basis of property acquired as a result of the sale or exchange.

(c) An election to have the benefits of section 112 (m) shall be made in the manner prescribed in § 39.112 (m)–4.

§ 39.112 (m)–4 Nature and effect of election—(a) Alternative elections. (1) A taxpayer entitled to the benefits of section 112 (m) in respect of a sale or exchange of property may elect—

(i) To treat such sale or exchange as an involuntary conversion under the provisions of section 112 (f), and in addition elect to reduce the basis of the property, in accordance with the regulations prescribed in § 39.112 (m)–3, by all or part of the gain that would otherwise be recognized under section 112 (f), or

(ii) To reduce the basis of the property, in accordance with the regulations prescribed in § 39.112 (m)–3, by all or part of the gain realized upon the sale or exchange.
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§ 39.112 (m)–3 Reduction of basis of property pursuant to election under section 112 (m)–(a) General rule. (1) In addition to the adjustments provided in section 112 (f) and (c) and the provisions of the regulations relating thereto, which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made to the basis of the unrecognized gain under section 112 (m) if the taxpayer so elects. Such further adjustment shall be made only with respect to the cost or other basis of a unit of property the taxpayer subject to the allowance for depreciation under section 23 (l) and which remains in the hands of the taxpayer immediately after the sale or exchange, the time of reduction of the basis is the date of the sale or exchange; in all other cases the time of reduction of the basis is the date of the sale or exchange in respect of which the election is made, or which is acquired by the taxpayer in the same taxable year in which such sale or exchange occurs. If the property is in the hands of the taxpayer immediately after the sale or exchange, the time of reduction of the basis is the date of the sale or exchange; in all other cases the time of reduction of the basis is the date of the sale or exchange of property which is of a character subject to the allowance for depreciation under section 23 (l).

(2) The reduction of basis under section 112 (m) in the amount of the unrecognized gain shall be made in respect of the cost or other basis, as the case may be, of all units of property of the class specified. The cost or other basis of each unit shall be decreased in an amount equal to such proportion of the unrecognized gain as is determined in accordance with paragraph (a) of this section, without regard to this section, of such unit bears to the aggregate of such adjusted bases of all units of such property, but the amount so reduced shall not be more than the amount of such adjusted basis. If in the application of such rule the adjusted basis of any unit is reduced to zero, the process shall be repeated to reduce further the adjusted basis of the remaining units of property by the portion of the unrecognized gain which is not absorbed in the first application of the rule. For such purpose the "adjusted basis" of a unit of property shall be the basis of the unit of property converted into property or into money, such money being included in the basis of such property and an election under such section to treat the sale or exchange as an involuntary conversion under section 112 (l) may be exercised independently of each other. An election under section 112 (m) must be filed with the return for the taxable year in which the sale or exchange occurs. Where practicable, the certificate of the Federal Communications Commission required by § 39.112 (m)–1 should be filed simultaneously.

(b) If, in pursuance of an election to have the basis of its property adjusted under section 112 (m) the taxpayer desires to have such basis adjusted in any manner other than as prescribed in the regulations set forth in § 39.112 (m)–3 (a) the precise method (including allocation of amounts) should be set forth in detail on separate sheets accompanying the election. Consent of the Commissioner to any departure from such general rule shall be effected only by a closing agreement entered into under the provisions of section 3760.

§ 39.112 (m)–4 Manner of election. (a) An election under the provisions of section 112 (m) shall be in the form of a written statement accompanied by a legally executed and filed in duplicate. Such statement shall be signed by the taxpayer or his authorized representative. In the case of a corporation the statement shall be signed with the corporate name, followed by the signature and title of at least two officers of the corporation empowered to sign for the corporation, and the corporate seal must be properly affixed. An election under section 112 (m) to reduce the basis of property and an election under such section to treat the sale or exchange as an involuntary conversion under section 112 (l) may be exercised independently of each other. An election under section 112 (m) must be filed with the return for the taxable year in which the sale or exchange occurs. Where practicable, the certificate of the Federal Communications Commission required by § 39.112 (m)–1 should be filed simultaneously.

(b) If, in pursuance of an election to have the basis of its property adjusted under section 112 (m) the taxpayer desires to have such basis adjusted in any manner other than as prescribed in the regulations set forth in § 39.112 (m)–3 (a) the precise method (including allocation of amounts) should be set forth in detail on separate sheets accompanying the election. Consent of the Commissioner to any departure from such general rule shall be effected only by a closing agreement entered into under the provisions of section 3760.

§ 39.112 (n) Statutory provisions; recognition of gain or loss; gains from sale or exchange of residence. Sec. 112. Recognition of gain or loss. * * *

(a) Gain from sale or exchange of residence. (1) Nonrecognition. [herein in this subsection called "old residence") used by the taxpayer as his principal residence is sold by him and, within a period beginning on the date of such sale and ending one year after such date, property (hereinafter in this subsection called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

(2) Rules for application of subsection. For the purposes of this subsection:

(A) An exchange by the taxpayer of his principal residence for another property shall be considered as a sale of such residence, and the acquisition of a residence upon the exchange of property shall be considered as a purchase of such residence.

(B) If the taxpayer's residence (as a result of destruction in whole or in part, theft, or colorum) is compulsorily or involuntarily converted into property or into money, such destruction, theft, or colorum shall be considered as a sale of such residence; and if the residence is reconverted into property which is used by the taxpayer as his residence such reconverted property shall be considered as a purchase of such property by the taxpayer.

(C) In the case of an exchange or conversion described in subparagraph (A), (B), (C) in determining the extent to which the

Saturday, September 26, 1953

Application of section 112 (f) and (m)–3

Sale price of X Corporation stock $100,000

Gain realized: $75,000

Proceeds of sale: $100,000

Amount expended in manner prescribed in section 112 (f)–3: $50,000

Amount not expended in manner prescribed in section 112 (f)–3: $50,000

Realized gain recognized under section 112 (f) (not to exceed the amount of proceeds of sale): $25,000

Amount applied toward basis: $25,000

Gain recognized for tax purposes: None

Application of section 112 (f) (9)–3

Basis of property (cost or market value as of date of acquisition) $125,000

Decreased in amount of proceeds not expended under section 112 (f)–3: $75,000

Balance: $50,000

Increased in amount of gain recognized under section 112 (f)–3: $25,000

Basis of Y Corporation stock in A's hands: $50,000

[Table of figures and calculations related to the gain and basis of property converted]
§ 39.112 (n)–1

Gain from sale or exchange of residence—(a) In general.

Gain from the sale of a property used by the taxpayer as his principal residence (referred to in this section as "the old residence") will not be recognized if the taxpayer within a period beginning one year before the date of such sale and ending one year after such date purchases property and uses such property as his principal residence (referred to in this section as the "new residence") except to the extent that the taxpayer's selling price exceeds the taxpayer's cost of purchasing the new residence. In the case of a new residence the construction of which was commenced by the taxpayer at any time before the expiration of one year after the date of the sale of the old residence, the one year after the sale of the old residence referred to in the preceding sentence shall be considered as including a period of 18 months from the date of the sale of the old residence. Such nonrecognition of gain is mandatory. This section applies only with respect to gains; losses from sales of property used by the taxpayer as his principal residence are recognized or not recognized without regard to this section.

(b) Rules for application of section—

(1) Property used by the taxpayer as his principal residence. (2) Whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence, for example, if the taxpayer purchases his new residence before he sells his old residence, the fact that he temporarily rents out the new residence during the period before he vacates the old residence shall not, if all the facts and circumstances in the case, prevent the new residence from being, considered as property used by the taxpayer as his principal residence. Property used by the taxpayer as his principal residence may include a houseboat, a house trailer, or stock held by a tenant-stockholder in a cooperative apartment corporation as those terms are defined in section 23 (a) (2), if the apartment which the taxpayer is entitled to occupy as such stockholder is used by him as his principal residence. Property used by the taxpayer as his principal residence does not include personal property such as a piece of furniture, a radio, etc., which, in accordance with the applicable local law, is not a fixture.

(i) Where part of a property is used by the taxpayer as his principal residence and part is used for other purposes, an allocation must be made to determine the application of this sec-
tion. If the old residence is used only partially for residential purposes, only that part of the gain allocable to the residential portion may be considered as a capital gain. Capital gains are not recognized because of the tax-shelter effect of the sale. Commissions and other selling expenses paid or incurred by the taxpayer on the purchase of the new residence are to be included in determining such gain. In the case of an acquisition of a residence upon the sale of an exchange or conversion which is considered as a sale under this section, the fair market value of the new residence shall be considered as the taxpayer's cost of purchasing the new residence. The taxpayer's cost of purchasing the new residence includes only so much of such cost as is attributable to acquisition, construction, reconstruction, or improvements made within the two-year period prior to the sale of such residence, as the case may be, in which the purchase and use of the new residence must be made in order to have gain on the sale of the old residence. The taxpayer's cost of purchasing the new residence is considered as the cost of purchasing the new residence.
of the old residence, the purchased residence shall, in no event, be treated as a new residence if such purchased residence is sold or otherwise disposed of by him prior to the date of the sale of the old residence. The taxpayer's purchase and use of the new residence, the period within which the purchase and use of the new residence must be made in order to have any gain on the sale of the old residence recognized, the taxability of such gain or loss from the sale of the new residence, the treatment of any part of such gain or loss, and the like, are all governed by the rules and regulations applicable to sales of real property. For example, if the taxpayer is on extended active duty with the army from January 1, 1951, to December 31, 1953, and sells his old residence on January 1, 1952, the latest date during the period January 1, 1952, to January 1, 1955, the taxpayer may use a new residence constructed by him and have any part of the gain on the sale of the old residence not recognized under this section. If the taxpayer is in the United States after the date of sale of the old residence, for any such period as is required under this section, the taxpayer may, in no event, be treated as a sale.

(2) If the return for the taxable year or years in which the purchase of the new residence occurs, or the intention not to make such a purchase is formed, or the period expires, is filed with the district director of the Internal Revenue Service, the taxpayer shall give to such district director the notification described in subparagraph (1) of this paragraph in his return for the taxable year in which such purchase occurs, or such intention is formed, or such period expires. If, however, the return for the taxable year or years in which such purchase occurs or such intention is formed, or such period expires, is filed with a different district director of internal revenue, the taxpayer, at the time of filing such return, shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized. In addition to giving such notification at the time he files his return for the taxable year or years in which such purchase occurs, or such intention is formed, or such period expires, he shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized. In addition to giving such notification at the time he files his return for the taxable year or years in which such purchase occurs, or such intention is formed, or such period expires, he shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized.

(2) If the return for the taxable year or years in which the purchase of the new residence occurs, or the intention not to make such a purchase is formed, or the period expires, is filed with the district director of the Internal Revenue Service, the taxpayer shall give to such district director the notification described in subparagraph (1) of this paragraph in his return for the taxable year in which such purchase occurs, or such intention is formed, or such period expires. If, however, the return for the taxable year or years in which such purchase occurs or such intention is formed, or such period expires, is filed with a different district director of internal revenue, the taxpayer, at the time of filing such return, shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized. In addition to giving such notification at the time he files his return for the taxable year or years in which such purchase occurs, or such intention is formed, or such period expires, he shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized. In addition to giving such notification at the time he files his return for the taxable year or years in which such purchase occurs, or such intention is formed, or such period expires, he shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized.

(2) If the return for the taxable year or years in which the purchase of the new residence occurs, or the intention not to make such a purchase is formed, or the period expires, is filed with the district director of the Internal Revenue Service, the taxpayer shall give to such district director the notification described in subparagraph (1) of this paragraph in his return for the taxable year in which such purchase occurs, or such intention is formed, or such period expires. If, however, the return for the taxable year or years in which such purchase occurs or such intention is formed, or such period expires, is filed with a different district director of internal revenue, the taxpayer, at the time of filing such return, shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized. In addition to giving such notification at the time he files his return for the taxable year or years in which such purchase occurs, or such intention is formed, or such period expires, he shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized. In addition to giving such notification at the time he files his return for the taxable year or years in which such purchase occurs, or such intention is formed, or such period expires, he shall give such notification to the district director of internal revenue with whom the taxpayer filed his return for the taxable year or years in which the gain from the sale of the old residence was realized.
in the case of vessels acquired through the Maritime Commission (or its successor) see sections 510 and 611 of the Merchant Marine Act of 1936 (46 U.S.C. 1160, 1161). For special rules for determining the basis of property recovered in respect of war losses, see section 137 (d). For special rules for determining the basis for gain or loss in the case of the disposition of a share of stock acquired pursuant to the exercise of a restricted stock option where the option price was between 85 percent and 95 percent of the fair market value of the stock on the date of the option grant, see section 130A (B). For special rules for determining the basis, both unadjusted and adjusted, of property acquired or improved with the proceeds of a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or production of, rare earths, see sections 39.113 (a) (1) to 113 (a) (23) inclusive.

§ 39.113 (a)–2 General rule. In general, the basis of property is the fair market value of such property at the time the property should have been included in the last inventory. Thus, the basis is subject, however, to the exceptions stated in sections 113 (a) (1) to 113 (a) (23) inclusive.

§ 39.113 (a) (1) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; inventory items. See section 113. Adjusted basis for determining gain or loss.—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property, except that—

(1) Inventory value. If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

§ 39.113 (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 an inventory are stated in §§ 39.23 (c)–1 to 39.22 (d)–7, inclusive.

§ 39.113 (a) (2) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; gifts after December 31, 1929. See section 113. Adjusted basis for determining gain or loss of property. The basis of property shall be the cost of such property, except that—

(2) Gifts after December 31, 1929. If the property was acquired by gift after December 31, 1929, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period prior to the date of gift as provided in section 113 (b) is greater than the fair market value of the property at the time of the gift, the basis shall be such fair market value.

All titles to property acquired by gift relate back to the time of the gift, even though the interest of the person whom it was at, the time of the gift, legal, equitable, vested, contingent, conditional, or otherwise. Accordingly, all property shall be acquired by gift at the time of the gift. In the hands of every person acquiring property by gift, the basis is always the same, whether such person receives the property immediately after the transfer by the donor, or as remainderman under the instrument of gift, or whether such person is any other person to whom such uniform basis is applicable. Such uniform basis applies to the property in the hands of the donee or the beneficiary under a gift instrument, both during the term of the trust and after the distribution of the trust corpus. Adjustments to basis, as required by section 113 (b) are to be made as respects the period prior to the gift, and the period after the gift. With respect to the latter period, the adjustments to the uniform basis are to be made in accordance with paragraph (c) of § 39.113 (a) (5)–1.

(3) The time of the gift is the time when the gift is consummated. Delivery, actual or constructive, is requisite to a gift. When determining the time of the gift, the passing of title was, at the time of the gift, the passing of title to a gift. In determining the time of the gift, the passing of title is decisive.

§ 39.113 (a) (3)–1 Transfer in trust after December 31, 1929.—(a) Property included. Section 113 (a) (3) applies in general to all property acquired after December 31, 1929, by transfer in trust. It does not apply to property acquired by bequest or devise, by an instrument which, under section 113 (a) (5) is to be treated as though it were a will, or to property acquired as a gift by transfer in trust made at any time after December 31, 1929. With these exceptions, section 113 (a) (3) applies to all property acquired after December 31, 1929, by any transfer in whatever description. If the property was acquired as a gift by transfer in trust, it is not within section 113 (a) (3) but is within section 113 (a) (2) or section 113 (a) (4) the purpose of a State gift tax, or if the gift is not subject to such tax, its value as ascribed for the purpose of a State gift tax, shall be deemed to be the fair market value of the property at the time of the gift.

(b) Basis. The basis of property so acquired is the same as it would be in the hands of the grantor, increased in the case of such property or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by a transfer in trust, this basis

§ 39.113 (a) (3)–1
§ 39.113 (a) (4) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; gifts or transfers in trust before January 1, 1921.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property, except that—

(4) Gift or transfer in trust before January 1, 1921; if the property was acquired by gift or transfer in trust on or before December 31, 1920, and shall be the fair market value of such property at the time of such acquisition.

§ 39.113 (a) (4)–1 Gift or transfer in trust before January 1, 1921—(a) Property included. Section 113 (a) (4) applies to a transfer of property in a trust created before January 1, 1921, by gift or transfer in trust. It does not apply to property acquired by a devisee or bequestee; or by an instrument which, under section 113 (a) (5), is to be treated as though it were a will.

(b) Basis. The basis is 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 § 39.113 (a) (2)–1, or by equivalent methods.

§ 39.113 (a) (5) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; property transmitted at death.

Sec. 113. Adjusted basis for determining gain or loss.—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property, except that—

(5) Property transmitted at death. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. In the case of property transferred in trust to pay the income for life to or upon the order of direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis is in the hands of the person entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. For the purpose of this paragraph property passing without full and adequate consideration under a general power of appointment exercised by will shall be deemed to be property passing from the individual exercising such power by bequest or devise. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, and if the decedent died after August 26, 1957, and if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year ending on or before the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company, then the basis is the fair market value of the property at the time of such acquisition or the basis in the hands of the decedent, whichever is lower. In the case of an election under section 811 (j), the time of acquisition of the property shall, for the purpose of this subparagraph, be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate. For the purposes of the surviving spouse's one-half share of community property held by the decedent and the surviving spouse, under the community property laws of any State, Territory or possession of the United States or any foreign country, shall be considered to be property "acquired by bequest, devise, or inheritance" from the decedent, if the death of the decedent was after December 31, 1947, and if at least one-half of the total community interest in such property was includible in determining the value of the decedent's gross estate under section 811.

(b) Basis. Section 113 (a) (5) provides three rules for determining the basis of property transmitted at death, first, a rule governing property generally, second, a rule applicable to property held by the executor of a will, and, third, a special rule applicable to property held by the personal representative of an estate.

(1) General rule. Except as provided in subparagraphs (2) and (3) of this paragraph, the basis of property acquired by the decedent's estate from the decedent, and if the death of the decedent was after December 31, 1947, under the law governing the descent and distribution of the property of the decedent is the fair market value at the time of such acquisition or the basis of such property held by the decedent, if the death of the decedent was after December 31, 1947, and if at least one-half of the total community interest in such property was includible in determining the value of the decedent's gross estate under section 811.

(2) Property acquired by bequest, devise, or inheritance. For the purposes of this paragraph such part of such one-half share of the surviving spouse's one-half share of community property held by the decedent and the surviving spouse shall be considered to be property "acquired by bequest, devise, or inheritance" from the decedent, if the death of the decedent was after December 31, 1947, and not in the case of an election made under section 811 (j), the time of acquisition of the property shall, for the purposes of this paragraph such part of such one-half share of the surviving spouse's property which would exist without the application of subsection (a) (4) of this section, shall be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate of the decedent. If the property was acquired by bequest, devise, or inheritance, or by equivalent methods, the basis shall be the fair market value of such property at the time of such acquisition.

(3) Of property transmitted at death. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. In the case of property transferred in trust to pay the income for life to or upon the order of direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis is in the hands of the person entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. For the purpose of this paragraph property passing without full and adequate consideration under a general power of appointment exercised by will shall be deemed to be property passing from the individual exercising such power by bequest or devise. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, and if the decedent died after August 26, 1957, and if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year ending on or before the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company, then the basis is the fair market value of the property at the time of such acquisition or the basis in the hands of the decedent, whichever is lower. In the case of an election under section 811 (j), the time of acquisition of the property shall, for the purpose of this subparagraph, be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate. For the purposes of the surviving spouse's one-half share of community property held by the decedent and the surviving spouse, under the community property laws of any State, Territory or possession of the United States or any foreign country, shall be considered to be property "acquired by bequest, devise, or inheritance" from the decedent, if the death of the decedent was after December 31, 1947, and if at least one-half of the total community interest in such property was includible in determining the value of the decedent's gross estate under section 811.

§ 39.113 (a) (4)
by bequest, devise, or inheritance, is, on the one hand, to be 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 quite uncertain whether the taxpayer would have realized it on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of another has been terminated. Such postponement may be, for example, until the administration of the decedent’s estate is completed, until the period of the possession or enjoyment of another has not until in the case of certain events has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

(2) Special rule with respect to stock in a foreign personal holding company. In the case of decedents dying after August 23, 1937, the basis of stock of a foreign corporation acquired from the decedent by will or under the law governing descent and distribution of property of decedents, where such foreign corporation was acquired not later than two years preceding the date of the decedent’s death was the foreign personal holding company, is the fair market value of such stock at the time of such acquisition, i.e., the date of the decedent’s death, or the basis in the hands of the decedent (with proper adjustments to the date of the decedent's death) which was the fair market value on the date of death, but only to the same extent and for the same purposes as the fair market value on March 1, 1913, is taken under section 113 (a) (1). (2) If the property is an investment by the decedent under a will (as, for example, in the case of a sale by a fiduciary under a will of property transmitted from the decedent, and the reinvestment of the proceeds) the cost or other basis to the fiduciary is taken in lieu of the fair market value at the time when the decedent dies.

(c) Adjustments to basis. (1) In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or gift, or by inheritance at the death of the decedent, the basis of such property is always the same.

(i) Whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a 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.

(ii) Whether during or after administration, or settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

(2) Adjustments to basis required by section 113 (b) are made in accordance with the same principles. Thus, the deductions for depreciation and for depletion are allowed, under section 23 (d) and section 23 (m) both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands of the trustee but also in the hands of the remainderman and every other person to whom the uniform basis is applicable. Similarly, the deductions allowed or allowable under section 23 (d) and section 23 (m), both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands 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). (3) Similarly, adjustments in respect of capital expenditures or losses, tax-free exchanges, or other items for which adjustment to basis is required to be made by section 113 (d) and shall furnish to the Commissioner, in such format and at such time and in such manner as the Commissioner may require.

(i) Sales of remainder and other interests in real property terminated at death. The following is an illustration of the rule stated in paragraph (b) 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 as reflected in such sale or other disposition. If, in the time of A’s death, B sells his remainder, the increase or decrease in the value of the land reflected, and realized by B, in the sale of his interest is always the same.

As used hereafter in this chapter (Regulations 109) of the deduction and the remainder of this section is considered to be the date at which such property is valued for estate tax purposes. Thus, in such cases, generally the basis will be the value at the date of the decedent’s death (but with certain limitations) the value at the date one year after his death or, in the case of such property distributed by the executor (or trustee, in certain cases) within one year after the decedent’s death, the value as of the time of such distribution. See § 81.11 of this chapter (Regulations 109).

(a) Fair market value. For the purposes of this section, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or the optional value as appraised for such purpose, whenever is applicable as provided in subparagraph (3) of paragraph (b) of this section, or if the estate is not subject to such tax, its value appraised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of such estates.

(b) Property acquired before March 1, 1913; revaluations by fiduciary. (1) If the decedent died before March 1, 1913, the fair market value on that date is deemed to be the value on the date of death, but only to the same extent and for the same purposes as the fair market value on March 1, 1913, as taken under section 113 (a) (1). (2) If the property is an investment by the decedent under a will (as, for example, in the case of a sale by a fiduciary under a will of property transmitted from the decedent, and the reinvestment of the proceeds) the cost or other basis to the fiduciary is taken in lieu of the fair market value at the time when the decedent dies.

(c) Adjustments to basis. (1) In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or gift, or by inheritance at the death of the decedent, the basis of such property is always the same.

(i) Whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a 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.

(ii) Whether during or after administration, or settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

(2) Adjustments to basis required by section 113 (b) are made in accordance with the same principles. Thus, the deductions for depreciation and for depletion are allowed, under section 23 (d) and section 23 (m) both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands of the trustee but also in the hands of the remainderman and every other person to whom the uniform basis is applicable. Similarly, the deductions allowed or allowable under section 23 (d) and section 23 (m), both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands 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). (3) Similarly, adjustments in respect of capital expenditures or losses, tax-free exchanges, or other items for which adjustment to basis is required to be made by section 113 (d) and shall furnish to the Commissioner, in such format and at such time and in such manner as the Commissioner may require.

(i) Sales of remainder and other interests in real property terminated at death. The following is an illustration of the rule stated in paragraph (b) 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 as reflected in such sale or other disposition. If, in the time of A’s death, B sells his remainder, the increase or decrease in the value of the land reflected, and realized by B, in the sale of his 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 received from the sale of the property 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 sale is such a sale of the proceeds received from the sale of the land transmitted from the decedent which bears the same proportion to such uniform basis as B’s remainder interest constitutes to the value at the time of the decedent’s death. As to the taxability of survivor annuity payments in accordance with this rule, see § 33.22 (b) (2)–2.

§ 39.113 (a) (6) Statutory provisions; adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property: except that— • • •

(6) Tax-free exchanges generally. In the case of a sale of the property acquired from the decedent by the will, the life tenant and every other person to whom a uniform basis under this section is applicable, shall make and maintain records in detail all deductions, distributions, or other items for which adjustment to basis is required to be made by section 113 (d) and shall furnish to the Commissioner, in such format and at such time and in such manner as the Commissioner may require.

(i) Sales of remainder and other interests in real property terminated at death. The following is an illustration of the rule stated in paragraph (b) 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 as reflected in such sale or other disposition. If, in the time of A’s death, B sells his remainder, the increase or decrease in the value of the land reflected, and realized by B, in the sale of his 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 received from the sale of the property 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 sale is such a sale of the proceeds received from the sale of the land transmitted from the decedent which bears the same proportion to such uniform basis as B’s remainder interest constitutes to the value at the time of the decedent’s death. As to the taxability of survivor annuity payments in accordance with this rule, see § 33.22 (b) (2)–2.
amount of loss to the taxpayer that was recognized under the provisions of section 112 (b) or (1) to be received without the recognition of gain or loss, and in part of other property, the basis of the property transferred shall be allocated between the properties (other than money) received, and for the purpose of the allocation of such property the basis shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

(a) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. A purchased a share of stock in the X Corporation in 1939 for $100. Upon a reorganization of the X Corporation in 1952, a received in place of his stock in the X Corporation a share of stock in the Y Corporation worth $80, a Treasury bond worth $80, and in addition $20 in cash. A realized a gain of $80 upon the exchange, all of which is recognized under section 112 (c) (1). The basis of the property received in exchange is the basis of the X stock ($100) decreased in the amount of money received ($20) and in the amount of $80 that was recognized ($30), which results in a basis for the property received of $10. This basis of $10 is apportioned between the Treasury bond and the share of stock, the basis of the Treasury bond being its fair market value at the date of the exchange, $50, and of the share of stock, the remainder, $50.

(b) Section 112 (a) 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) or (1) if the property transferred is subject to a liability, such assumption or assignment (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer upon the exchange. This paragraph shall not apply to property acquired by a corporation in exchange for the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

Example. An individual, owns an apartment house which has no adjusted basis in his hands of $60,000, but which is subject to a mortgage of $30,000. On September 1, 1935, he transfers such apartment house to C, receiving in exchange therefor $50,000 in cash and another apartment house with a fair market value on that date of $60,000. The transfer to C is made subject to the $60,000 mortgage, but C does not assume such mortgage. C realizes a gain of $30,000 on the exchange, computed as follows:

- Value of property received $90,000
- Cash $50,000
- Liabilities subject to which old property was transferred $60,000

Gain realized $30,000

Since section 112 (k) does not apply to section 112 (b) or (1) or to section (c) as relates to section 112 (b) (1), $30,000 of such $50,000 gain is recognized. The basis of the apartment house acquired by C upon the exchange is $60,000, computed as follows:

- Adjusted basis of property transferred $50,000
- Cash $50,000
- Liabilities subject to which property was transferred $60,000

Amount of liabilities transferred $30,000

Difference $20,000

Plus: Amount of gain recognized upon the exchange $20,000

Basis of property acquired upon the exchange $50,000

§ 39.113 (a) (6)–2 Treatment of assumption of liabilities. (a) For the purposes of section 113 (a) (6) the amount of any liabilities 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 recognized gain or loss to the taxpayer under the law applicable to the year in which the exchange was made.

(b) The application of this section may be illustrated by the following examples:

Example (1). A, an individual, owns property having an adjusted basis of $100,000 and on which there is a purchase money mortgage of $50,000. On September 1, 1930, A exchanges the property to B, the property assumed in exchange for all the capital stock of the X Corporation and the assumption of the $50,000 mortgage. The capital stock of the X Corporation has a fair market value of $100,000. Under section 112 (b) (6), no gain is recognized. The basis of such stock in A's hands is $76,000, computed as follows:

- Adjusted basis of property transferred $100,000
- Cash $50,000
- Liabilities subject to which property was transferred $50,000

Gain realized $24,000

B's basis of such stock in A's hands is $24,000

Example (2). B, an individual, owns an apartment house which has an adjusted basis in his hands of $50,000, but which is subject to a mortgage of $30,000. On September 1, 1932, B transfers such apartment house to C, receiving in exchange therefor $80,000 in cash and another apartment house with a fair market value on that date of $60,000. The transfer to C is made subject to the $60,000 mortgage, but C does not assume such mortgage. C realizes a gain of $30,000 on the exchange, computed as follows:

- Value of property received $90,000
- Cash $50,000
- Liabilities subject to which old property was transferred $60,000

Gain realized $30,000

Since section 112 (k) does not apply to section 112 (b) or (1) or to section (c) as relates to section 112 (b) (1), $30,000 of such $50,000 gain is recognized. The basis of the apartment house acquired by C upon the exchange is $60,000, computed as follows:

- Adjusted basis of property transferred $50,000
- Cash $50,000
- Liabilities subject to which property was transferred $60,000

Amount of liabilities transferred $30,000

Difference $20,000

Plus: Amount of gain recognized upon the exchange $20,000

Basis of property acquired upon the exchange $50,000

§ 39.113 (a) (7) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; transfers to corporations.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—** *(7) Transfers to corporation. If the property is acquired—

(A) After December 31, 1917, and in a taxable year beginning before January 1, 1930, by a corporation in connection with a reorganization, and immediately thereafter no interest or control in such property of 50 percent or more remained in the hands of the transferor, 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 such conversion was made) determining the taxable status of such property. The basis of property increased or decreased as the result of an involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, confiscation, or condemnation of such residence, or the sale or exchange of such residence under threat or imminent danger of destruction, occurred after December 31, 1950. In the case of property purchased by the taxpayer which resulted, under section 112 (f) (1), in the nonrecognition of any part of the gain or loss realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of the property decreased in the amount of the gain not so recognized; and if the gain so purchased consists of more than one amount of gain, the bases of the properties so acquired determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

Example. A vessel purchased by A in 1935 for $200,000 in cash. The vessel was also destroyed in 1950 and A receives insurance in the amount of $220,000.

(b) The application of the provisions of section 113 (a) (8) may be illustrated by the following example:

Example. A taxpayer realizes $22,000 from the involuntary conversion of his barn in 1952; the adjusted basis of the barn to him was $10,000, and he spent in the same year $20,000 for a new barn which resulted in the nonrecognition of $10,000 of the $12,000 gain on the conversion. The unadjusted basis of the new barn to the taxpayer would be $10,000—the cost of the new barn ($20,000) less the amounts of the gain not recognized on the conversion ($10,000). The unadjusted basis of the new barn would not be a substituted basis in the hands of the taxpayer within the meaning of section 113 (a) (2). (3). If the replacement of the converted barn had been made by the taxpayer by the purchase of two smaller barns which, together, were replaced in service or use to the converted barn and which cost $3,000 and $12,000, respectively, the basis of each barn (8,000 and 12,000) less in each case the cost of the property so converted, determined in the amount of the gain not recognized by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of such property. The basis of the two barns bears to the cost of both barns the same ratio as their respective costs.
§ 39.113 (a) (10) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; wash sales of stock.

Sec. 113. Adjusted basis for determining gain or loss—(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 a share of stock in the same corporation, the basis of which (or the contract or option to acquire which) resulted in the nondenudability (under section 118 of this chapter or the corresponding provisions of prior income tax laws, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, then the basis shall be the basis of the stock or securities so sold or disposed of, increased or decreased, as the case may be, by the difference, if any, between the price at which the property was acquired and the price at which such substantially identical stock or securities were sold or otherwise disposed of.

§ 39.113 (a) (10)–1 Stocks or securities acquired in “wash sales.” The application of section 113 (a) (10) may be illustrated by the following examples:

Example (1). A purchased a share of common stock in the Y Corporation for $80 in 1925, which he sold January 15, 1926, for $80. On February 1, 1925, he purchased a share of common stock of the same corporation for $90. No loss from the sale is recognized under section 118. The basis of the new share is $110; that is, the basis of the old shares increased by $10, the excess of the price at which the new share was acquired ($90) over the price at which the old share was sold ($80). If by section 113 (a) (10) this rule is applicable.

Example (2). A purchased a share of common stock of the Y Corporation for $100 in 1925, which he sold January 15, 1926, for $80. On February 1, 1925, he purchased a share of common stock of the same corporation for $90. No loss from the sale is recognized under section 118. The basis of the new share is $90; that is, the basis of the old share ($100) decreased by $10, the excess of the price at which the old share was sold ($100) over the price at which the new share was acquired ($90). If by section 113 (a) (10) this rule is applicable.

§ 39.113 (a) (11) Statutory provisions; adjusted basis for determining gain or loss; property acquired during affiliation.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

(11) Property acquired during affiliation. In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to inter-company transactions in respect of which a gain or loss was not recognized. 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, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1926. If by section 113 (a) (11) this rule is applicable.

(b) 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 was made or was required under the regulations governing the making of consolidated returns, shall be determined in accordance with such regulations. If by section 113 (a) (11) this rule is applicable.

(c) Except as otherwise provided in Regulations 129 (Part 24 of this Chapter) the basis of property after a consolidated return period shall be the same as immediately prior to the close of such period.

§ 39.113 (a) (12) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; basis established by Revenue Act of 1932.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

(12) Basis established by Revenue Act of 1932. If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1929, 47 Stat. 109, was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

§ 39.113 (a) (12)–1 Basis of property established by Revenue Act of 1932. (a) Section 113 (a) (12) provides that if the property was acquired, after February 28, 1913, in any taxable year beginning before January 1, 1934, and the basis of the property, for the purposes of the Revenue Act of 1929, was prescribed by section 113 (a) (6), (7), or (9) of that Act, then for the purposes of the Internal Revenue Code the basis shall be the same as the basis prescribed in the Revenue Act of 1932.

(b) If, after December 31, 1923, and in any taxable year beginning before January 1, 1934, in pursuance of a plan of reorganization and without the surrender or exchange of any property of the distributing corporation for any consideration, any property was transferred to a shareholder in a corporation a party to the reorganization stock or securities of a corporation a party to the reorganization, then as is provided in section 113 (a) (9) of the Revenue Act of 1932, the basis of the stock in respect of which the distribution was made must be apportioned between such stock and the old shares of such corporation held by such shareholder. The basis of the old shares and the new shares or securities shall be determined in accordance with the following:

(1) If the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as the stock in respect of which the distribution is made, 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.

(2) If the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or if the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the
§ 39.113 (a) (13) Property contributed in kind by a partner to a partnership. The basis of property contributed in kind by a partner to partnership capital after February 28, 1913, is the cost or other basis thereof to the contributing partner. Annual allowances to the partnership for depletion and depreciation allowances are not to be taken into account in the determination of the distribution shares of the partners in accordance with their agreement in respect of the sharing of gains or losses affecting partnership capital. If the basis of such contributed property is less than the fair market value thereof at the date of transfer to the partnership, the annual allowances for depletion and depreciation thereon are to be limited to such basis and may be apportioned among the partners according to their agreement with respect to the sharing of gains or losses affecting partnership capital. In the case of property contributed in kind as a distribution in pursuance of the plan of reorganization, stock or securities will be presumed to have been made from the earliest purchased stock. In general, any material difference in character or preference or terms sufficient to distinguish the stock or securities from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

(2) If the stock in respect of which a distribution in reorganization is made was purchased at different times or at different prices, and the identity of the lots cannot be determined, any sale of the original stock or of different lots of the different purchased stock (see § 39.22 (a)-8) and any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

(4) If the stock in respect of which a distribution in reorganization is made was purchased at different times or at different prices, and the identity of the lots cannot be determined, any sale of the stock or securities distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

(c) If without the surrender of his stock there is acquired by a shareholder in a corporation a party to a reorganization, as a distribution in pursuance of the plan of reorganization, stock or securities in a corporation a party to the reorganization, such acquisition of new shares or securities by the shareholder will be treated as a dividend to the extent described in § 39.112 (e)-5.

§ 39.113 (a) (13) Statutory provisions; adjusted basis for determining gain or loss; base (unadjusted) of property; property acquired by or from partnerships.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property, except that—

(13) For the purpose of this section, if any property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferee. In no case shall the amount of gain or decrease 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 be greater than the amount of gain or decrease 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. However, any property distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be the same as the basis in the hands of his partnership interest as is properly allocable to such property.

(b) If a new partner is admitted to the partnership, or if an existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain has been realized or loss sustained by any partner.

(c) For rules as to allocation of partnership gain or loss in the case of family partnerships, see section 191 and the regulations thereunder.

§ 39.113 (a) (14) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; property acquired before March 1, 1913.

Sec. 119. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property except that—

(14) Property acquired before March 1, 1913. In the case of property acquired before March 1, 1913, if the property was transferred at a time when the fair market value of such property was less than the cost of such property, the basis of such property will be its fair market value in the hands of the transferee at the time of the transfer. If the property was transferred at a time when the fair market value of such property was greater than the cost of such property, the basis of such property will be its fair market value in the hands of the transferee at the time of the transfer.

In the case of property acquired after March 1, 1913, the basis of property transferred at a time when the fair market value of such property was less than the cost of such property will be its fair market value in the hands of the transferee at the time of the transfer. If the property was transferred at a time when the fair market value of such property was greater than the cost of such property, the basis of such property will be its fair market value in the hands of the transferee at the time of the transfer.

In the case of property acquired under section 113 (a) adjusted for the period before March 1, 1913, or the fair market value of the property as of March 1, 1913, whichever is higher.

(b) The basis as of March 1, 1913, for determining loss in the case of property acquired before that date is the cost or other basis provided for such property under section 113 (a) adjusted for the period before March 1, 1913, or the fair market value of the property as of March 1, 1913, whichever is higher.

(c) For rules as to allocation of provisions of those sections is considered to be the cost or other basis for determining loss in the case of property acquired before that date is the cost or other basis provided for such property under section 113 (a) adjusted for the period before March 1, 1913, or the fair market value of the property as of March 1, 1913, whichever is higher.

(d) The basis as of March 1, 1913, for determining gain in the case of property acquired before that date is the cost or other basis provided for such property under section 113 (a) adjusted for the period before March 1, 1913, or the fair market value of the property as of March 1, 1913, whichever is higher.

(e) A provision of section 113 (a) (14) may be illustrated by the following example:

Example. A, who makes his returns on the calendar year basis, purchased on March 1, 1901, property having a useful life of 50 years for $100,000. Assuming, for the purpose of this example, that there are no additions and betterments to be taken into account, the depreciation sustained on the property before March 1, 1913, was $10,000, so that the original cost adjusted to March 1, 1913, for depreciation sustained prior to that date was $90,000. As of that date the property had a fair market value of $49,000, with a remaining life of 30 years. (i) For the purpose of determining gain from the sale or other disposition of the property on March 1, 1922, the basis of the property is the fair market value of $94,003 as of March 1, 1913, adjusted for depreciation of $4,003, which is $90,000, with a remaining life of 30 years. (ii) For the purpose of determining a loss from the sale or other disposition of such property on March 1, 1922, the basis of the property is the fair market value of $49,000 as of March 1, 1913, adjusted for depreciation of $4,003, which is $45,000, with a remaining life of 30 years.
property in 1952, the basis of the property is the cost of the property, without reference to the fair market value as of March 1, 1913, adjusted for depreciation before March 1, 1913, and after February 28, 1913, the amount of depreciation sustained before March 1, 1913, in this example is $10,000, and if the amount of such gain or loss, if after February 28, 1913, is assumed to be $81,467, the aggregate amount of depreciation for which such cost or such adjustment shall be made is $91,467. The adjusted basis for determining the loss in 1952, is $8,583 ($100,000 less $91,467).

(d) What the fair market value of property was on March 1, 1913, as a question of fact to be established by competent evidence. In determining the fair market value of stock in a corporation, due regard shall be given to the fair market value of the corporate assets on such date. In the case of property traded in public exchanges, actual sales at or about the base date afford evidence of value. In general, the fair-market value of a block of or a particular kind of property is not to be determined by a forced sale price or an estimate of what a whole block or aggregate would bring upon the market at one and the same time, but such value should be determined by ascertaining as the basis the fair market value of each unit of the property. All relevant facts and elements of value as of the base date should be considered in every case.

§ 39.113 (a) (15) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; property received by a corporation on complete liquidation of another.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—** *(16) Property received by a corporation on complete liquidation of another, if the property was property included in the liquidation, in a distribution in complete liquidation of another corporation within the meaning of section 112 (b) (6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which exchange has been made in pursuance of the provisions of section 113 (a) (15) of the Revenue Act of 1936, as amended, shall in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1936, as amended.

§ 39.113 (a) (15) Basis of property received by a corporation in complete liquidation of another corporation. (a) Except as otherwise provided in this section, the basis of property received in complete liquidation, without the recognition of gain or loss as provided in section 113 (b) (6) shall be the same as the basis of the property in the hands of the liquidating corporation with proper adjustments as provided in section 113. See section 113 (b) (6).

(b) In the case of property received in liquidation after December 31, 1935, and before June 23, 1936, in a taxable year of the recipient corporation beginning after December 31, 1935, the basis of such property in the hands of the recipient corporation shall be the same as it would have been upon the liquidation of the property described in section 112 (b) (5) of the Code but which is described in section 112 (b) (5) of the Revenue Act of 1934, as amended by the Revenue Act of 1935, if—(1) Such property was received in a liquidation which was completed before June 23, 1936; and

(2) Such liquidation constituted a complete liquidation within the meaning of section 112 (b) (6) of the Revenue Act of 1934, as added by the Revenue Act of 1935;

(3) No gain or loss would have been recognized under section 112 (b) (6) of the Revenue Act of 1934, as amended, upon the receipt of such property and

(4) The recipient corporation was the successor corporation within the meaning of section 112 (b) (6) of the Revenue Act of 1934, as amended.

§ 39.113 (a) (15) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property; property received in certain corporate liquidations.

Sec. 113. Adjusted basis for determining gain or loss—(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—** *(16) Property acquired in connection with exchanges and distributions in obedience to certain orders of the Securities and Exchange Commission. If the property was acquired in a taxable year beginning before January 1, 1945, in any manner described in section 372 prior to its amendment by the Revenue Act of 1942, the basis shall be that prescribed in such section (prior to its amendment by such Act) with respect to such property. If the property was acquired in a taxable year beginning after December 31, 1944, in any manner described in section 372 (other than section 372 (16)) after its amendment by such Act, the basis shall be that prescribed in such section (after its amendment by such Act) with respect to such property.

[Sec. 115 (a) (18) as amended by sec. 171 (b), Rev. Act 1942]

(18) Property received in certain corporate liquidations. If the property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock with respect to which gain was realized, but with respect to which, as the result of an election made by him under section 197 (7) of the Act of 1936, the extent to which gain was recognized was determined under such paragraph, then the basis shall be the same as the basis of such stock cancelled or redeemed in the liquidation, decreased in the amount of any money received by him, and increased in the amount of any money received by him in the liquidation which was completed before January 1, 1945, and in any manner described in section 372 prior to its amendment by the Revenue Act of 1942. If the property was acquired in a taxable year beginning after December 31, 1944, in any manner described in section 372 (other than section 372 (16)) after its amendment by such Act, the basis shall be that prescribed in such section (after its amendment by such Act) with respect to such property.

[Sec. 115 (a) (18) as amended by sec. 120 (b), Rev. Act 1943; sec. 206 (b), Rev. Act 1950; sec. 316 (b), Rev. Act 1951]

§ 39.113 (a) (15) Basis of property received in certain corporate liquidations—(a) Property included. Section 113 (a) (18) applies only to property (other than money) acquired—

(1) By a qualified electing shareholder;

(2) Upon a distribution in complete liquidation of a domestic corporation.

(i) Pursuant to a plan of liquidation adopted after May 25, 1936, in accordance with which the distribution is in complete cancellation or redemption of all of the stock and the transfer of all of the property in the liquidation occurs within the month of December, 1938, or

(ii) Pursuant to a plan of liquidation adopted after February 28, 1944, in accordance with which the distribution is in complete cancellation or redemption of all the stock and the transfer of all of the property in the liquidation occurs within some one calendar month of the calendar year 1944; or

(iii) Pursuant to a plan of liquidation adopted after December 31, 1950, in accordance with which the distribution is in complete cancellation or redemption.
of all the stock and the transfer of all the property in the liquidation occurs within some one calendar month of the adoption of the plan and (3) In cancellation or redemption of only those shares of stock which were owned by such qualified electing shareholder at the time of the adoption of the plan of liquidation and on which he realizes gain.

It applies to all the property, except money, so acquired, though such property may consist in whole or in part of stock or securities acquired by the liquidating corporation after April 9, 1933, if subdivision (i) of this subparagraph is applicable, or after December 10, 1943, if subdivision (ii) of this subparagraph is applicable, or after August 15, 1950, if subdivision (iii) of this subparagraph is applicable.

(b) Basis. (1) The basis of property so acquired is the same as the basis of the shares cancelled or redeemed of the same class, and increased in the amount of gain recognized under the provisions of section 112 (b) (7) of the Internal Revenue Code, as the case may be. 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 the proportion that the fair market value of each such property as of the date of acquisition bears to the fair market value of all such properties on the date of cancellation or redemption.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. The X Corporation distributed all its property in liquidation during the month of October, 1925, pursuant to the provisions of section 112 (b) (7) of the Internal Revenue Code. On an individual and a qualified electing shareholder, received, in cancellation or redemption of 100 shares of stock owned by him at the time of adoption of the plan of liquidation, $1,000 in cash and property (other than stock or securities acquired by the corporation after August 15, 1930) with a fair market value of $12,000, and stock acquired by the liquidating corporation after August 15, 1930, with a fair market value of $4,000. The basis of the shares owned by A was $600 per share, or $10,000. A's ratable share of the earnings and profits of the X Corporation accumulated after February 28, 1913 (computed as provided in section 112 (b) (7) of the Internal Revenue Code) was $3,500. His gain is $7,000, but under section 112 (b) (7) of the Internal Revenue Code only $3,500 of this gain is recognized, $3,500 thereof being taxed as a dividend. The basis of all the property other than money received by A is $13,500, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted basis of stock cancelled</td>
<td>$10,000</td>
</tr>
<tr>
<td>Less money received</td>
<td>$1,000</td>
</tr>
<tr>
<td>Remainder</td>
<td>$9,000</td>
</tr>
<tr>
<td>Gain recognized</td>
<td>$6,000</td>
</tr>
<tr>
<td>Basis of property acquired</td>
<td>$15,000</td>
</tr>
</tbody>
</table>

§ 39.113 (a) (19) Statutory provisions; adjusted basis for determining gain or loss on a sale of stock or securities; general rules; stock dividends and stock rights.

(a) 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 of any character in a taxable year beginning before January 1, 1936, or in respect of which was acquired in a taxable year beginning December 31, 1935, stock which did not constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution, the basis for determining gain or loss from a sale of either the stock in respect of which the distribution was made or the stock dividend shall (except as otherwise prescribed in § 39.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 39.113 (a) (19)–2.

(b) Stock rights acquired after December 31, 1935. In the case of stock in respect of which were acquired after December 31, 1935, stock subscription rights (whether or not constituting income to the shareholder within the meaning of the sixteenth amendment to the Constitution) or in respect of which were acquired in a taxable year beginning after December 31, 1935, stock subscription rights which did not constitute income 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 from a sale or other disposition of either 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 § 39.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 39.113 (a) (19)–2.

(c) Stock rights acquired before January 1, 1925. In the case of stock in respect of which were acquired before January 1, 1925, stock subscription rights (whether or not constituting income 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 from a sale or other disposition of either 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 § 39.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 39.113 (a) (19)–2.

§ 39.113 (a) (19)–2 Exceptions to general rules—(a) Proceeds of sale of rights reported as income. In the case of stock rights sold in a taxable year beginning before January 1, 1936, the amount of any part of the proceeds of the sale of such stock rights should not have been included in gross income to the shareholder within the meaning of the sixteenth amendment to the Constitution in the case of such rights, the basis for determining gain or loss from a sale or other disposition of either 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 § 39.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 39.113 (a) (19)–2.

§ 39.113 (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 of any character
RULES AND REGULATIONS

a subsequent sale or other disposition of the stock in respect of which the rights were acquired shall be the same as though the rights had not been acquired.

(b) Receipt of stock dividend or stock right reported as income in prior years. In the case of stock dividends or stock rights acquired in a taxable year beginning before January 1, 1936, the general rules for ascertaining the basis for determining gain or loss set forth in §39.113 (a) (19)–1, §39.113 (a) (12)–1, and §39.22 (a)–8, or article 59 of Regulations 65, as the case may not apply for any reason there was included in the gross income of the shareholder as a dividend for such year, as, for example, pursuant to the provisions of section 251 (c) of the Revenue Act of 1918 or the corresponding provisions of prior revenue acts, or as a result of the decision of the Supreme Court in Koshland v. Helvering (296 U. S. 451) an amount reflecting the acquisition of such stock dividend or stock rights, and if before June 29, 1936, such amount was not excluded from gross income for such year. In such case, for determining gain or loss with respect to the old stock shall be the same as though the stock dividends or the stock rights had not been acquired, and the basis with respect to the old stock dividend or stock right shall be an amount equal to that at which such stock dividend or stock right was excluded in gross income for the year of its acquisition.

(c) Gain or loss upon sale of, old or new stock finally determined upon basis inconsistent with general rules. The general rules for ascertaining the basis for determining gain or loss on such sale or other disposition of old stock, subscription rights, or new stock in a receivership proceeding, or in a proceeding begun under section 77 of the National Bankruptcy Act, as amended, are set forth in §39.113 (a) (20)–1. Property acquired by railroad corporation in railroad reorganization proceeding. If the property of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, was acquired by reason of an order of a court having jurisdiction of such corporation—

(A) In a receivership proceeding, or

(B) In a proceeding begun under section 77 of the National Bankruptcy Act, as amended, and the acquiring corporation is a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, or

the court, in such proceeding, the basis shall be the same as though the stock of the railroad corporation whose property was so acquired. The term "reorganization," as used in this paragraph, shall not be limited by the definition of such term in section 112 (g).

§39.113 (a) (21) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property. If the acquiring corporation is a common carrier in the transportation of persons or property in interstate commerce, or a reorganization constitutes a reorganization in pursuance of an order of the court and is an integral step in the consummation of a reorganization plan approved by the court having jurisdiction of the proceeding. If section 113 (a) (21) applies, section 270 of the Bankruptcy Act (11 U. S. C. 670), relating to the adjustment of basis by reason of the cancellation or reduction of indebtedness in a corporate reorganization proceeding, is inapplicable. Moreover, if the transaction is within the provisions of section 112 (b) (21) and may also be considered to be within any other provision of section 113 (a), then the provisions of section 113 (a) (21) only shall apply.

§39.113 (a) (22) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property acquired on reorganization of certain corporations.

§39.113 (a) (29) Statutory provisions; adjusted basis for determining gain or loss; basis (unadjusted) of property. The basis of property shall be the cost of such property, except that—*

§39.113 (a) (20)

§39.113 (a) (20)

§39.113 (a) (20)

§39.113 (a) (20)
§ 39.113 Nb (1)

Was treated as a taxable exchange and, in pursuance of a plan of reorganization, to a corporation organized or made use of to effectuate such plan, the basis of such property in the hands of the acquiring corporation is the same as it would be in the hands of the insolvent corporation, increased in the amount of gain realized upon such transfer under the law applicable to the year in which the transfer was made. In any such case, the adjustments provided by section 270 of the Bankruptcy Act (11 U.S.C. 670) or section 113 (b) (3) of the Internal Revenue Code, shall not be made in respect of any indebtedness canceled pursuant to such plan of reorganization under which the transfer was made. If the transaction falls within the provisions of section 113 (a) (22) the basis of the property involved shall be determined pursuant to such provisions, notwithstanding that the transaction might otherwise fall within another provision of section 113 (a) (22). Section 113 (a) (22) are applicable in the determination of basis for all taxable years beginning after December 31, 1933, except that the basis so determined shall not be given effect in the determination of the tax liability for any taxable year beginning January 1, 1943. With the exception indicated, the basis so prescribed is applicable from the date of acquisition of the property involved under such section 113 (b) relating to adjusted basis shall, as if section 113 (a) (22) were a part of the Internal Revenue Code and prior internal revenue laws applicable to expenditures described in section 113 (b) (1) (B) the “amount allowable” is the amount computed with reference to the basis provided in section 113 (a) (22).

(c) The effect of the application of section 113 (a) (22) may be illustrated by the following examples:

Example (1). On January 1, 1936, the Y Corporation, a taxpayer making its returns on the calendar year basis, acquired depreciable property from the X Corporation as the result of a transaction described in section 113 (a) (22). On January 1, 1935, the property had, in the hands of the X Corporation, a basis of $500,000, an adjusted basis of $510,000, and a fair market value as of January 1, 1935, of $690,000, and an estimated remaining life of 20 years. The 1935 transaction was treated as a taxable exchange and, accordingly, the X Corporation claimed and was allowed depreciation in the amount of $69,000 for each of the eight taxable years 1935 through 1942. The 1936 transaction was treated as a taxable exchange and, accordingly, the Y Corporation claimed and was allowed depreciation in the amount of $67,000. On June 30, 1953, the property was sold for $160,000. The basis of the property at the date of the sale is determined as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basis to X Corporation</td>
<td>$500,000</td>
</tr>
<tr>
<td>Adjusted basis for depreciation in the hands of both X and Y Corporations (sec. 113 (b) (22))</td>
<td>$510,000</td>
</tr>
</tbody>
</table>

Deduct:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deleption allowed in amount of $67,000 in the year 1953</td>
<td>$67,000</td>
</tr>
</tbody>
</table>

Sale price

Deduct:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss sustained</td>
<td>$6,250</td>
</tr>
</tbody>
</table>

For the taxable year 1953 and succeeding taxable years, reason of the difference between the $67,000 depreciation allowance and the $60,000 deduction previously allowed.

Example (2). Assume the same facts as in example (1), except that the property acquired by the Y Corporation had a fair market value as of January 1, 1935, of $690,000, instead of $510,000, and that the Y Corporation claimed and was allowed depreciation in the amount of $89,000 for each of the eight taxable years 1935 through 1942. Inclusive, and in the amount of $50,000 for the taxable years 1943 to 1951, inclusive. In such case, the amount of the loss sustained upon the sale of the property would be computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted basis for depreciation in the hands of Y Corporation as computed in example (1)</td>
<td>$510,000</td>
</tr>
<tr>
<td>Deduct:</td>
<td></td>
</tr>
<tr>
<td>Deleption allowed in amount of $89,000 per year for 8 years, Jan. 1, 1935, to June 30, 1953</td>
<td>$672,000</td>
</tr>
<tr>
<td>Deleption allowance</td>
<td>$61,750</td>
</tr>
</tbody>
</table>

Sale price

Deduct:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss sustained</td>
<td>$6,250</td>
</tr>
</tbody>
</table>

No change in the tax liability is authorized for taxable years preceding 1943 by reason of the difference between the $89,000 depreciation allowance and the $50,000 deduction previously allowed.

§ 39.113 (a) (23)

Statutory provisions; adjusted basis for determining gain or loss; general rule.

§ 39.113 (b) (1) Statutory provisions; adjusted basis for determining gain or loss. * * *

(b) Adjusted basis. The adjusted basis for determining the gain or loss from the sale or other disposition of property, however acquired, shall be the basis determined under subsection (a), adjusted as 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 (plant), but no such adjustments shall be made for taxes or other carrying charges, or for expenditures described in section 23 (b), 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 of the amount of deductions in computing net income under this chapter or prior income tax laws, and

(II) Requiring (by reason of the deduction so allowed) in a reduction for any taxable year of the taxpayer's taxes under this chapter (other than the determination of the basis of the stock or other property described in chapter F of chapter 3, or prior income, war profits, or excess-profits tax laws, but not less than the amount allowable under this chapter to be determined by all such factors.

Ch. 15 of this subparagraph shall not apply in respect of any period since February 28, 1913, and before January 1, 1932, unless an election has been made under subsection (a).

§ 39.113 (b) (1)
§ 39.113 (b) (1)–1 Adjusted basis—
(a) 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. In the case of such property as is described in section 113 (a) (1) (23) (inclusive), the basis therein provided, adjusted to the extent provided in section 113 (a) (23) (inclusive), is the value of the property, including the cost of improvements and betterments made to the property. In the case of minerals and oil or gas wells the following shall not be considered as items properly chargeable to capital account:

(1) Expenditures made in the taxable year 1932 or subsequent taxable years which are allowable under article 235 or 235A of Regulations 77, article 23 (m)–15 or 23 (m)–16 of Regulations 86, article 23 (m)–15 or 23 (m)–16 of Regulations 94 (26 CFR, 1938 ed., Part 3) article 23 (m)–15 or 23 (m)–16 of Regulations 101 (26 CFR, 1939 ed., Part 9) (19.23 (m)–15 or 19.23 (m)–16 of Regulations 103 (26 CFR, 1938 ed., Supps.) (19.23 (m)–15 or 19.23 (m)–16 as deductions in computing net income; (ii) expenditures made in taxable years prior to 1932 which were allowed, or which may hereafter be allowed, in computing the net income of the taxpayer for such taxable years.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. A, who makes his returns on the calendar year basis, purchased property in 1941 for $10,000. He subsequently expended $8,000 for improvements and betterments made to this property by the taxpayer himself. A sells the property in 1952 for $20,000, the amount of his gain will be $4,000.

(3) Capital expenditures and carrying charges with respect to property (whether real or personal, improved or unimproved, and whether productive or unproductive) such as taxes and interest, which the taxpayer may elect to treat either as chargeable to capital account or, in the manner provided in § 39.113 (b) (4) is an allowable deduction, but for which deductions have not been taken for any taxable year, are properly chargeable to capital account. The term ‘taxes’ includes duties and excise taxes (see § 39.23 (3)–2) but does not include income taxes.

(4) Expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical, described in section 23 (bb) (2) are allowable pursuant to section 23 (bb) (2) (c) (3) (b) (2).

§ 39.113 (b) (1)–1 Adjusted basis—
(a) 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. In the case of such property as is described in section 113 (a) (1) (23) (inclusive), the basis therein provided, adjusted to the extent provided in section 113 (a) (23) (inclusive), is the value of the property, including the cost of improvements and betterments made to the property. In the case of minerals and oil or gas wells the following shall not be considered as items properly chargeable to capital account:

(1) Expenditures made in the taxable year 1932 or subsequent taxable years which are allowable under article 235 or 235A of Regulations 77, article 23 (m)–15 or 23 (m)–16 of Regulations 86, article 23 (m)–15 or 23 (m)–16 of Regulations 94 (26 CFR, 1938 ed., Part 3) article 23 (m)–15 or 23 (m)–16 of Regulations 101 (26 CFR, 1939 ed., Part 9) (19.23 (m)–15 or 19.23 (m)–16 of Regulations 103 (26 CFR, 1938 ed., Supps.) (19.23 (m)–15 or 19.23 (m)–16 as deductions in computing net income; (ii) expenditures made in taxable years prior to 1932 which were allowed, or which may hereafter be allowed, in computing the net income of the taxpayer for such taxable years.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. A, who makes his returns on the calendar year basis, purchased property in 1941 for $10,000. He subsequently expended $8,000 for improvements and betterments made to this property by the taxpayer himself. A sells the property in 1952 for $20,000, the amount of his gain will be $4,000.

(3) Capital expenditures and carrying charges with respect to property (whether real or personal, improved or unimproved, and whether productive or unproductive) such as taxes and interest, which the taxpayer may elect to treat either as chargeable to capital account or, in the manner provided in § 39.113 (b) (4) is an allowable deduction, but for which deductions have not been taken for any taxable year, are properly chargeable to capital account. The term ‘taxes’ includes duties and excise taxes (see § 39.23 (3)–2) but does not include income taxes.

(4) Expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical, described in section 23 (bb) (2) are allowable pursuant to section 23 (bb) (2) (c) (3) (b) (2).
affected by the disallowance of such de-
duction. Examples of such other taxable
years are taxable years to which there
was a carry-over or carry-back of a net
operating loss or an unused excess-prof-
tability credit, or to which the deduction
for depreciation, etc., was allowed, and
taxable years for which a computa-
tion under section 32 (b) (12) or
section 27 was made reference to
the tax-benefit amount which the reduc-
tion was allowed. In determining
whether the disallowance of any part
of the de-
duction, etc., would not
have resulted in an increase in any
pre-
taxingly
pre-
be considered to have exceeded a
minor reduction of $1,000 limited to
a reduction for any taxable
year of the taxpayer's taxes.

(b) One of the fac-
tors involved in determin-
ing the adjust-
ment to basis as of any date is the
amount allowable for periods prior to
such date. The amount allowable for
such prior periods is determined under
the law applicable to such prior periods;
all adjustments required by the law
ap-
plied

in determining the adjusted basis of the
property for the purpose of determining
the amount allowable. Since provisions
cor-
responding to the amendment to section
113 (b) (2) of Public Law 539 (82d Congress)
are deemed included in all

Taxes applicable to taxable
years ending after December 31, 1931,
the amount allowable for any such taxable
year must be computed with the appli-
cation of such provisions. For

example, if the adjusted basis of property
is determined as of January 1, 1952, if
an election was properly made under
section 113 (d) and if the property was
held since January 1, 1930, then the
amount allowable which is taken into ac-
count in computing the adjusted basis
amount of the taxable year exceeded the amount allowable, the
tax-benefit amount allowed with respect to each of such properties shall be
an allocated portion of the tax-benefit
amount which is determined reference to the sum of the amounts allowed and the sum of the amounts allowable with
respect to such several properties.

(iv) In the case of property held by
a partnership or trust, the computa-
tion of the tax-benefit amount allowed shall take into account the tax benefit of the partners or beneficiaries, as the case may be,
from the deduction by the partner-
ship or trust of the tax benefit allowed to
the partnership or the trust. For this
purpose, the determination of the
amount allowed which resulted in a tax
benefit to the partners or beneficiaries
shall be made in the same manner
as that provided above with respect
to the taxes of the person holding the
property.

(v) A taxpayer seeking to limit the
adjustment to basis to the tax-benefit
amount allowed for any period, in lieu
of the amount allowed, must establish the
tax-benefit amount allowed. A failure
to make adequate proof of the tax-
benefit amount allowed with respect to one pe-
riod does not preclude the taxpayer from
limiting the adjustment to basis to the
tax-benefit amount allowed with respect
to another period for which adequate
proof is available. For example, a cor-
porate transferee may have available
adequate records with respect to the tax
benefit effect of the deduction for the taxable
years 1946 and 1947 of erroneous depre-
ciation, but may not have available ade-
quate records with respect to the deduc-
tion or excessive depreciation for a prior period during which the property was
held by its transferee. In such case,
assuming a proper election is made under
section 113 (d), the corporate transferee
shall not be denied the right to apply
this section with respect to the erroneous
depreciation for the period for which
adequate proof is available.

(b) In section 113 (d), (1) (b), (c),
(3) and (4) of the Internal
Revenue Code of 1954, as amended by
Public Law 539 (July 14, 1952) there was a final decision of a
court determining the amount allowable
for a particular taxable year, such
determination (but only for the pur-
pose of determining the tax-benefit
amount allowable with respect to such
allowable amount) must be adjus-
ted to the extent necessary to reflect
to the law applicable to the taxable year
for which the amount was allowable.

(D) Although Public Law 539 amends
the law applicable to all taxable years
ending after December 31, 1951, the
amendment does not open for refund,
credit, or assessment of a deficiency any
taxable year for which such refund,
credit, or assessment is barred by any
law or rule of law.

(1) Property with transferred
basis.
The following rules apply in the deter-
mination of the adjustments to basis of
property in the hands of a transferee,
donee, or grantee which are required by
section 113 (b) (2) with respect to the
period the property was held by the
transferee, donee, or grantee:

(i) An election under section 113
(d) by a transferee, donee, or grantee
made after the date of the transfer,
gift, or grant of the property shall not
affect the basis of such property in the
hands of the transferee, donee, or grantee.
Such an election made before the date
of the transfer must be taken into account
in determining under section 113 (b) (2)
the adjustments to basis as of the date
of the transfer, gift, or grant. Such an
election under section 113 (d) was
made by the transferee, donee, or
gratee.
(ii) An election by the transferee, donee, or grantee shall be applicable in determining the adjustments to basis for the period during which the property was held, whether or not the transferor, donor, or grantor, of whom the transferee, donee, or grantee had made an election, provided that the property was held by the transferee, donee, or grantee at any time on or before the date on which his election was made.

(b) The application of this paragraph may be illustrated by the following example:

Example (1). The case of Corporation A discloses the following facts:

<table>
<thead>
<tr>
<th>Year</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount allowed</td>
<td>Amount allowable</td>
<td>Amount allowed</td>
<td>Amount allowable</td>
<td>Amount allowable</td>
<td>Amount allowable</td>
</tr>
<tr>
<td>1951</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>1952</td>
<td>$7,000</td>
<td>$6,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>1953</td>
<td>$9,000</td>
<td>$9,000</td>
<td>$9,000</td>
<td>$9,000</td>
<td>$9,000</td>
<td>$9,000</td>
</tr>
<tr>
<td>1954</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Total</td>
<td>$26,000</td>
<td>$26,000</td>
<td>$26,000</td>
<td>$26,000</td>
<td>$26,000</td>
<td>$26,000</td>
</tr>
</tbody>
</table>

The cost or other basis is to be adjusted by $16,500 with respect to the years 1952–1954, that is, by the amount allowable but not less than the amount allowed which reduced the taxpayer's taxes. An adjustment must also be made with respect to the years 1949–1951, the amount of such adjustment depending upon whether an election was properly made under section 113 (d).

If no such election was made, the amount of the adjustment with respect to the years 1949–1951 is $10,500, that is, the amount allowed but not less than the amount allowable. If an election was properly made, the amount of the adjustment with respect to the years 1949–1951 is $19,500, that is, the amount allowable but not less than the amount allowable which reduced the taxpayer's taxes.

Example (2). Corporation A purchased a building on January 1, 1950, at a cost of $100,000. On the basis of the facts reasonably known to exist at the end of 1950, a period of 50 years should have been used as the correct useful life of the building; nevertheless, depreciation was computed by Corporation A on the basis of a useful life of 25 years, and was allowed for 1950 through 1953 as a deduction in an annual amount of $4,000. The building was sold on January 1, 1954. Corporation A did not make an election under section 113 (d). Now part of the amounts allowed Corporation A for any of the years 1950 through 1953 resulted in a reduction of Corporation A's taxes. The adjusted basis of the building as of January 1, 1954, is $86,166, computed as follows:

Example (3). The facts are the same as in Example (2), except that Corporation A made a proper election under section 113 (d). In such case, the adjusted basis of the building as of January 1, 1954, is $92,000, computed as follows:

Example (4). If it is assumed that in Example (2), or in Example (3), all of the $4,000 amount allowed Corporation A as a deduction for depreciation for the year 1950, resulted in a reduction of A's taxes, the adjustment to the basis of the building for depreciation for 1953 would reduce the entire $4,000 deduction. In such case, the adjusted basis of the building as of January 1, 1954, would be $80,083 in Example (2), and $90,000 in Example (3).

Example (5). The facts are the same as in Example (2) except that for the year 1950 all of the $4,000 amount allowed Corporation A as a deduction for depreciation for that year resulted in a reduction of A's taxes. In such case, the adjusted basis of the building remain the same as those set forth in Example (2).

Example (6). The facts are the same as in Example (3) except that for the year 1950 all of the $4,000 amount allowed Corporation A as a deduction for depreciation resulted in a reduction of A's taxes. In such case, the adjusted basis of the building as of January 1, 1954, is $90,126, computed as follows:

Example (7). Exhaustion, wear and tear obsolescence, amortization, and depletion sustained in respect of any period prior to March 1, 1913.

(c) Certain stock distributions. (1) In the case of stock, the cost or other basis must be diminished 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) (2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. A, who makes his returns upon the calendar year basis, purchased stock in 1923 for $6,000. He received in 1924 a distribution of $2,000 paid out of earnings and profits of the corporation accumulated before March 1, 1919. The adjusted basis for determining the gain or loss from the sale or other disposition of the stock in 1953 is $5,000 less $2,000, or $3,000, and the amount of the gain from the sale or other disposition of the stock is the difference between $3,000 and the amount realized from the sale or other disposition.

(d) Stock of United States shareholders of a foreign personal holding company. In the case of the stock of the United States shareholders in a foreign personal holding company the cost or other basis must be adjusted also to the amount provided by the foregoing rules. For adjustment for the purpose of this section, the amounts provided in section 22 (e) (2) (A), as so § 39.125 (a)–1.

(2) For adjustment to basis of bonds on account of amortizable bond premium, see §§ 39.125 (a)–1 to 39.125 (c)–2, inclusive. For adjustment to basis of short-term municipal bonds as defined in section 22 (e) (2) (A), see § 39.22 (d)–1.

(4) For adjustment to basis on account of expenditures attributable to a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 22 (b) (15) and § 39.32 (b)–1.

(5) With respect to taxable years ending after December 31, 1960, the basis shall also be adjusted to take into account the amount of expenditures for development and exploration of mines or mineral deposits treated as deferred expenses under section 23 (e) (2) and (7) (2) (F-1) The basis so adjusted shall also be reduced by the amount of such expenses allowed as deductions under such sections which results in a reduction of the taxpayer's liability for income taxes, see §§ 39.125 (a)–1 to 39.125 (c)–2, inclusive.
tax but not less than the amounts allowable under such sections for the taxable year and prior years, for each such property, if a taxpayer's hands for purposes of determining gain or loss shall be made in the following manner and order:

1. In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable) whether or not a lien is placed against such property securing such indebtedness, which 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 such property shall have been canceled or reduced;

2. In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation or reduction of the indebtedness, there is a lien (other than a lien incurred to purchase property) securing such indebtedness secured by such lien shall have been canceled or reduced;

3. Any excess of the total amount by which the indebtedness shall have been canceled or reduced over the sum of the adjustments made under subparagraphs (1) and (2) of paragraph (f) shall be applied to reduce the cost or other basis of the property of the taxpayer, other than inventory and notes receivable or accounts receivable, against which such property has been canceled or reduced in such proceeding, the cost or other basis of which shall be decreased (but not below its fair market value) in an amount equal to such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, 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 over the sum of the adjustments made under subparagraphs (1) and (2) of paragraph (f) of this paragraph shall be exhausted.

(b) 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 any accrued interest unpaid which shall not have resulted in a tax liability in any income tax return;

4. The phrase "indebtedness incurred to purchase" includes (1) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien on the property which the debtor, as purchaser of such property, has assumed by paying 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.

6. Any determination of value in a proceeding under the Bankruptcy Act (11 U. S. C. 1 et seq.) shall not constitute a determination of fair market value for the purposes of this section.

7. The basis of any of the debtor's property, other than inventory and notes or accounts receivable, as specified in this section shall be determined in accordance with the provisions of this section.

8. §39.113(b)(1)–3 Adjusted basis; cancellation of indebtedness, special cases. 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 §39.113(b)(1)–2. Variations from such rule may, for example, include adjusting the basis of any part of the taxpayer's property greater than their fair market value; and

9. 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 subparagraphs (1), (2), and (3) of this paragraph shall be applied to reduce the cost or other bases of inventory and notes and accounts receivable, as follows:

(a) The cost or other basis of inventory, notes receivable or accounts receivable, as the case may be, shall be decreased (but not below its fair market value) in an amount equal to such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, 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 over the sum of the adjustments made under subparagraphs (1), (2), and (3) of this paragraph shall be exhausted.

(b) Except where the context otherwise requires, property means all of the debtor's property, other than inventory and notes or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, 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 over the sum of the adjustments made under subparagraphs (1), (2), and (3) of this paragraph shall be exhausted.

(c) The phrase "indebtedness incurred to purchase" includes (1) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien on the property which the debtor, as purchaser of such property, has assumed by paying and

(d) 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.

(e) Any determination of value in a proceeding under the Bankruptcy Act (11 U. S. C. 1 et seq.) shall not constitute a determination of fair market value for the purposes of this section.

(f) The basis of any of the debtor's property, other than inventory and notes or accounts receivable, as specified in this section shall be determined in accordance with the provisions of this section.
§ 39.113 (b) (1)–4 Adjusted basis; mutual savings banks, building and loan associations, and cooperative banks. (a) The adjustments to the cost or other basis of property provided in section 125 shall be allowable for such portion of the premises, or adjusting the basis of all the tax-exempt property. Thus, adjustment to basis of property in the hands of the taxpayer is a substituted basis, as defined in section 113 (b) (1). The basis thus adjusted for the period during which the property was held by the transferor, donor, or grantor, shall be the basis determined under section 113 (b) (1)–4, adjusted as herein provided.

(2) Substituted basis. The term "substituted basis", as used in this section, means a basis determined under any provision of this section or under any other provision of the tax law, providing that the basis shall be adjusted in any manner prescribed in this section.

(3) Discharge of indebtedness. Where in the case of a corporation any amount is excluded from gross income, reduced by the amount of any deduction disallowed under section 22 (b) (9) and the particular properties to which the reduction shall be allocated, shall be determined under regulations (prescribed by the Commissioner) with the approval of the Secretary of the Treasury, with respect to the time of the filing of the consent by the taxpayer referred to in section 22 (b) (9) in the case of the discharge of indebtedness in which the discharge occurred except in the case of property not held by the taxpayer on the first day in which the full amount of the discharge occurred.

§ 39.113 (b) (2)–1 Substituted basis. (a) 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 provided in paragraph (a) (1), (2), and (3) shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in the period during which the property was held by the transferor, donor, or grantor, or during which the property was held by the person for whom the basis is to be determined. A similar basis shall be applied in the case of a series of substituted bases.

§ 39.113 (b) (3)–1 Adjusted basis; discharge of corporate indebtedness; general rule. (a) In addition to the adjustments provided in section 113 (b) (1), and § 39.113 (b) (1)–1 which are required to be made with respect to the cost or other basis of property, and except as otherwise provided in section 113 (a) (21) or (22), or 113 (b) (1), a further adjustment shall be made in any case in which there shall have been an adjustment of a substituted basis, as defined in section 113 (b) (2), (3)–1, and 39.113 (b) (3)–2 shall also be made, whenever necessary, after first making in respect of such substituted basis a proper adjustment of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor. Such similar adjustments shall also be applied in the case of a series of substituted bases.

(b) The application of this section may be illustrated by the following example:

Example. Z realizes a gain of $10 ($1,250 of sale price over adjusted basis) upon sale of a tax-exempt bond on June 30, 1952. It was sold at a noncallable bond maturing on January 1, 1962. Z was exempt from tax purposes and without profit, although such institutions were exempt from tax for taxable years beginning before January 1, 1952. Further adjustments must be made under section 113 (b) for the entire period since the acquisition of property. Thus, adjustment to basis must be made for depreciation allowable for all prior years and for no subsequent basis. The bond, which is a substituted basis, as otherwise provided in section 113 (b) (1)–1, is an excluded property, reduced by the amount of any deduction disallowed under section 22 (b) (9) and the particular properties to which the reduction shall be allocated, shall be determined under regulations (prescribed by the Commissioner) with the approval of the Secretary of the Treasury, with respect to the time of the filing of the consent by the taxpayer referred to in section 22 (b) (9) in the case of the discharge of indebtedness in which the discharge occurred except in the case of property not held by the taxpayer on the first day in which the full amount of the discharge occurred.

§ 39.113 (b) (3)–2 Adjusted basis; discharge of corporate indebtedness; general rule. (a) In addition to the adjustments provided in section 113 (b) (1), and § 39.113 (b) (1)–1 which are required to be made with respect to the cost or other basis of property, and except as otherwise provided in section 113 (a) (21) or (22), or 113 (b) (1), a further adjustment shall be made in any case in which there shall have been an adjustment of a substituted basis, as defined in section 113 (b) (2), (3)–1, and 39.113 (b) (3)–2 shall also be made, whenever necessary, after first making in respect of such substituted basis a proper adjustment of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor. Such similar adjustments shall also be applied in the case of a series of substituted bases.

(c) In the case of a mortgage purchased, acquired, or originated at a premium, where the principal of such mortgage is prepaid, after the payment of any principal payments, adjustments to the basis of the premium must be made for all taxable years (whether or not the institution was exempt from tax during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period or the payment of a series of loans of such institution. For the purpose of this adjustment, the term "premium" includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees, or brokerage fees, but such value does not include amounts paid for accrued interest.
counts receivable) whether or not a lien has been discharged, the cost or other amount of such discharge of the indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay 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), and any deduction disallowed under section 113 (b) (2) of the taxable year 1952. (But see § 39.113 (b) (3)-2.)

Example (2). The M Corporation assumed an issue of A bonds which it had issued at a premium and an issue of B bonds which it had issued at a discount. In July 1952 it purchased, for less than face value, a bond of each series. The amount of income attributable to the discharge of the B bonds is $1,033 of the amount of unamortized premium is $205. The amount of income attributable to the discharge of the A bonds is $550. If the M Corporation under section 22 (b) (9) elects to have excluded from gross income the amount of income attributable to the discharge of both bond issues, the total reduction in basis of the property of the M Corporation shall not exceed $2,580. If the M Corporation elects only with respect to the A bonds, the total reduction in basis shall not exceed $1,209 (or $950 if the election is with respect to the B bonds). If the M Corporation excludes only an amount of $950 the amount of income attributable to the discharge in basis of the property of the M Corporation shall nevertheless be $1,209 (or $950 if the exclusion is with respect to the B bonds).

§ 39.113 (b) (3)-2 Adjusted basis; discharge of corporate indebtedness; special cases. (a) Section 39.113 (b) (3) prescribes the general rule to be followed in adjusting basis of property where there is a proper exclusion under gross income under section 22 (b) (9). The taxpayer may, however, have the basis of his property adjusted in a manner different from that set forth in § 39.113 (b) (3) upon a proper showing of the satisfaction of the Commissioner. Such adjustment, however, shall be consistent with the principles of § 39.113 (b) (3)–1 (b) (7). 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.

(b) Request for variations from the general rule prescribed in § 39.113 (b) (3)–1 shall be filed by the taxpayer with its return for the taxable year in which the discharge of indebtedness occurred unless such consent is permitted under § 39.113 (b) (3)–1 (b) (1). In case such request shall be filed with the amended return or claim for credit or refund, as the case may be. Agreement between the taxpayer and the Commissioner as to any variations from such general rule shall be effected only by a closing agreement entered into under the provisions of section 7660. If no agreement is reached between the taxpayer and the Commissioner as to variations from the general rule prescribed in § 39.113 (b) (3)–1, then the consent filed on Form 982 shall be deemed to be a consent to the application of such general rule and such general rule shall prevail in the determination of the basis of the taxpayer's property, unless the taxpayer shall show that it does not consent to the application of the general rule.

§ 39.113 (b) (4) Statutory provisions; adjusted basis for determining gain or loss.

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loss; adjustment of capital structure before September 22, 1938.

Sec. 113. Adjusted basis for determining gain or loss.

(b) Adjusted basis. The adjusted basis for determining the gain or loss from the sale or other disposition of any property, or with respect to any property ever acquired, shall be the basis determined under subsection (2), as hereinafter provided.

(4) Adjustment of capital structure prior to September 22, 1938. Where a plan of reorganization of a corporation, approved by the court and under section 77B of the National Bankruptcy Act, as amended, is consummated by adjustment of the capital or debt structure, such corporation, without the transfer of its assets to another corporation, and a final judgment or decree in such proceeding has been entered prior to September 22, 1938, then the provisions of section 270 of the National Bankruptcy Act, as amended, shall not apply in respect of the property of such corporation. For the purposes of this paragraph the term "reorganization" shall not be limited by the definition of such term in section 39.113 (c).

[Sec. 113 (b) (4) as added by sec. 122, Rev. Act 1943]

§ 39.113 (b) (4)–1 Adjusted basis; exception to section 270 of the Bankruptcy Act, as amended. The adjustment to basis provided by section 270 of the Bankruptcy Act (11 U. S. C. 670) and by §§ 39.113 (b) (1)–2 and 39.113 (b) (1)–3 shall not be made if, in a proceeding under section 77B of such act, 48 Stat. 912, indefinitely suspended or nullified by a plan of reorganization which was consummated by adjustment of the capital or debt structure of the insolvent corporation, and the final judgment or decree in such proceeding was entered prior to September 22, 1938. Section 113 (b) (4) and this subchapter do not apply in respect of the transfer of assets of the insolvent corporation to another corporation.

§ 39.113 (c) Statutory provisions; adjusted basis for determining gain or loss; property on which lessee has made improvements.

Sec. 113. Adjusted basis for determining gain or loss. * * *

(c) Property on which lessee has made improvements. Neither the basis nor the adjusted basis of any portion of real property shall, in the case of the lessor of such property, be increased or diminished on account of improvements made by the lessee in respect of such property and attributable to buildings erected or other improvements made by a lessee in respect of such property was included in gross income of the lessor for any taxable year beginning before January 1, 1942, the basis of such portion of such property shall be properly adjusted for the amount so included in gross income.

[Sec. 113 (c) as added by sec. 115 (b), Rev. Act 1942]

§ 39.113 (c)–1 Property on which lessee has made improvements. In any case in which a lessee of real property has erected buildings or made other improvements upon the leased property and the lease is terminated by forfeiture or otherwise resulting in the realization by such lessor of income which, were it not for the provisions of section 22 (b) (11) would be includible in gross income of the lessor, the amount excluded from gross income shall not be taken into account in determining the basis or the adjusted basis of such property or any portion of such property attributable to such buildings or improvements, the basis of each portion of such property shall be properly adjusted for the amount so included in gross income.

For example, a lease in 1952 to B for a period of 25 years unimproved real property and in accordance with the terms of the lease B erected a building on the property. It was estimated that upon expiration of the lease the building would have a depreciated value of $50,000, which value the lessor elected to report (beginning in 1951) as income over the term of the lease. If reporting was used until 1942. In 1952 B forfeits the lease. The amount of $50,000 reported as income by A during 1952 is includible in the basis of the building erected by the lessee and the lease was forfeited in 1940 when the building was worth $75,000, such amount, having been included in gross income under the law applicable to the building, would be added to the basis of the property represented by the improvements in the hands of A. If in such case A did not report during the period of the lease any income attributable to the value of the building erected by the lessee and the lease was forfeited in 1940, then the amount so included in gross income would be added to the basis of the property represented by the improvements in the hands of A. As to treatment of such property for the purposes of capital gains and losses, see section 117.

§ 39.113 (d) Statutory provisions; adjusted basis for determining gain or loss; depreciation, etc., allowed before 1953.

Sec. 113. Adjusted basis for determining gain or loss.

(d) Election in respect of depreciation, etc., allowed before 1953. Any person may elect to have clause (ii) of such section (b) (1) (B) determined as added by section 77B of the National Bankruptcy Act and a final judgment or decree in such proceeding has been entered prior to September 22, 1938. Section 113 (b) (4) and this subchapter do not apply in respect of the transfer of assets of the insolvent corporation to another corporation.

§ 39.113 (d)–1 Property on which lessee has made improvements.

Sec. 113. Adjusted basis for determining gain or loss. * * *

(d) Election in respect of depreciation, etc., allowed before 1953. Any person may elect to have clause (ii) of such section (b) (1) (B) determined as added by section 77B of the National Bankruptcy Act and a final judgment or decree in such proceeding has been entered prior to September 22, 1938. Section 113 (b) (4) and this subchapter do not apply in respect of the transfer of assets of the insolvent corporation to another corporation.

[Sec. 113 (d) as added by sec. 2, Pub. Law 559 (82d Cong.)]

§ 39.113 (d)–1 Election as to amounts allowed in respect of depreciation, etc., if election is made before February 28, 1952. (a) Any person may elect to have the adjustments to the cost or other basis of such property under section 113 (b) (1) (B) determined in accordance with clause (ii) of such section, by filing with the district director of internal revenue, on or before December 31, 1952, the written statement of election provided in paragraph (b) of this section. The statement must be filed with the district director with whom the return must be filed (determined under section 33 (b) as of December 31, 1952). Such election shall be irrevocable after December 31, 1952, and shall apply with respect to all periods since February 28, 1952, and before January 1, 1953. The election shall apply to the property held by the person making the election at any time on or before the date of such election.

(b) A taxpayer may include in an election filed before December 31, 1952, a statement that the election shall take effect when filed, and in such case the election shall be irrevocable on the date filed, and shall not apply to any property acquired by the taxpayer after such date. If an election is made before December 31, 1952, and does not contain such statement, the election may be revoked by filing on or before December 31, 1952, in the same office in which the election was filed, a statement of revocation executed in the same manner as the election.

Such an election made before December 31, 1952, and revoked on or before that date, shall be deemed made on December 31, 1952, and shall apply to all property held by the taxpayer as of the date of revocation and shall apply to all periods since February 28, 1952, and before the date of revocation.

(c) A copy of the written statement of election must be filed with the first income tax return, amended return, or claim for refund filed on or after the date on which the election is made.

(d) An election by a partnership is not an election by the partnership of which he is a member, but a separate election must be made by the partnership. Similarly, an election by a corporation applies only with respect to the partnership, and is not applicable to the separate property of the partners. A similar rule applies with respect to elections by trusts and beneficiaries of such property.

(e) An election which conforms in substance to the provisions of this section shall not be deemed invalid solely because it was filed prior to the date on which the regulations in this section were promulgated.

(b) Rules applicable to making of election. The following rules are applicable to the making of an election under section 113 (d).

(1) Form of election. The election shall be in the form of a statement in writing addressed to the district director of internal revenue with whom filed, shall state the name and address of the taxpayer making the election, and shall contain a statement that such taxpayer elects to have the provisions of section 113 (b) (1) (B) (B) apply in respect of all periods since February 28, 1913, and before January 1, 1953.

(2) Signature. The written statement of election shall be signed by the taxpayer making the election, if an individual, or, if the taxpayer making the election is not an individual, the statement shall be executed in the same manner as is required in the
§ 39.114 Basis for depreciation and depletion.

Sec. 113. Basis for depreciation and depletion—(a) Basis for depreciation. The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 112 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) Basis for depletion. The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 112 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(2) Discovery value in the case of mines. In the case of mines (except mines for the purpose of determining the gain upon any property shall be the adjusted basis provided in section 112 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(a) Definition of gross income from property. As used in this paragraph the term "gross income from property" means the gross income from mining, the term "mining" as used herein, shall be considered to include: (i) the mining of all minerals and 100 per centum of the net income of the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchases of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance for such discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to discovery value. Depletion allowances include mineral oil and gas wells in § 39.23 (m) as follows: (i) The term "depletion" as used herein shall be considered to include, in respect of any property, the amount allowable under paragraph (4) of this subsection discovered by the taxpayer after December 31, 1952, as shown by the postmark on the envelope containing the written statement of election or as proved by other available evidence of the mailing date.

§ 39.114-1 Basis for allowances of depreciation and depletion. The basis upon which exhaustion, wear and tear, and obsolescence, and depletion will be allowed in respect of any property is the same as provided in section 115 (a) as adjusted as provided in section 114 (c) for the purpose of determining the gain from the sale or other disposition of such property, except that as provided in section 114 (c) in the case of the mining of timber which is considered to be a sale or exchange of such timber under section 117 (c) (1), the basis shall be the fair market value of such timber as of the first day of the taxable year in which it is cut; and as provided in § 39.23 (m)–3, relating to depletion based on discovery value, in § 39.23 (m)–4, relating to percentage depletion in the case of oil and gas wells, in § 39.23 (m)–5, relating to percentage depletion in the case of certain minerals, and in sections 23 (cc) (2) and (2) (4), relating to basis for depletion.

§ 39.115 (a) Statistical provisions; distributions by corporations; definition of dividend.

Sec. 115. Distributions by corporations—(a) Dividends. The term "dividends" as used in sections 201 (e), section 204 (11) and section 207 (a) (3) and (b) (3) (where the term refers to distributions paid to policyholders (other than companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property, (i) out of its earnings or profits accumulated after February 28, 1913, or (ii) out of the earnings or profits of the taxable year computed after February 28, 1913, 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. In the case of a corporation which, under the law applicable to the taxable year in which any distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504 (c) or section 505 or a corresponding provision of a prior income-tax law, is a personal holding company under the law applicable to such taxable year, such term also means any distribution (whether or not a dividend, defined as such by the reference in this chapter to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, less the sum of the following:

(1) The net operating loss credit provided in section 26 (c) (1); (2) The dividend carry-over provided in section 27 (c); and

(3) The deduction for amounts for retirement of indebtedness provided in section 504 (b).

§ 39.116 (a)–1 Dividends. The term "dividends" as used in the provisions of chapter 1 (except when used in section 201 (e), section 204 (f) and section 207 (a) (11) and section 207 (a) (3) and (b) (3) where the term refers to dividends of insurance companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, less the sum of the following:

(1) The net operating loss credit provided in section 26 (c) (1); (2) The dividend carry-over provided in section 27 (c); and

(3) The deduction for amounts for retirement of indebtedness provided in section 504 (b).

§ 39.116 (a)–2 Definite provisions; statutory provisions; definitions

Sec. 116. Regulations under chapter 1—(a) Definitions. The term "definite provisions" as used in the provisions of chapter 1 (except when used in section 201 (e), section 204 (f) and section 207 (a) (11) and section 207 (a) (3) and (b) (3) where the term refers to dividends of insurance companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, less the sum of the following:

(1) The net operating loss credit provided in section 26 (c) (1); (2) The dividend carry-over provided in section 27 (c); and

(3) The deduction for amounts for retirement of indebtedness provided in section 504 (b).

§ 39.116 (a)–3 Regulation of dividends

Sec. 117. Regulations under chapter 1—(a) Regulation of dividends. The term "regulation of dividends" as used in the provisions of chapter 1 (except when used in section 201 (e), section 204 (f) and section 207 (a) (11) and section 207 (a) (3) and (b) (3) where the term refers to dividends of insurance companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, less the sum of the following:

(1) The net operating loss credit provided in section 26 (c) (1); (2) The dividend carry-over provided in section 27 (c); and

(3) The deduction for amounts for retirement of indebtedness provided in section 504 (b).
(1) Earnings or profits accumulated since February 28, 1913, or

(2) Earnings or profits of the taxable year computed without regard to the amount of such earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

(b) In the case of a corporation which, under the law applicable to the taxable year in which a distribution is made, is a personal holding company or which, for the taxable year in respect of which a distribution is made under section 504 (c) relating to dividends paid within the taxable year, or section 506, relating to deficiency dividends, or corresponding provisions of a prior income-tax law, was under the applicable law a personal holding company, the term "dividend," in addition to the meaning set forth in the first sentence of section 115 (a) also means a distribution to its shareholders as follows: A distribution within a taxable year of the corporation, or of a shareholder, is a dividend to the extent of the corporation's subchapter A net income less the sum of the net operating loss credit provided in section 26 (c) (1) of the dividend carry-over provided in section 27 (c) and the deduction for amounts for retirement of indebtedness provided in section 506 (b) for the taxable year in which, or, in the case of a distribution under section 504 (c) or section 506, the taxable year in respect of which, the distribution is made.

(c) The term "distributions" does not include distributions under section 115 (c) relating to distributions in liquidation, section 115 (e) relating to distributions by personal service corporations, or section 115 (f) relating to stock dividends or certain distributions by insurance companies. In all other cases the term includes any distribution to shareholders to the extent made out of accumulated or current earnings or profits.

(d) A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributee when the cash or other property is understoodly made subject to their demands.

(e) The application of section 115 (a) may be illustrated by the following examples:

Example (1). At the beginning of the calendar year 1952, the P Corporation, a personal holding company, had no accumulated earnings or profits. During that year it made no earnings or profits but its subchapter A net income, due to the disallowance of certain deductions, was $10,000. It received no interest income. On December 1, 1952, the corporation distributed $10,000 to its shareholders. If the distribution was made. It is immaterial whether the P Corporation is a personal holding company for the taxable year 1953 or whether it had any income for that year.

Example (2). In 1953, a deficiency in personal holding company income was established against the P Corporation for the taxable year 1948 in the amount of $55,500 based on an undistributed subchapter A net income of $52,500 which consisted of a subchapter A net income of $50,000 minus a deduction of $10,000 for amounts for retirement of indebtedness provided in section 504 (b). The P Corporation complied with the provisions of section 266 and in December 1952 it distributed $52,500 to shareholders as "deficiency dividends." The distribution of $52,500 is a taxable dividend since it does not exceed $50,000 of the $55,500 of $52,500 for 1948, the taxable year with respect to which the distribution was made, minus $5,500 of the deduction for retirement of indebtedness provided in section 504 (b).

Example (3). At the beginning of the calendar year 1952, the P Corporation, a personal holding company, had $100,000 of accumulated earnings and profits for the year amounted to $100,000. In 1952, the corporation made the following distributions to its shareholders on December 31, 1952, $15,000, and on January 1, 1953, $1,000, the latter amount being received as a deduction under section 504 (c) in its personal holding company return for 1952 filed on March 15, 1953. Both distributions are taxable dividends in full, since they do not exceed the subchapter A net income for 1952, the taxable year in which the distribution of $15,000 was made and with respect to which the distribution of $1,000 was made. It is immaterial whether the P Corporation is a personal holding company for the taxable year 1953 or whether it had any income for that year.

Example (4). At the beginning of the taxable year 1952 of the corporation, a personal holding company, had a deficit in earnings and profits of $200,000. During that year it made earnings and profits of $55,000. For that year it had a subchapter A net income of $100,000, a net operating loss credit under section 26 (c) (1) of $10,000 and a deduction for retirement of indebtedness under section 26 (c) (2) of $10,000. During that taxable year it distributed $100,000 to its shareholders $100,000 of the $100,000 is a taxable dividend to the extent of $80,000 (subchapter A net income of $100,000 minus the net operating loss credit of $10,000 and the deduction for retirement of indebtedness of $10,000). No interest shall be allowed or paid in respect of any overpayment of tax resulting from the inclusion in taxable income by any shareholder of his proportionate share of the distribution of $100,000.

Example (5). If the facts were the same as in example (4) except that the P Corporation had bad earnings and profits for the taxable year 1952 of $90,000, the distribution of $100,000 would be a taxable dividend to the extent of $90,000 since its earnings and profits for that year, $80,000, exceed $80,000 (subchapter A net income of $100,000 minus the net operating loss credit of $10,000 and the deduction for retirement of indebtedness of $10,000).

§ 39.115 (a)–2 Earnings or profits. (a) In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated before March 1, 1913) due consideration must be given to the facts, and, while more bookkeeping entries increasing or decreasing surplus will not be conclusive, 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 and filing its tax returns under sections 41, 42, and 43 or the corporation's subchapter C for the taxable year 1952, computed on the installment basis, or where adjustments basis may not be the accrual basis in determining earnings and profits; a corporation computing income on the installment basis, or where adjustments basis may be the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 22 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 22 (a) (b) and which is segregated accordingly in the unearned premium reserve.

(b) Among the items entering into the computation of corporate earnings or profits for a particular period are all income excepted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22 (a) or corresponding provisions of prior Revenue Acts. Corporation income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22 (a) or corresponding provisions of prior Revenue Acts and which is unearned under the provisions of section 22 (a) (b) and which is segregated accordingly in the unearned premium reserve.

(c) (1) In the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on costs or other basis without regard to March 1, 1913, value. In computing the earnings and profits for any period beginning after February 28, 1913, the only depletion or depreciation deductions to be considered is those based on (1) the cost or other basis, if the depreciable or depreciable asset was acquired subsequent to February 28, 1913, (2) adjusted cost or March 1, 1913, value, whichever is higher, if acquired before March 1, 1913. Thus, discovery or percentage depletion under all Revenue Acts for mines and oil and gas wells is not to be taken into consideration in determining the earnings and profits of a corporation. Similarly, where the basis of property in the hands of a corporation is a substituted basis, such basis, and not the fair market value of the property at the time of the acquisition by the corporation, is the basis for depletion and depreciation for the purpose of determining earnings and profits of the corporation.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:
Example. Oil producing property which A had acquired in 1946 at a cost of $28,000 was transferred to the Y Corporation in December 1946, in exchange for all of its capital stock. The fair market value of the stock and of the property as of the date of the transfer was $247,000. The Y Corporation, after four years' operations, effected in 1952 a cash distribution to A in the amount of $55,000. In determining the extent to which the earnings and profits of the Y Corporation available for dividend distributions have been increased, any reduction in the value of the stock or other property received in the exchange in 1946 regardless of the fair market value of the property or of the stock issued in exchange therefor.

(d) A loss sustained for a year before the taxable year does not affect the earnings or profits accumulated since 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 before the year for which the loss was sustained, reduces surplus as of March 1, 1913, after such loss has been adjusted. And, if the surplus as of March 1, 1913, was sufficient to absorb such excess, distributions to shareholders after the year of the loss are out of earnings or profits accumulated since the year of the loss to the extent of such earnings.

(e) With respect to the effect on the earnings or profits accumulated since February 28, 1913, of distributions made on or after January 1, 1916, and before August 6, 1917, out of earnings or profits accumulated before March 1, 1913, which distributions were specifically declared to be out of earnings or profits accumulated before March 1, 1913, see section 31(b) of the Revenue Act of 1916, as amended by section 1211 of the Revenue Act of 1917.

§ 39.115 (a) (3) Effect on earnings or profits of certain tax-free exchanges and tax-free distributions (b) If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation of the transferor shall be made as between the transferor and transferee corporations.

(b) If a transaction described in paragraph (a) (3) of this section has such effect on the earnings or profits of the transferee corporation as of the day on which such transaction occurred the proportionate part of such earnings or profits of the transferee corporation accumulated as of such day and properly allocable to the transferee; and there shall be included in the current earnings and profits of the transferee for the taxable year of the transferee in which such transaction occurred the proportionate part of the earnings and profits of the transferee corporation accumulated after the beginning of such taxable year and properly allocable to the transferee. The amount so included in the current earnings and profits of the transferee shall not exceed the proportionate part of the earnings and profits of the transferee corporation accumulated as of the day on which such transaction occurred.

(c) 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:

1. The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders—

(i) Of stock or securities in such corporation or in another corporation a party to the reorganization in any taxable year beginning before January 1, 1934, without the surrender of the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932) or

(ii) Of stock (other than preferred stock) in another corporation which is a party to the reorganization without the surrender of the distributees of stock in the distributing corporation if the distribution occurs after October 29, 1931 (see section 112 (b) (11)) or

(iii) Of stock or securities in such corporation or in another corporation a party to the reorganization 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.

(2) 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, in the case of an exchange or distribution in complete liquidation of another corporation, under the circumstances described in section 112 (b) (6) of the Revenue Act of 1936, or of the Internal Revenue Code, 1938.

(3) The distribution in any taxable year (beginning December 31, 1938) of stock or securities, or other property or money, in the case of an exchange or distribution in complete liquidation of another corporation, under the circumstances described in section 371 (relating to exchanges and distributions in compliance with 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.

(4) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment of the Constitution or because exempt from tax under section 115 (f) of the Revenue Act of 1934 or of a corresponding provision of a prior Revenue Act.

(5) The distribution, in any taxable year beginning after December 31, 1931, by or on behalf of an insolvent corporation, in connection with a section 112 (b) (10) reorganization, of stock or securities in kind or as a substitute for dividends or in any other manner, of any property owned or used, or designated or made available to use to effectuate the plan of reorganization, if under section 112 (b) no gain to the distributees from the receipt of such stock or securities was recognized by law.

A distribution described in subparagraph (a) (2) (i), (ii), (iii), (iv), or (v) of this paragraph does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution. In the event that the corporation makes such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or otherwise, in the case, however, of amounts distributed in liquidation (other than a tax-free liquidation or reorganization described in subparagraph (a) (5)) 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 since the date of the distribution, or by other corporation to which the earnings or profits are transferred upon such reorganization or otherwise, in the case, however, of amounts distributed in liquidation (other than a tax-free liquidation or reorganization described in subparagraph (a) (5)).

(d) For the purposes of this section, the term "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1938, have the meanings assigned to such terms in section 111 of the Revenue Act of 1932, and for any taxable year beginning after December 31, 1933, and before January 1, 1938, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934, for any taxable year beginning after December 31, 1935, and before January 1, 1938, have the meanings assigned to such terms in section 112 of the Revenue Act of 1935, 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.

§ 39.115 (b) Statutory provisions; distributions by corporations; source of distribution.

Sec. 115. Distributions by corporations.

(a) (1) Source of distributions. For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, and any increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be proportionate to the stock provided in section 113. The preceding sentence shall not apply to a distribution which is part of the meaning of the last sentence of subsection (a).

[Sec. 115 (b) as amended by sec. 223 (b), Rev. Act 1942]

§ 39.115 (b) (1) Sources of distribution in general. (a) For the purpose of income taxation every distribution made...
by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits. In determining the source of a distribution it should be given first, to the earnings or profits of the taxable year; second, to the earnings or profits accumulated since February 28, 1913, only in case thereof, and, in the extent that, the distributions made during the taxable year are not regarded as out of the earnings or profits of that year third, to the earnings or profits accumulated since February 28, 1913, have been distributed; and, fourth, to sources other than earnings or profits only after the earnings or profits have been distributed.

(b) If the earnings or profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings or profits at the time of the distribution) are sufficient to cover all the distributions made during that year, then each distribution is a taxable dividend. See §39.115 (a)-(1). If the distributions made during the taxable year exceed the earnings or profits of such year, then that proportion of each distribution which the total of the earnings or profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings or profits of that year. The portion of each such distribution which is not regarded as out of earnings or profits of the taxable year shall be considered a taxable dividend to the extent of the earnings or profits accumulated since February 28, 1913, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings or profits accumulated since February 28, 1913, and available on the date of the distribution, the portion not including the date on which the distribution was made was not prorated to the date of the distribution and did not include the date on which the distribution was made.

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

Example. At the beginning of the calendar year 1905, the M Corporation had $12,000 in earnings and profits accumulated since February 28, 1913. Its earnings and profits for 1902 amounted to $39,000. During the year it made quarterly distributions of $18,000 each. Of each of the four distributions, $7,500 (that portion of $18,000 which the amount so distributed bears to the earnings and profits of the taxable year), bears $60,000, the total distributions made during the year, to the earnings and profits of the taxable year, and of the first and second distributions, $7,500 and $4,500, respectively, were paid out of the earnings and profits accumulated since February 28, 1913, and before the taxable year, as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar. 10</td>
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</tr>
<tr>
<td>June 10</td>
<td>$15,000</td>
</tr>
<tr>
<td>Sep. 10</td>
<td>$15,000</td>
</tr>
<tr>
<td>Dec. 10</td>
<td>$15,000</td>
</tr>
</tbody>
</table>

Total amount taxable as dividends: $60,000

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 one of 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 the corporate stock may be accomplished, for example, by the complete retirement of all 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 them, or by the retirement of any part of the stock, whether or not pro rata among the shareholders.

The term "amounts distributed in complete liquidation" means a distribution of earnings or profits of the taxable year or other basis of the stock provided in section 112. The gain recognized from such distribution shall be determined under section 112. In the case of amounts distributed (whether before January 1, 1939, or after December 31, 1938) in complete partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in partial liquidation or in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a State was a State group (as defined in section 301 (a) (5)) existed after August 26, 1937, and before January 1, 1938, then, despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a gain from the sale or exchange of a capital asset held for more than 6 months.

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 1941 at a cost of $1,500, and the remainder of 10 shares in December 1951 at a cost of $2,500. He receives on April 1, 1952, a distribution of $300 per share in complete liquidation, or $6,000 on the shares acquired in 1941, and $3,000 on the 10 shares acquired in December 1951. The gain of $1,000 on the shares acquired in 1941 is a long-term capital gain to be treated as provided in section 111 and section 39.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 111. The gain of $1,000 on the shares acquired in 1951 is a short-term capital loss to be treated as provided in section 117.

Example (2). A, an individual who makes his income tax returns on the calendar year basis, owns 20 shares of participating preferred stock of the Z Corporation, 10 shares of which were acquired in 1943 for $1,700 and 10 shares of which were acquired in January
§ 39.115 (d) Statutory provisions; distributions by corporations; other distributions from capital.

Sec. 115. Distributions by corporations.

• • •

(d) Other distributions from capital. If any amount made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis shall be applied against and reduce the shareholder's basis in its stock or in rights to acquire its stock.

§ 39.115 (d)–1 Distributions other than a dividend. (a) Under section 115 (d) any distribution (including a distribution on the basis of the shareholders as to medium of payment) shall be considered as a dividend if it is not treated as a dividend, whether or not otherwise a dividend.

[b]Sec. 115 (d) as amended by sec. 214 (b), Rev. Act 1939]

§ 39.115 (d)–1 Distributions other than a dividend. (a) Under section 115 (d) any distribution (including a distribution on the basis of the shareholders as to medium of payment) shall be considered as a dividend if it is not treated as a dividend, whether or not otherwise a dividend.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. In 1952 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 $8,000 paid out of earnings or profits of the O Corporation accumulated before March 1, 1913. This distribution must be applied by the shareholder to the basis of its stock in the O Corporation reducing such basis to $2,000. The $2,000 does not constitute a part of the earnings or profits of the M Corporation. If the M Corporation subsequently sold its stock in the O Corporation for $9,000, it realizes a gain of $1,000, which constitutes a part of its earnings or profits for taxation purposes.

§ 39.115 (d)–2 Distributions from depletion or depreciation reserves. A reserve created as corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost or other basis of the property will not be considered as having been paid out of earnings or profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock or other property to the extent that such reserve represents the excess of the discovery value to the extent that such reserve represents the excess of the discovery value over the cost or other basis for determining gain or loss, is, when realized, a taxable gain or loss to the extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution. A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock which 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.

§ 39.115 (f)–1 Stock dividends. A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholder within the meaning of the sixteenth amendment to the Constitution. A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock which 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.

§ 39.115 (f)–2 Election of shareholders as to medium of payment. (a) Whenever a distribution is made by a corporation to its shareholders (whether exercised before or after the declaration thereof), payable either (1) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraphs (a), (b), or (c) of section 113 (d) or (e) of section 115 (f)–1, then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

§ 39.115 (g) Statutory provisions; distributions by corporations; redemption of stock.

§ 39.115 (g)
§ 39.115 (g)–1 Distribution in redemption or cancellation of stock taxable as a dividend—(a) In general. (1) If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or re- demption 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.

(b) If the distribution and redemption or cancellation of stock taxable as a dividend and in connection with a cancellation or redemption of stock (whether or not such stock was issued as a stock dividend) at such 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 such 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.

(2) Redemption through use of subsidiary corporation. A corporation (hereinafter referred to as the issuing corporation) and the issuing corporation controls (directly or indirectly) the acquiring corporation, the amount paid for the acquisition of the stock shall constitute a taxable dividend from the issuing corporation to the extent that the amount paid for such stock would have been considered, under paragraph (1), as essentially equivalent to a taxable dividend if such amount had been distributed in liquidation or cancellation or redemption to the issuing corporation and had been applied by the issuing corporation in redemption of its stock. For the purposes of this paragraph the term "stock possessing directly or indirectly, stock of the corporation, is not essentially equivalent to the distribution of a taxable dividend.

(3) Redemption of stock to pay death taxes. The provisions of this subsection shall not apply to any part of any amount so distributed with respect to stock the value of which is included in determining the value of the gross estate of a decedent. In accordance with section 811, as is distributed after such decedent's death and within the period of limitations for the assessment of estate tax provided in section 874 (a) (determined without the application of section 870) or within 90 days after the expiration of such period, and as is not in excess of the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of such death.

That the value of the stock in such corporation for estate tax purposes comprises more than 35 per centum of the value of the gross estate of any decedent.

[Sec. 115 (g) as amended by secs. 208 (a), 209 (a), Rev. Act 1950; sec. 320 (a), Rev. Act 1941]

§ 39.115 (g)–2 Distribution in redemption or cancellation of stock taxable as a dividend to a taxable corporation. For the purposes of this section, the value of any dividend distribution by a corporation to a taxable corporation of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder continues to be interested in the affairs of the corporation, does not effect 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 or more 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.

(b) Distribution in redemption or cancellation of stock taxable as a dividend to another corporation. (1) If stock of one corporation (hereinafter referred to as the acquiring corporation) and if the issuing corporation controls, directly or indirectly, the acquiring corporation, the amount paid for such stock may constitute a taxable dividend to such shareholder.

For the purposes of this paragraph, the issuing corporation is deemed to control the acquiring corporation if it owns, directly or indirectly, stock possessing 50 per centum or more of the total combined voting power of all classes of stock or 50 per centum of the total value of shares of all classes of stock of the corporation.

(2) Where stock of one corporation is acquired by another corporation and the issuing corporation controls the acquiring corporation, the amount paid for such stock shall be treated, under section 115 (g) as though such amount had first been distributed to the issuing corporation and immediately thereafter had been distributed by such corporation in redemption or cancellation of any stock of the acquiring corporation entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of such corporation.

(3) In determining whether the estate of the decedent is comprised of stock of a corporation of sufficient value to satisfy the percentage requirements of section 115 (g) (3) the total value, in aggregate, of all classes of stock of a corporation includible in the gross estate is taken into account. Thus, if the gross estate of the decedent, valued for purposes of the Federal estate tax at $200,000, includes common stock of Corporation A valued at $300,000, preferred stock of Corporation B valued at $100,000, preferred stock of Corporation C valued at $80,000, section 115 (g) (3) is applicable to distributions in cancellation or redemption of either stock of Corporation A (comprising $300,000/$1,000,000 or 30 per centum of the gross estate) or preferred stock of Corporation B (comprising $300,000/$1,000,000 or 30 per centum of the gross estate) but not to distributions in cancellation or redemption of stock of Corporation C (comprising only 5 per cent of the gross estate).

(4) Section 115 (g) (3) applies to distributions made after the death of the decedent and before the expiration of the 3-year period of limitations for the assessment of estate tax provided in section 874 (a) (determined without the application of any provision of extending or suspending the running of such period of limitations) or within 90 days after the expiration of such period, since the period for assessment of estate tax prescribed in section 874 (a) is a period of three years after the filing of the estate tax return, section 115 (g) (3) applies only to distributions made not later than three years and 90 days after the filing of the estate tax return.

(5) While section 115 (g) (3) will most frequently have application in the case where stock is canceled or redeemed from the executor or administrator of an estate, the section is also applicable to distributions in cancellation or re- demption of stock included in the decedent's gross estate but held after the time of the redemption by any person who acquired the stock by any of the means comprehended by the subdivisions of section 811, including the heir, legatee, devisee of the decedent, a surviving joint tenant, surviving spouse, appointee, or in default of appointment, or a trustee of a trust cre-
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noted by the decedent. Thus, section 115 (g) (3) may apply with respect to a distribution in cancellation or redemption of stock from a donee to whom the decedent has transferred stock in contemplation of death where the proceeds of such stock is included in the decedent's gross estate under section 811 (c) (1) (A). Similarly, section 115 (g) (3) may apply to the stock distributed from a beneficiary of the estate to whom an executor has distributed the stock pursuant to the terms of the will of the decedent. However, section 115 (g) (2) is not applicable where the stock is redeemed from a stockholder who has acquired the stock by gift or purchase from any person to whom such stock has passed from the decedent.

(6) The total application of section 115 (g) (3) with respect to stock included in the gross estate of any decedent can never exceed the amount of the stock, inheritance, legacy, or succession tax (including any interest collected as a part of such taxes) imposed because of the decedent's death. In determining whether the total distributions in redemption of such stock made within the period of time prescribed in section 115 (g) (3) exceed the amount of such taxes and interest, account shall be taken of all such distributions without regard to whether the distribution would be treated as a dividend were it not for section 115 (g) (3).

(7) For the purpose of section 115 (g) (3) the Federal estate tax or any other estate, inheritance, legacy, or succession tax shall be ascertained after the allowance of any credit, relief, discount, refund, remission, or reduction of tax.

(8) The sole effect of section 115 (g) (3) is to exempt from tax as a dividend a distribution to which such section is applicable when made in redemption of stock includible in a decedent's gross estate. Such section does not, however, in any other manner affect the principles set forth in paragraph (a) of this section. Thus, if stock of a corporation is owned equally by A, B, and the C Estate, and the corporation redeems one-half of the stock of each shareholder, the determination of whether the distributions to A and B are essentially equivalent to dividends shall be made without regard to the effect which section 115 (g) (3) may have upon the taxability of the distribution to the C Estate.

§ 39.115 (h) (j) Statutory provisions; distributions by corporations; effect on earnings and profits of distributions of tax-free property. Sec. 115, Distribution by corporations. * * *

(a) Effect on earnings and profits of distributions of tax-free property. The distribution (whether before January 1, 1959, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) If no gain is recognized on the distribution (whether before January 1, 1959, or on or after such date) to a distributee from the receipt of which neither gain nor loss was recognized by law, or

(2) If the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1913, if the provisions of subsection 115 (f) of such Act were in force on December 31, 1943, and the distribution was not in payment of a prior Revenu Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) Definition of partial liquidation. As used in this section the term "amounts distributed by partial liquidation 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."
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Example (2). On January 2, 1910, the M Corporation acquired an appreciable property for a stock valued at $1,000. The fair market value of such property in the hands of the M Corporation was $2,200. On December 31, 1950, the M Corporation transferred such property in exchange for $1,000 in cash and all the N Corporation stock, which has a fair market value of $1,100. The purpose of computing the total earnings and profits of the M Corporation was the gain on such transaction, which in cash is $1,000 and stock worth $100 minus $1,100, the adjusted basis for computing gain, determined without regard to December 31, 1931, value), $1,000 of which is recognized under section 112 (d), since this was the amount of money received, although for the purpose of computing net income the gain is only $800 (the sum of $1,000 in cash and stock worth $1,100 minus $2,200, the adjusted basis for computing gain determined by giving effect to March 1, 1914, value). Such earnings and profits will therefore be increased by $800. In doing this, the earnings and profits of the M Corporation for any period beginning after February 28, 1915, in such transaction, like the taxable gain, is only $800, all of which is recognized under section 112 (d), the increase in earnings and profits of such amount. Such earnings and profits will therefore be increased by only $800 as a result of this transaction. If the increase in that part of the earnings and profits consisting of increase in value of property accreted basis, thereon, but on or after, March 1, 1913, see §39.115 (m)-1.

Example (3). On July 1, 1952, the R Corporation transferred such property to the S Corporation in exchange for $50,000 cash and all the S Corporation stock, which had a fair market value of $100,000. For purposes of computing net income the R Corporation has realized a gain of $50,000 as a result of this transaction. The R Corporation therefore is required to compute earnings and profits, under section 112 (c). For the purpose of computing earnings and profits, however, the R Corporation has realized a loss of $25,000, the amount of which is recognized under the provisions of section 112 (e). The earnings and profits of the R Corporation are therefore neither increased nor decreased as a result of the transaction. The adjusted basis of the S Corporation stock in the hands of the R Corporation for purposes of computing earnings and profits, however, will be $225,000 (though only $100,000 for the purpose of computing net income), computed as follows:

- Basis of property transferred... $500,000
- Less money received on exchange... 25,000
- Plus gain or minus loss recognized on exchange... None

Basis of stock... 475,000

Less adjustments utilized in determining adjusted basis of property transferred... \( \frac{50,000}{100,000} \) 100,000

Adjusted basis of stock... 375,000

If, therefore, the R Corporation should subsequently sell the S Corporation stock for $100,000, a loss of $800 will again be realized for the purpose of computing earnings and profits, all of which will be recognized under the provisions of section 111 (b) (12) of the Internal Revenue Code.
the effect on earnings and profits, where a corporation receives (after February 28, 1913) from a second corporation a distribution which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, section 115 (d) provides certain rules. It provides that the amount of such distribution shall not increase the earnings and profits of the first or receiving corporation in the following cases: (1) No such increase shall be made in the year of the distribution which (under the law applicable to the year in which the distribution was made) is directly applied in reduction of the basis of the stock in respect of which the distribution was made and (2) no such increase shall be made if (under the law applicable to the year in which the distribution was made) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received. Where, therefore, there is received by a corporation a distribution in which the distribution was made, as, for example, a distribution in 1934 from earnings and profits accumulated before March 1, 1913, requires that the amount of such distribution be applied against and reduce the basis of the stock with respect to which the distribution was made, there is no increase in the earnings and profits by reason of the receipt of such distribution. Similarly, where there is received by a corporation a distribution from another corporation in the form of a stock dividend and the law applicable to the year in which such distribution was made requires the allocation, as between the old stock and the stock received as a dividend, of the basis of the old stock, then there is no increase in the earnings and profits by reason of the receipt of such stock dividend even though such stock dividend constitutes income within the meaning of the sixteenth amendment to the Constitution.

(b) The principles set forth in paragraph (a) of this section may be illustrated by the following examples:

Example (1). The X Corporation in 1902 distributed to its shareholders, $10,000 which was out of earnings and profits accumulated before March 1, 1913, and did not exceed the adjusted basis of the stock in respect of which the distribution was made. This amount of $10,000 was, therefore, deductible and under the provisions of section 115 (b) must be applied against and reduce the adjusted basis of the stock in respect of which the distribution was made. The earnings and profits of the Y Corporation are not increased by reason of the receipt of this distribution.

Example (2). The Z Corporation in 1904 had outstanding common and preferred stock of which 100 shares of the common and no preferred. The stock had a cost basis to the Y Corporation of $10,000. In December of that year it received a dividend of 100 shares of the preferred stock of which distribution is a stock dividend which, under section 115 (f) of the Revenue Act of 1904, was not taxable and as such was included in the gross income of the Y Corporation. The original cost of $10,000 is allocated to the 200 shares of the Z Corporation none of which has been sold or disposed of. See section 113 (a) and (f) and 39.113 (a) (1913). The earnings and profits of the Z Corporation are not increased by reason of the receipt of each stock dividend.

§ 39.115 (m) Statutory provisions: distributions by corporations; earnings and profits increase in value of property accrued before March 1, 1913.

Sec. 115. Distributions by corporations. ** ** **

(m) Earnings and profits; increase in value of property accrued before March 1, 1913.

(1) Adjustments to earnings and profits reflecting increase in value accrued before March 1, 1913. (a) The first sentence of section 115 (m) (1) of the Revenue Act of 1913 provides certain rules. It provides that the amount of such distribution shall not increase the earnings and profits of the property involved determined without regard to its March 1, 1913, value, then, except as provided in paragraph (b), an increase (properly reflecting such difference) shall be made in part of the earnings and profits consisting of an increase in value of property accrued before March 1, 1913.

(2) If the application of subsection (1) to the X Corporation, the Z Corporation and the general rule with respect to computing the amount of such distribution would result in a loss which is to be applied in reduction of the decrease in earnings and profits for any period beginning after February 28, 1913, with respect to any matter which would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (b), an increase (properly reflecting such difference) shall be made in part of the earnings and profits consisting of an increase in value of property accrued before March 1, 1913.

[Sec. 115 (m) as added by sec. 501 (a), Sec. Rev. Act 1940]

§ 39.115 (m)-1 Adjustments to earnings and profits reflecting increase in value accrued before March 1, 1913.

(a) The first sentence of section 115 (m) provides certain rules:

(b) (1) Section 115 (m) (1) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of such increase in value of property accrued before, but realized on or after, March 1, 1913.

(2) The effect of section 115 (m) (1) may be illustrated by the following examples:

Example (1). The X Corporation acquired nondepreciable property before 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 1952 for $12,500. The increase in earnings and profits for the period beginning after February 28, 1913, with respect to any matter which would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (b), an increase (properly reflecting such difference) shall be made in part of the earnings and profits consisting of an increase in value of property accrued before March 1, 1913.

(2) The Y Corporation acquired nondepreciable property in 1903 at a cost of $10,000. Assuming no additions or betterments, and that the depreciation sustained before March 1, 1913, was $10,000, the adjusted cost as of that date was $90,000. Its fair market value as of March 1, 1913, was $150,000. For the purpose of determining gain from the sale, the basis of the property is the fair market value of $150,000. On March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, the adjusted basis of the property would have been $78,000 instead of $81,467, the adjusted basis for determining gain. In 1952 ($94,000 less $81,467) to $12,533 and the gain would be $12,467 ($25,000 less $12,533). The increase in earnings and profits accumulated since February 28, 1913, is $5,000. For the purpose of determining gain from the sale, the basis of the property is the adjusted basis of $12,500. For the purpose of determining gain, as of March 1, 1913, adjusted for depreciation, is $12,467. If the depreciation since February 28, 1913, had been based on an adjusted cost of $50,000 ($10,000 less $40,000) instead of $10,000, the difference of $35,000 represents the increase in earnings and profits consisting of an increase in value of property accrued before March 1, 1913.

(c) (1) Section 115 (m) (2) is an exception to the general rule in section 115 (m) (1) and also operates as a limitation on the application of section 115 (m) (1). It provides that, if the application of the first sentence of section 115 (m) (1) to the X Corporation, the Z Corporation and the general rule with respect to computing the amount of such distribution would result in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, the amount of such distribution shall be made in that part of the earnings and profits consisting of an increase in value of property accrued before, but realized on or after, March 1, 1913.

(b) (1) Section 115 (m) (1) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of such increase in value of property accrued before, but realized on or after, March 1, 1913.

(2) The effect of section 115 (m) (1) may be illustrated by the following examples:

Example (1). The X Corporation acquired nondepreciable property before March 1, 1913, at a cost of $8,000. Its fair market value as of March 1, 1913, was $13,000, and it was sold in 1953 for $10,000. Under (2) of the first sentence of section 115 (m) (2) the adjusted basis would be $13,000 and there would be a loss of $5,000. The application of (2) of
§ 39.116 Statutory provisions; additional exclusions from gross income.

Sec. 116. Exclusions from gross income. In addition to the exclusions listed in section 115 (a)(2)(A) and (B), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) Earned amounts without the United States—(1) bona fide resident of foreign country. In the case of an individual citizen of the United States who has resided in a foreign country and has been in that country for a period of at least 90 days in any 12-month period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)) attributable to such period; but such amounts shall be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph. If the 12-month period includes an entire taxable year, the amount excluded under this paragraph shall not exceed $10,000.

(b) Any individual not an alien and who is a bona fide resident of a foreign country and who is in such country for an uninterrupted period of 180 days in any taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)) attributable to such period; but such amounts shall be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph. If the 180-day period includes an entire taxable year, the amount excluded under this paragraph shall not exceed $2,000. If the 180-day period does not include an entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed $5,000. If the 180-day period ends on or after March 1, 1913, the amount of such deduction shall be reduced by 50%, and the deduction shall be limited to $2,000.

(c) Amounts attributable to the sale of a United States Savings Bond, series E or H, which was issued after March 1, 1913, and which was held by the taxpayer at the time of sale.

(d) Any income received by the United States government from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(e) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(f) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(g) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(h) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(i) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(j) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(k) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(l) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(m) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(n) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(o) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(p) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(q) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(r) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(s) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(t) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(u) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(v) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(w) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(x) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(y) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.

(z) Any income received by a United States government agency from the sale of United States Savings Bonds, series E or H, which were held by the taxpayer at the time of sale.
to such government, international organization, or such Commonwealth—

(A) If such individual is not a citizen of the United States or is a citizen of the Commonwealth of the Philippines (whether or not a citizen of the United States) and was a resident of the Commonwealth of the Philippines for an uninterrupted period of at least two years before the date on which he changes his residence from the Commonwealth of the Philippines to the United States, and such individual was a bona fide resident of the Commonwealth of the Philippines for the entire taxable year; or

(B) If, in the case of an employee of a foreign government or of the Commonwealth of the Philippines, the services are of a character similar to those performed by such employee of the Government of the United States in foreign countries or in the Commonwealth of the Philippines, as the case may be; and

(C) If, in the case of an employee of a foreign government or of the Commonwealth of the Philippines, the foreign government, or the Commonwealth grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country or such Commonwealth as the case may be.

(2) Certificate 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 similar services in such foreign country or such Commonwealth as the case may be.

(3) Amounts constituted earned income as defined in section 116 (a) (3) shall be excluded from gross income in the case of an individual citizen of the United States who establishes to the satisfaction of the Commissioner that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, if such amounts are from sources without the United States and attributable to such uninterrupted period, and are paid by the law of the foreign country as compensation for personal services and capital invested therein (except amounts received for services performed as an employee of the United States or any agency thereof) which is attributable to that part of such period of service which is within the taxable year.

(4) If such amount is from sources within the United States, the portion of such amount which is attributable to service within the United States shall be considered as earned income, but the total amount which shall be treated as the earned income of the taxpayer from such trade or business shall, in no case, exceed 20 percent of his share of the net profits of such trade or business. No general rule can be prescribed defining the trades or businesses in which personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by the individual taxpayer or his representative; and the method of determining whether any items shall be excluded from gross income under the provisions of section 116 (a) (2) is prescribed in regulations thereunder.

§ 39.116-1 Earned income from sources without the United States—(a) Resident of a foreign country. (1) Amounts constituting earned income as defined in section 116 (a) (3) shall be excluded from gross income in the case of an individual citizen of the United States who establishes to the satisfaction of the Commissioner that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, if such amounts are from sources without the United States and attributable to such uninterrupted period, and are paid by the law of the foreign country as compensation for personal services and capital invested therein (except amounts received for services performed as an employee of the United States or any agency thereof) which is attributable to that part of such period of service which is within the taxable year.

(2) The entire amount received as professional fees may be treated as earned income, provided that the amount has been a bona fide resident of a foreign country or a former resident of the United States stationed outside continental United States, during the entire taxable year, and income derived from sources within the United States or elsewhere on vacation or business trips will not necessarily deprive the citizen of his status as a bona fide resident of a foreign country, provided that the law of such foreign country (or of the United States) is a bona fide resident of a foreign country shall be determined by the application, to the extent feasible, of the principles of §§ 39.111-1, 39.211-4, 39.211-5, and 39.211-14, to which constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.

(3) Amounts otherwise constituting earned income is excluded from gross income under the provisions of section 116 (a), there shall not be included as a deduction from gross income any items of expenses or losses or other deductions properly applicable to or chargeable against amounts extracted from gross income under this paragraph.

(4) The entire amount received as professional fees may be treated as earned income, provided that the amount has been a bona fide resident of a foreign country or a former resident of the United States stationed outside continental United States, during the entire taxable year, and income derived from sources within the United States or elsewhere on vacation or business trips will not necessarily deprive the citizen of his status as a bona fide resident of a foreign country, provided that the law of such foreign country (or of the United States) is a bona fide resident of a foreign country shall be determined by the application, to the extent feasible, of the principles of §§ 39.111-1, 39.211-4, 39.211-5, and 39.211-14, to which constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.

(5) The entire amount received as professional fees may be treated as earned income, provided that the amount has been a bona fide resident of a foreign country or a former resident of the United States stationed outside continental United States, during the entire taxable year, and income derived from sources within the United States or elsewhere on vacation or business trips will not necessarily deprive the citizen of his status as a bona fide resident of a foreign country, provided that the law of such foreign country (or of the United States) is a bona fide resident of a foreign country shall be determined by the application, to the extent feasible, of the principles of §§ 39.111-1, 39.211-4, 39.211-5, and 39.211-14, to which constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.

(6) (a) The entire amount received as professional fees may be treated as earned income, provided that the amount has been a bona fide resident of a foreign country or a former resident of the United States stationed outside continental United States, during the entire taxable year, and income derived from sources within the United States or elsewhere on vacation or business trips will not necessarily deprive the citizen of his status as a bona fide resident of a foreign country, provided that the law of such foreign country (or of the United States) is a bona fide resident of a foreign country shall be determined by the application, to the extent feasible, of the principles of §§ 39.111-1, 39.211-4, 39.211-5, and 39.211-14, to which constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.

(7) The entire amount received as professional fees may be treated as earned income, provided that the amount has been a bona fide resident of a foreign country or a former resident of the United States stationed outside continental United States, during the entire taxable year, and income derived from sources within the United States or elsewhere on vacation or business trips will not necessarily deprive the citizen of his status as a bona fide resident of a foreign country, provided that the law of such foreign country (or of the United States) is a bona fide resident of a foreign country shall be determined by the application, to the extent feasible, of the principles of §§ 39.111-1, 39.211-4, 39.211-5, and 39.211-14, to which constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.
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will be entitled to the exclusion provided by section 116 (a). An extension of time may be granted for more than 6 months in the case of taxpayers who are abroad. For extensions of time for filing returns, see section 116 (a) and § 39.3-3.

(8) In estimating his gross income for the purpose of making a declaration of estimated tax for any taxable year, a citizen of the United States is not required to include earned income which it is reasonable to believe will be excluded from gross income under the provisions of section 116 (a) and the regulations thereunder.

(c) The term "foreign country" means territory under the sovereignty of a government other than that of the United States, it does not include a possession or territory of the United States.

(b) Presence in a foreign country. (1) Amounts constituting earned income as defined in section 116 (a) (2) shall be excluded from gross income irrespective of when they are received. (2) For taxable years ending after January 1, 1953, there is no limitation upon the amount which may be excluded from gross income pursuant to subparagraph (1). (1) For taxable years ending after December 31, 1952, but only with respect to amounts received after such date, the amount excluded from gross income under the provisions of section 116 (a) (2) shall not exceed $20,000 if the 18-month period includes the entire taxable year. If attributable to a period of 18 consecutive months in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received.

For taxable years ending before January 1, 1953, may be taken into account in determining whether the exclusion allowed by section 116 (a) (2) applies to income attributable to such period, and (iii) paid for gross income comprising the income earned, thereafter will be excludable from gross income under the provisions of section 116 (a) and the regulations thereunder.

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(c) The term "foreign country" means territory under the sovereignty of a government other than that of the United States, it does not include a possession or territory of the United States.

(b) Presence in a foreign country. (1) Amounts constituting earned income as defined in section 116 (a) (2) shall be excluded from gross income irrespective of when they are received. (2) For taxable years ending after January 1, 1953, there is no limitation upon the amount which may be excluded from gross income pursuant to subparagraph (1). (1) For taxable years ending after December 31, 1952, but only with respect to amounts received after such date, the amount excluded from gross income under the provisions of section 116 (a) (2) shall not exceed $20,000 if the 18-month period includes the entire taxable year. If attributable to a period of 18 consecutive months in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received.

(c) The term "foreign country" means territory under the sovereignty of a government other than that of the United States, it does not include a possession or territory of the United States.
Example (1). On February 1, 1953, Mr. White, a citizen of the United States privately employed, arrived in Puerto Rico on a business assignment. Completion of his assignment he departed for a new assignment in Venezuela. On June 1, 1953, at 9 a.m. he arrived in Venezuela, where he remained until 2 p.m. on October 25, 1954, at which time he departed for another assignment in Puerto Rico for a new assignment in the United States. During the 18-month period commencing on June 25, 1953, and ending with the close of October 24, 1954, the taxpayer was in a foreign country an aggregate of 510 full days; in addition, during the 18-month period commencing on June 2, 1953, and ending with the close of December 1, 1954, he was in a foreign country an aggregate of 510 full days. The exemption from tax granted by section 116 (a) (2) will thus apply to income attributable to the entire period which commences with April 25, 1953, and ends with the close of December 1, 1954, a period of approximately 19 consecutive months.

Example (2). At 2 p.m. on January 18, 1952, Mr. Brown, a citizen of the United States privately employed, arrived in England on a business trip from the United States. On May 19, 1952, at 10 a.m. he departed from England by steamer and arrived in the United States on May 21, 1952. After spending a period therein on official business, he left the United States by steamer on June 9, 1952, and arrived in France at 3 p.m. June 14, 1952. At 8 a.m. on February 3, 1953, he departed from France by airplane for a brief visit to Puerto Rico, arriving there on February 4, and thence went to England, arriving there at 1 a.m. on February 12, 1953, where he remained until midnight, July 18, 1953, at which time the 510 full-day requirement was satisfied in respect of the period of 18 consecutive months which began with January 19, 1952, and ended with the close of July 18, 1953, the taxpayer was in a foreign country or countries an aggregate of 510 full days; in addition, during the 18-month period ending with January 19, 1952, and ending with the close of December 15, 1952, he was in a foreign country or countries an aggregate of 510 full days. The exemption from tax granted by section 116 (a) (3) will thus apply to income attributable to the entire period which commences with January 19, 1952, and ends with the close of December 15, 1952. The computation with respect to each period may be illustrated as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Full days</th>
</tr>
</thead>
<tbody>
<tr>
<td>First 18-month period (1-19-52 to 7-18-53)</td>
<td>121</td>
</tr>
<tr>
<td>Second 18-month period (8-16-53 to 12-15-53)</td>
<td>233</td>
</tr>
<tr>
<td>Total full days</td>
<td>354</td>
</tr>
</tbody>
</table>

Example (3). On March 6, 1952, at 3 p.m. Mr. Green, a citizen privately employed, arrived in Cuba where he remained until 9 a.m. June 25, 1953, when he departed from Cuba for a short business trip to Puerto Rico. Upon completion of his negotiation, he departed from Puerto Rico, arriving there at 2 p.m. on July 24, 1953, where he remained until 10 a.m. August 24, 1953, at which time he departed from such country for a new assignment in the United States. He again arrived in Mexico at 9 a.m. September 5, 1953, where he remained until 8 a.m. January 1, 1954, at which time he departed from such country for a new assignment in the United States. During the 18-month period commencing with March 7, 1952, and ending with the close of September 6, 1953, the taxpayer was in a foreign country or countries an aggregate of 664 full days; during the 18-month period commencing with July 1, 1952, and ending with the close of December 31, 1953, he was in a foreign country an aggregate of 510 full days. The exemption from tax granted by section 116 (a) (2) will thus apply to income attributable to any part of the period which commences with April 30, 1952, and ends with the close of December 31, 1953, a period of approximately 19 consecutive months.

## § 30.116-2 Income of foreign governments, international organizations, and their employees

(a) Foreign governments and their employees. (1) The exemption provided in section 116 (a) (2) will thus apply to income attributable to the entire period which commences with January 19, 1952, and ends with the close of December 15, 1952. The computation with respect to each period may be illustrated as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Full days</th>
</tr>
</thead>
<tbody>
<tr>
<td>First 18-month period (1-19-52 to 7-18-53)</td>
<td>121</td>
</tr>
<tr>
<td>Second 18-month period (8-16-53 to 12-15-53)</td>
<td>233</td>
</tr>
<tr>
<td>Total full days</td>
<td>354</td>
</tr>
</tbody>
</table>

(b) International organizations and their employees. (1) Subject to the provisions of section 1 of the International Organizations Immunities Act (22 U. S. C. 288), the income of an international organization (as defined in section 288d) that is realized from investments in the United States in stocks, bonds, or other domestic securities, owned by such international organization or any agency, instrumentality, subdivision, or本国 government which grants an equivalent exemption to employees of the Government of the United States for income or other sources other than their salaries, fees, or wages, referred to above, is subject to Federal income tax. The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from income tax. But see section 116 (a) (2).

## § 39.116-2

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 for income or other sources other than their salaries, fees, or wages, referred to above, is subject to Federal income tax. The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from income tax. But see section 116 (a) (2).
§ 39.116-3

(c) No person shall, by reason of the provisions of this title, be considered as receiving diplomatic status or as receiving any of the privileges, exemptions, or immunities herein provided for in this title [International Organizations Immunities Act] unless he (i) shall have been designated by the President through appropriate Executive order as being entitled to the privileges, exemptions, and immunities herein provided. The President shall be authorized, in the light of the circumstances, by appropriate Executive order to withhold or withdraw from any such organization or its officers or employees any of the privileges, exemptions, and immunities provided for in this title (including the amendments made by this title) or to condition or limit the enjoyment by any such organization or its officers or employees of any of such privileges, exemptions, and immunities provided for in this title.

§ 39.116-4

§ 39.116-3 Bridges to be acquired by State or political subdivisions. (a) Any or all or any part of the State or political subdivisions (hereafter referred to as a * * * officer, or employee) claiming a refund under the provisions of section 116 (e) of an amount equal to or in excess of the amount of tax levied, assessed, collected, and paid in respect of such participation or making an appropriation for such participation, at the time such compensation is earned, and (ii) the individual is an officer or employee of such organization at such time. The compensation of citizens of the United States who are officers or employees of an international organization is not exempt from income tax. But see section 116 (a) (3).

§ 39.116-5 Exclusion of certain cost-of-living allowances. (a) Amounts received by Government civilian personnel stationed outside the continental United States as cost-of-living or post allowances in accordance with regulations approved by the President are, by the provisions of section 116 (j), excluded from gross income. Such allowances shall be considered as retaining their characteristics under section 116 (j) notwithstanding any possible combination thereof with any other allowance, such as a quarters allowance, made available to the taxpayer by the President, or other allowance, either to the State or to the political subdivision, that the taxpayer agrees to receive the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of the 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 by the alien or any other person in favor of the United States upon its demand the entire amount of the refund with interest at 6 percent per annum from the date of the refund thereby sought; and (b) Any statement, verified by a written declaration that it is made under the penalties of perjury, made by the claimant, made by the President, and therein in any other manner than as are specifically set forth herein. Sec. 2. The privileges, exemptions, and immunities herein granted notwithstanding the fact that the similar privileges, exemptions, and immunities granted to a State, its officers, or employees, may be conditioned upon the existence of reciprocity by that State with respect to compensation of the preceptor such officer or employee; or (2) shall have been duly notified to and accepted by the Secretary of State as a quarters allowance, as, for example, the term "continental United States" includes only the States of the United States as allowances or otherwise under the terms of title IX of the Foreign Service Act of 1948 (25 U. S. C. 1131 et seq.) are, by the provisions of section 116 (d) (2), excluded from gross income.

§ 39.116-6 Exclusion of certain allowances of Foreign Service personnel, including those of the Foreign Service of the United States, to be considered as retaining their characteristics under the provisions of title IX of the Foreign Service Act of 1948 (25 U. S. C. 1131 et seq.) are, by the provisions of section 116 (d) (2), excluded from gross income.
§ 39.116-6 Exclusion of certain income from sources within Puerto Rico.

(a) There is excluded from gross income in the case of an alien who is a bona fide resident of Puerto Rico during the entire taxable year income derived from sources within Puerto Rico, excluding amounts which are short-term capital losses under section 116 (e) shall be included in the inventory of amounts received for services performed as an employee of the United States or any agency thereof. Whether the individual is a permanent or seasonal resident of Puerto Rico shall be determined in general in compliance with the principles of section 116 (1), (2), (3), and 116 (5), relating to what constitutes residence or non-residence, as the case may be, in the United States in the case of an alien individual. Once bona fide residence in Puerto Rico has been established, temporary absence therefrom in the United States or elsewhere on vacation or business trips will not necessarily deprive an individual of his status as a bona fide resident of Puerto Rico. An individual taking up residence in Puerto Rico during the course of the taxable year is not entitled for such year to the exclusion provided in section 116 (f).

(b) There is excluded from gross income, in the case of an individual citizen of the United States who during such taxable year changes his residence from Puerto Rico to a place outside Puerto Rico after having been a bona fide resident of Puerto Rico for a period of at least two years immediately preceding the date of such change in residence, income derived from sources within Puerto Rico which is attributable to the part of such period of Puerto Rican residence which precedes the date of such change in residence, except such income as consists of amounts received for services performed as an employee of the United States or any agency thereof.

(c) In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of § 39.116-6 (1) thereof, such amount shall not be allowed as a deduction from gross income unless such expenses, losses, or deductions consist of amounts received for services or payments to, or chargeable against, the amounts so excluded from gross income. The apportionment and allocation of such expenses, losses, or deductions as between income from sources within Puerto Rico and income from other sources shall be determined in accordance with the principles of section 119 and the regulations thereunder.

§ 39.117 (a) Statutory provisions; capital gains and losses; definitions.

Sec. 117. Capital gains and losses—(a) Definitions.

(1) Capital assets. The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) Stock in trade of the taxpayer or 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, or property of a kind which the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(B) Property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), or real property used in his trade or business;

(C) A copyright, a literary, musical, or artistic composition, or similar property, held by—

(i) A taxpayer whose personal efforts created such property;

(ii) A taxpayer in whom hands the basis of such property is determined, for the purpose of determining income or loss, change, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property; or

(D) An 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, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

(2) Short-term capital gain. The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 12 months, over the long-term capital gains for the taxable year over the short-term capital gains for such year;

(3) Net short-term capital loss. The term "net short-term capital loss" means less from the sale or exchange of a capital asset held for not more than 12 months, if and to the extent such loss is taken into account in computing net income;

(4) Long-term capital gain. The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 12 months, if and to the extent such gain is taken into account in computing gross income;

(5) Long-term capital loss. The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 12 months, if and to the extent such loss is taken into account in computing net income;

(6) Net long-term capital gain. The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the short-term capital gains for such year;

(7) Net long-term capital loss. The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year;

(8) Net capital gain. The term "net capital gain" means the excess of long-term capital gains over long-term capital losses for the taxable year;

(9) Net capital loss. The term "net capital loss" means the excess of long-term capital losses over long-term capital gains for the taxable year;

(10) Capital gain—(A) Corporations. In the case of a corporation, the term "net capital gain" means the excess of the gains from sales and exchanges of capital assets over the losses from such sales and exchanges and any other income (other than salaries) of the taxpayer which may have been included under Supplement T, "net income" as used in this subparagraph shall be read as "adjusted gross income.

(B) Property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), or real property used in his trade or business;

(C) A copyright, a literary, musical, or artistic composition, or similar property, held by—

(i) A taxpayer whose personal efforts created such property;

(ii) A taxpayer in whom hands the basis of such property is determined, for the purpose of determining income or loss, change, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property; or

(D) An 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, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.
Territory or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding six months (described as long-term capital gains and long-term capital losses).

(b) In the case of a corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over 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 "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 amounts brought forward under section 117 (e) and the gain or loss realized upon the sale or other disposition of any such obligation.

Example (1). A (not a life insurance company) buys a Treasury bill upon issuance for $99,999.40. As of the close of the forty-fifth day of the life of such bill, he sells it to the Treasury (a life insurance company) for $99,998.50. The entire net gain to A of $0.50 may be taken into account as a single item of income without allocating $1 to interest and $0.50 to gain. If B holds the bill until maturity his entire net gain of $0.50 may similarly be taken into account as a single item of income without allocating $1 to interest and $0.50 to loss.

Example (2). The facts in this example are the same as in example (1) except that the selling price to B is $99,998.50. The net gain to A of $0.50 may be taken into account without allocating $1 to interest and $0.50 to loss, and, similarly, if B holds the bill until maturity his entire net gain of $1.50 may be taken into account as a single item of income without allocating $1 to interest and $0.50 to gain.

(e) The phrase "short-term" as applied to the category of gains and losses arising from the sale or exchange of capital assets held for less than six months (the phrase "long-term" to the category of gains and losses arising from the sale or exchange of capital assets held for more than six months) is determined by whether or not capital gains and losses arising from the sale or exchange of such assets held for more than six months (described as long-term capital gains and long-term capital losses) shall be segregated from gains and losses arising from the sale or exchange of such assets held for not more than six months (described as short-term capital gains and short-term capital losses) (see § 39.117 (b) (6)).

§ 39.117 (b)

**RULES AND REGULATIONS**

Territory or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding six months (described as long-term capital gains and long-term capital losses).

(b) In the case of a corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over 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 "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 amounts brought forward under section 117 (e) and the gain or loss realized upon the sale or exchange of a capital asset shall be taken into account regardless of the period for which the capital asset has been held. Nevertheless, the net short-term capital gain or loss and the net long-term capital gain or loss must be separately computed. In computing the adjusted gross income or the net income of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of the excess is allowable as a deduction from the net income for the taxable year, the whole amount of the gain ($2,000) is includible in gross income. Since the net long-term capital gain exceeds the net short-term capital loss by $500, 50 percent of the excess ($250) will be deductible from income under section 23 (ee) and 117 (b). For instance, if an individual realizes $2,000 of long-term capital gain and sustains $1,500 of short-term capital loss during the taxable year, the whole amount of the gain ($2,000) is includible in gross income. Since the net long-term capital gain exceeds the net short-term capital loss by $500, 50 percent of the excess ($250) will be deductible from income under section 23 (ee) and 117 (b).

(b) In the case of an estate or trust, for the purpose of computing the deduction allowable under sections 23 (ee) and 117 (b) any long-term or short-term capital gains which, under section 102 (b) or (c) are includible in the gross income of its income beneficiaries as gains derived from the sale or exchange of capital assets must be excluded in determining whether, for the taxable year of the estate or trust, its net long-term capital gain exceeds its net short-term capital loss. For example, during 1952 a trust realized a gain of $3,000 upon the sale of stock held for 10 months. Under the terms of the trust instrument all of such gain must be distributed not later than 30 days after the close of the year to A, the sole income beneficiary. The trust is not entitled to any deduction with respect to such gain under sections 23 (ee) and 117 (b). On the other hand, assuming A had no other capital gains or losses in 1952, he would be entitled to a deduction of $500.

§ 39.117 (c) Statutory provisions; capital gains and losses; alternative taxes.

Sec. 117. Capital gains and losses. • • •

(a) Alternative tax. Corporations. If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, the excess shall be levied, collected, and paid, in lieu of the tax imposed by sections 13, 15, 16, 204, 207 (a) (1) or (3), 421, and 609, a tax determined
as follows, if and only if such tax is less than the tax imposed by such sections:

(A) A partial tax shall 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.

(B) There shall be ascertained an amount equal to 25 per centum of the excess of the net long-term capital gain over the net short-term capital loss, plus (2) 25 per cent (26 percent) if the taxable year begins before November 1, 1953, of such excess.

(C) The total tax shall be the partial tax computed under subparagraph (A) plus the amount computed under subparagraph (B).

(2) Other taxpayers. If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12 (or, in the case of certain tax-exempt trusts, in lieu of the tax imposed by section 421), a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

(A) A partial tax shall first be computed upon the net income reduced by an amount equal to 50 per centum of such excess, at the rates and in the manner as if this subsection had not been enacted.

(B) There shall be ascertained an amount equal to 25 per centum of the excess of the net long-term capital gain over the net short-term capital loss, in the case of certain tax-exempt trusts, in lieu of the tax imposed by section 421, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

(A) A partial tax shall first be computed upon the net income reduced by an amount equal to 25 per centum of the excess of the net long-term capital gain over the net short-term capital loss, plus (2) 25 percent if the taxable year begins before November 1, 1953, of such excess.

(b) In the case of the net long-term capital gain of any corporation except the net short-term capital loss, section 117 (c) (1) imposes an alternative tax in lieu of the tax imposed by sections 15, 15, 204, 207 (a) (1) or (2), and only if such alternative tax is less than the tax imposed by such sections.

Alternative tax under section 117 (c) (2)

<table>
<thead>
<tr>
<th>Net Income</th>
<th>Less 50 percent of Excess of net long-term capital loss over net short-term capital loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>$115,000</td>
<td>$15,000</td>
</tr>
</tbody>
</table>

Ordinary net income

Less non-

Income subject to normal tax and surtax

Combined normal tax and surtax under sections 11 and 12

$83,170

[(I) On amounts received or accrued from the disposal of coal to which the provisions of section 117 (c) (2) are applicable, the computation under section 117 (c) (2) of a tax in lieu of the tax imposed by section 500 shall be made without regard to section 117 (c) (2) that is, the partial tax under section 117 (c) (2) is less than the tax imposed under section 500, is computed without regard to section 117 (c) (2)]

§ 39.117 (d) Alternative tax in case net long-term capital gain exceeds net short-term capital loss.

(a) Section 117 (c) (2) imposes an alternative tax in lieu of the tax imposed by sections 11 and 12 (or, in the case of certain tax-exempt trusts, the tax imposed by section 421) if and only if such alternative tax is less than the tax imposed by sections 11 and 12 (or, in the case of certain tax-exempt trusts, the tax imposed by section 421) The alternative tax is the sum of (1) a partial tax, computed at the rates provided by sections 11 and 12 (or, in the case of certain tax-exempt trusts, the tax imposed by section 421) on the net income reduced by an amount equal to 50 percent of the excess of the net long-term capital gain (determined by taking into account 100 percent of the gains and losses upon the sale or exchange of capital assets held for more than six months) over the net short-term capital loss, plus (2) 25 percent (26 percent if the taxable year begins before November 1, 1953) of the excess of the net long-term capital gain over the net short-term capital loss.

§ 39.117 (d) Limitation on capital losses. (a) Section 117 (d) (1) provides that, in the case of a corporation, losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent of gains from such sales or exchanges, plus the net income of the taxpayer of $1,000, whichever is smaller. For purposes of this paragraph, the net income shall be computed without regard to gains or losses from sales or exchanges of capital assets. If the tax is to be based on Supplement T, "net income" as used in this paragraph shall be read as "adjusted gross income."

§ 39.117 (d) (2) Limitation on capital losses. (a) Section 117 (d) (2) provides that, in the case of a taxpayer other than a corporation, the 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, plus the net income of the taxpayer of $1,000, whichever is smaller. Thus, where an individual taxpayer has an ordinary net income of $5,000, has a loss of $4,000 from the sale of a capital asset which he held for more than six months, such net long-term capital loss of $4,000 is allowable only to the extent of $1,000 ($5,000 - $4,000) being a net capital loss. If the taxpayer's ordinary net income had been $400 instead of $5,000, only $400 of the net long-term capital loss of $4,000 would have been allowed, leaving a net capital loss

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of §3,000. For carry-over of a net capital loss, see § 39.117 (d) (1).

(d) In the case of a bank, as defined in section 104, the limitation under section 117 (d) (1) is modified by section 117 (1) so that the excess of any losses of the firm from sales, exchanges or changes of bonds, debentures, notes or certificates, or other evidences of an indebtedness issued by any corporation (including those 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 in full as an ordinary loss.

(c) In the case of a tax is computed under Supplement T, the term "net income" shall be read as "adjusted gross income."

(d) In the case of a joint return made by a husband and wife, 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 regard to the net short-term capital gains and losses of the spouses.

§ 39.117 (e) Statutory provisions; capital gains and losses; capital loss carry-over

Sec. 117. Capital gains and losses.

(a) Any taxpayer sustaining a net capital gain or loss shall be considered to have a net short-term capital gain or loss for any taxable year in which the net capital gain or loss exceeds the net capital gains and losses of the five succeeding taxable years.

(b) The practical operation of the provisions of section 117 (e) (1) may be illustrated by the following example:

Example. (1) For the taxable years 1950 to 1954, inclusive, an individual is assumed to have a net short-term capital loss, net short-term capital gain, net long-term capital gain, and net income as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Short-Term Gain</th>
<th>Net Long-Term Gain</th>
<th>Net Capital Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>$20,000</td>
<td>$30,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>1951</td>
<td>$20,000</td>
<td>$30,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>1952</td>
<td>$20,000</td>
<td>$30,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>1953</td>
<td>$20,000</td>
<td>$30,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>1954</td>
<td>$20,000</td>
<td>$30,000</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

(c) If a husband and wife making a joint return for any taxable year did not make such a joint return for any preceding taxable years (not exceeding five taxable years), the net capital loss as shown by each joint return shall be a short-term capital loss for the taxable year. If, however, a joint return was made for each of the preceding taxable years (not exceeding five taxable years), 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 each of such preceding taxable years, and the net capital loss allocated to each spouse shall be a short-term capital loss of such spouse for the taxable year, to the extent provided in section 117 (e) (1).

§ 39.117 (f)–(g) Statutory provisions; capital gains and losses; retirement of bonds, etc. gains and losses from short sales, etc.

Sec. 117. Capital gains and losses.

(a) Any taxpayer sustaining a net capital gain or loss shall be considered to have a net short-term capital gain or loss for any taxable year in which the net capital gain or loss exceeds the net capital gains and losses of the five succeeding taxable years. In the case of a joint return made by a husband and wife, 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 regard to the net short-term capital gains and losses of the spouses. For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

(b) For purposes of taxation any increment in value represented by the difference between the price paid and the redemption value received (whether at or before maturity) for savings bonds and savings certificates shall be considered as interest.

§ 39.117 (e)
sell property shall be considered as short-term capital gains or losses; and
(3) Gain from the sale or exchange of property, to the extent that the adjusted basis of such property is less than its adjusted basis determined without regard to section 124(a), shall be treated as ordinary income and the remaining

$500 would be subject to the provisions of section 117 (1)

(b) If the taxpayer acquires other property in an emergency for an emergency facility with respect to which amortization deductions have been allowed, and if the basis of such other property is determined by reference to the basis of the emergency facility, the basis of such other property is determined with regard to section 124A, and therefore the provisions of section 117 (3) apply with respect to the gain realized on such sale or exchange of the emergency facility unless (i) the taxpayer uses the emergency facility for more than six months, or (ii) the emergency facility is replaced by the taxpayer within the period described in paragraph (1) above. The provisions of section 117 (3) shall apply with respect to the basis of such other property determined with regard to section 124A.

§ 39.117 (h) Statutory provisions; capital gains and losses; holding period of property.

Sec. 117. Capital gains and losses. * * *

(h) Determination of period for which held. For the purpose of this section-

(1) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged for such property. In the case of stock or securities acquired by the taxpayer in an exchange for an emergency facility with respect to which amortization deductions have been allowed, and if the basis of such other property is determined by reference to the basis of the emergency facility, the basis of such other property is determined with regard to section 124A, and therefore the provisions of section 117 (3) apply with respect to the gain realized on such sale or exchange of the emergency facility unless (i) the taxpayer uses the emergency facility for more than six months, or (ii) the emergency facility is replaced by the taxpayer within the period described in paragraph (1) above. The provisions of section 117 (3) shall apply with respect to the basis of such other property determined with regard to section 124A.

§ 39.117 (h) Determination of period for which capital assets are held. (a) The period for which capital assets acquired in certain transactions described in sections 112, 113, 118, and 371 (c) the period for which such property is considered to have been held by the taxpayer for purposes of this chapter, there shall be included the period during which the property was held by the taxpayer but not acquired by the taxpayer by gift or for purposes of determining gain or loss from the sale or exchange of such property. In the case of property acquired after December 31, 1929, by gift (if under the provisions of section 113, such property has, for the purpose of determining gain or loss from the sale or exchange, the same basis in whole or in part in the hands of another person as it 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 non-deductibility (under section 118 of the Internal Revenue Code of 1939) of the loss of such stock or other disposition of substantially identical stock or securities, the period for which the stock or securities the loss from the sale or other disposition of which was not deductible was held must be included in the period for which the property was held by the taxpayer. In the case of capital gains or losses the acquisition of which resulted in the non-deductibility under section 118 of the Internal Revenue Code of 1939 the period for which the property was held by the taxpayer. If property acquired, as the result of a compulsory or involuntary conversion of other property of the taxpayer has under section 118 (a) (9) the same basis in whole or in part in the

§ 39.117 (h)
hands of the taxpayer as the property so converted, the period for which the property so converted was held by the taxpayer may be included in the period for which the property acquired was held by the taxpayer.

(b) The period for which the taxpayer has held stock, or stock subscription rights, used as evidence of such stock, or the portion thereof 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 its taxability under the rules applicable in the case of a stock dividend or stock right is fixed by the apportionment of the basis of such old stock.

(c) The period for which the taxpayer has held stock or securities issued to him by a corporation pursuant to the exercise by him of rights to acquire such stock or securities from the corporation will, in every case and whether or not the receipt of taxable gain was recognized in connection with the distribution of the stock dividend and include the day upon which the rights to acquire such stock or securities were exercised.

A taxpayer will be deemed to have exercised rights received from a corporation to acquire stock or securities if the taxpayer (or any person with whom the taxpayer is liable to treat as his agent with respect to the acquisition of the stock or securities) is in possession of such stock or securities and is able to acquire such stock or securities at the exercise price.

(d) The period for which the taxpayer has held a residence, the acquisition of which resulted, under the provisions of section 112 (n) in the nonrecognition of the gain realized on the sale, exchange, or involuntary conversion of another residence, shall include the period for which such other residence had been held as of the date of such sale, exchange, or involuntary conversion. See § 38.112 (n)–1.

§ 39.117 (l)–(j) Statutory provisions; capital gains and losses; bond, etc., losses of banks; gains and losses from involuntary conversion of assets; and from sales or exchanges of certain property used in the trade or business.

Sec. 117. Capital gains and losses. * * *

(1) Bond, etc., losses of banks. For the purposes of this chapter, in the case of a bank, as defined in section 104, if the losses of the taxable year from sales or exchanges 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 registered for the benefit of the holder of the security exceed the gains of the taxable year from such sales or exchanges, no such sale or exchange shall be considered a sale or exchange of a capital asset.

[Sec. 117 (l) as amended by sec. 150 (d), Rev. Act 1942]

(j) Gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business—(1) Definition of property used in the trade or business. For the purposes of this subsection, the term “property used in the trade or business” means property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 28 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property which would properly be includable in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in subsection (a) (1) (C). Such term also includes timber or coal with respect to which subsection (a) (1) (B) or (2) is applicable and unharvested crops to which paragraph (3) is applicable. Such term does not include property, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include property.

(2) General rule. If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of condemnation or otherwise) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses which results from sales of capital assets held for more than 6 months. If such gains do not exceed such losses, such losses shall be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing net income, except that subsection (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or condemnation or otherwise, the §400 loss is referred to this subparagraph are the following:

(i) Gains and losses from the sale, exchange, or involuntary conversion of “section 117 (j) property”, as defined in subparagraph (3) of this paragraph, held for more than six months.

(ii) Gains and losses from the involuntary conversion of capital assets held for more than six months.

(iii) Gains and losses upon the cutting or disposal of timber, or disposal of coal, to the extent provided in § 39.117 (k)–1.

(iv) Gains and losses upon the involuntary change, or involuntary conversion of livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held for more than six months or more than the date of acquisition. See § 39.117 (j)–2.

(v) Gains and losses from the sale, exchange, or involuntary conversion of an unharvested crop under the conditions specified in paragraph (d) of this section.

(2) For the purpose of this section, the “involuntary conversion” of property is the conversion of such property into money or other property as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of condemnation or otherwise, the §400 loss is, in every case and whether or not there was a conversion of the property into money or other property. For example, if a capital asset held for more than six months, with an adjusted basis of $400, is stolen, and the loss from this theft is not compensated for by insurance or otherwise, the $400 loss is included in the computations under section 117 (j)–1.

(3) For the purpose of this section, the term “section 117 (j) property” means property used in the trade or business of the taxpayer at the time of sale, exchange, or involuntary conversion, which is of a character subject to the allowance for depreciation provided in section 23 (1) or which is real property, except any such property which is within one of the following categories:

(i) Property of a kind which would properly be includable in the inventory of the taxpayer if on hand at the close of the taxable year, or which is held by the taxpayer primarily for sale to customers in the ordinary course of trade or business.

(ii) A copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in section 117 (a) (1) (C).

(iii) Livestock held for draft, breeding, or dairy purposes. See, however, subparagraph (1) (iv) of this paragraph.

(iv) Poultry.

(b) In determining whether the gains described in paragraph (a) (1) of this section exceed the losses described thereon, such gains and losses are taken into

§ 39.117 (l)–(j)
account in full, that is, 100 percent of such gains and losses is taken into account. The provisions of section 117 (d) limiting the deduction of capital losses are not applied to capital assets held for more than six months.

Thus, losses which are not deductible under section 24 or section 117 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), only the portion of the gain reported under section 44 is included in the computation for such taxable year under section 117 (j).

Any gains and losses which are not recognized under section 112 are not included in the computations under section 117 (j);

Thus, if property is involuntarily converted at a price at which the gain on such conversion is not recognized under the provisions of section 113 (d) such gain is not included in the computation under section 117 (j).

If it is determined under the above computations that the gains exceed the losses, all 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. All such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months. All such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months. All such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months. All such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months. All such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months.

The unharvested crop is on land which is "section 117 (j) property" as defined in paragraph (a) (1) (v) of the section are:

1. The unharvested crop is on land which is "section 117 (j) property" as defined in paragraph (a) (1) (v) of the section, and such land has been held for more than six months;
2. Such crop and such land are sold, exchanged, or converted at the same time and to the same person; and
3. No right or option (other than one customarily incident to a mortgage or other security transaction) is retained by the taxpayer, at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial.

A leasehold or estate for years is not "land" for the purpose of this section.

The following examples will illustrate the operation of the provisions of section 117 (j):

Example (1). A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1952 of the kind described in section 117 (j) are as follows:

1. Gain on sale of machinery, used in the business and subject to allowance for depreciation, held for more than 6 months...
2. Gain reported in 1953 (under sec. 44) on installment sale of real estate of factory premises used in the business (including building and land, each held for more than 6 months).
3. Gain on sale of vintage car (under sec. 44) on installment sale in 1952 of land held for more than 6 months, used in the business as a storage lot for trucks...
4. Gain on proceeds from reorganization as registered bearer bonds. As registered bearer bonds. As registered bearer bonds. As registered bearer bonds. As registered bearer bonds.
5. Gain on sale of machinery... at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial.

A leasehold or estate for years is not "land" for the purpose of this section.

The following examples will illustrate the operation of the provisions of section 117 (j):

Example (1). A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1952 of the kind described in section 117 (j) are as follows:

1. Gain on sale of machinery, used in the business and subject to allowance for depreciation, held for more than 6 months...
2. Gain reported in 1953 (under sec. 44) on installment sale of real estate of factory premises used in the business (including building and land, each held for more than 6 months).
3. Gain on sale of vintage car (under sec. 44) on installment sale in 1952 of land held for more than 6 months, used in the business as a storage lot for trucks...
4. Gain on proceeds from reorganization as registered bearer bonds. As registered bearer bonds. As registered bearer bonds. As registered bearer bonds.
5. Gain on sale of machinery... at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial.

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3. Gain on sale of vintage car (under sec. 44) on installment sale in 1952 of land held for more than 6 months, used in the business as a storage lot for trucks...
4. Gain on proceeds from reorganization as registered bearer bonds. As registered bearer bonds. As registered bearer bonds. As registered bearer bonds.
5. Gain on sale of machinery... at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial.

A leasehold or estate for years is not "land" for the purpose of this section.

The following examples will illustrate the operation of the provisions of section 117 (j):

Example (1). A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1952 of the kind described in section 117 (j) are as follows:

1. Gain on sale of machinery, used in the business and subject to allowance for depreciation, held for more than 6 months...
2. Gain reported in 1953 (under sec. 44) on installment sale of real estate of factory premises used in the business (including building and land, each held for more than 6 months).
3. Gain on sale of vintage car (under sec. 44) on installment sale in 1952 of land held for more than 6 months, used in the business as a storage lot for trucks...
4. Gain on proceeds from reorganization as registered bearer bonds. As registered bearer bonds. As registered bearer bonds. As registered bearer bonds.
5. Gain on sale of machinery... at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial.

A leasehold or estate for years is not "land" for the purpose of this section.

The following examples will illustrate the operation of the provisions of section 117 (j):

Example (1). A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1952 of the kind described in section 117 (j) are as follows:

1. Gain on sale of machinery, used in the business and subject to allowance for depreciation, held for more than 6 months...
2. Gain reported in 1953 (under sec. 44) on installment sale of real estate of factory premises used in the business (including building and land, each held for more than 6 months).
3. Gain on sale of vintage car (under sec. 44) on installment sale in 1952 of land held for more than 6 months, used in the business as a storage lot for trucks...
4. Gain on proceeds from reorganization as registered bearer bonds. As registered bearer bonds. As registered bearer bonds. As registered bearer bonds.
5. Gain on sale of machinery... at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial.

A leasehold or estate for years is not "land" for the purpose of this section.
for slaughter, purchased cows with calf. The calves were born while the cows were held by the taxpayer, and these cows were not held for breeding purposes.

§ 39.117 (k) Statutory provisions; capital gains and losses; gain or loss in the case of timber or coal.

Sec. 117. Capital gains and losses. ***(k)*** Gain or loss in the case of timber or coal. (1) A taxpayer who elects upon his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. In case such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under section 117 (k) (1), paragraph such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has owned, or has a contract right to cut, and shall be binding upon the taxpayer for the taxable year for which the election is made and for all subsequent taxable years. The election shall take the form of a computation in the return under the provisions of section 117 (k) (1) and section 117 (m) (25).

(ii) The election made under the provisions of section 117 (k) (1) shall be applicable with respect to all timber which was owned by the taxpayer or which the taxpayer had a contract right to cut, and the cutting of timber, whether or not actually sold or exchanged, shall be considered to be a sale or exchange, except that timber which is not cut for sale or for use in the taxpayer's trade or business and timber which was held for more than six months before the beginning of such taxable year and, cannot be made thereafter. The election shall take the form of a computation in the return under the provisions of section 117 (k) (1) and section 117 (m) (25).

The election shall be made in respect to such cutting during any taxable year which is owned by a taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year). Such owner shall not be considered to be the cost of the timber which was cut, in lieu of the actual cost or other basis of such timber, for all purposes for which such cost is a necessary factor. Thus, if the products of the timber cut during a taxable year were sold during such year, the fair market value of the beginning of such taxable year of the timber cut during such year shall be considered to be the cost of the timber which was cut, in lieu of the actual cost or other basis of such timber, for all purposes for which such cost is a necessary factor. The fair market value as of the taxable year of the timber cut during such year shall be used in computing the depletion unit and the allowance for depletion as provided in § 39.23 (m) (21). This is also the rule in case the products of the timber cut during one taxable year with respect to which an election has been made under section 117 (k) (1) are sold during a subsequent taxable year. The fair market value as of the taxable year in which the timber is cut is deemed to be the cost of such timber in computing the closing inventory for such year and the opening inventory for the succeeding year. With respect to the costs applicable in the determination of the amount of such inventories, there shall be included the fair market value of the timber cut during such year, the cost of cutting, the costs of cutting, including the products of the cutting, the costs of cutting, and any other expenses incident to the cost of converting the standing timber into the products in inventory. See § 39.23 (m) (4). The fact that the fair market value of the timber cut during the taxable year in which the timber is cut is deemed to be the cost of such timber shall not preclude the taxpayer from using any other method of determining the cost of the inventory of such timber as long as such method is in accordance with the regulations of the Commissioner of internal revenue.
applicable to, and has been elected by, the taxpayer.

(iv) For any taxable year for which the cutting of timber is considered to be a sale or exchange of such timber under section 117 (j) along with other property of the taxpayer under an agreement or business as defined in section 117 (j) (1) (1) Whether the gain or loss considered to have resulted from the cutting of the timber will be considered to be gain or loss resulting from the sale or exchange of capital assets held for more than six months depends upon the application of section 117 (j) to the taxpayer for the taxable year. See § 39.117 (j)–1.

(v) In case the products of the timber are sold after cutting, either in the form of logs or lumber or in the form of a manufactured product, the income from such sales shall be considered ordinary income. In determining the cost of the products sold, the cost of the timber shall be computed pursuant to the provisions of section 117 (c) (1) (A). Any gain or loss resulting from the disposal of the timber shall be considered to have resulted from the cutting of the timber and the income therefrom shall be considered to be income from an ordinary income source.

§ 39.117 (j) Statutory provisions; capital gains and losses; short sales, etc.

Sec. 117. Capital gains and losses. • • •

§ 39.117 (j)–1 Gains and losses from certain short sales of capital assets—

(a) General. Section 117 (j)–1 provides rules as to the tax consequences of certain short sales of property if, at the time of the short sale or on or before the date of the closing of the short sale, the taxpayer holds property substantially identical to that sold. The term "property" is defined in section 117 (j) (1) to include only stocks and securities (including stocks and securities dealt with on a "when issued" basis) and commodity futures, which are capital assets in the hands of the taxpayer.

(b) Treatment of short sales. (1) The first two rules, which are set forth in
section 117 (1) (1) are applicable whenever property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for not more than 6 months (determined without regard to rule (2) below, relating to the holding period) or is acquired by him after the short sale and on or before the date of the closing thereof. These rules are

Rule (1). Any gain upon the closing of such short sale shall be considered as a gain upon the sale of a capital asset held for not more than 6 months (notwithstanding the period of time any property used to close such short sale has been held); and

Rule (2). The holding period of such substantially identical property shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale.

(2) The third rule, which is set forth in section 117 (1) (2); is applicable whenever property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for more than 6 months. This rule is:

Rule (3). Any loss upon the closing of such short sale shall be considered as a loss upon the sale of a capital asset exchanged for a capital asset held for more than 6 months, notwithstanding the period of time any property used to close such short sale has been held. For the purpose of rule (3), the acquisition of an option to sell property at a fixed price is not considered to be a short sale, and the exercise or failure to exercise such option is not considered as a closing of a short sale.

(3) Rules (1) and (3) do not apply to the gain or loss attributable to so much of the property sold short as exceeds in quantity the substantially identical property referred to in sections 117 (1) (1) and 117 (1) (2) respectively, Rule (2) applies to the substantially identical property referred to in section 117 (1) (1) in the order of the dates of the acquisition of such property but only to so much of such property as does not exceed the quantity sold short. If property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for not more than 6 months, or is acquired by him after the short sale and on or before the date of the closing thereof, and if property substantially identical to that sold short has been held by the taxpayer on the date of the short sale for more than 6 months, all three rules are applicable.

(4) The following examples illustrate the application of these rules to short sales of stock in the case of a taxpayer who makes his return on the basis of the calendar year:

Example (1). A buys 100 shares of X stock at $10 per share on February 1, 1952, sells short 100 shares of X stock at $18 per share on July 1, 1952, and closes the short sale on August 2, 1952, by delivering the 100 shares of X stock purchased on February 1, 1952, to the lender of the stock used to effect the short sale. Since 100 shares of X stock had been held by A on the date of the short sale for not more than 6 months, the gain of $800 realized upon the closing of the short sale is, by application of rule (1), a short-term capital gain, but the holding period of the 100 shares of X stock purchased on February 1, 1952, would not be affected by section 117 (1). If, on the other hand, A purchased an additional 100 shares of X stock at $20 per share on August 1, 1953, and used such shares to close the short sale at that time, since 100 shares of X stock had been held by A on the date of the short sale for more than 6 months, the loss of $2,000 sustained upon the closing of the short sale would be, by application of rule (3), a long-term capital loss, and, since 100 shares of X stock had been held by A on the date of the short sale for more than 6 months, the holding period of the 100 shares of X stock purchased on July 1, 1953, would be considered, by application of rule (1), substantially identical. The only loss sustained upon the closing of the short sale for not more than 6 months, the gain of $1,000 realized upon the closing of the short sale at that time, since 100 shares of X stock had been held by A on the date of the short sale for more than 6 months, the holding period of the 100 shares of X stock purchased on July 1, 1953, would not be affected by section 117 (1).

Example (2). A buys 100 shares of X stock at $10 per share on February 1, 1952, sells short 100 shares of X stock at $18 per share on July 1, 1952, closes the short sale on August 1, 1953, with 100 shares of X stock purchased on August 2, 1952, sells at $16 per share the 100 shares of X stock purchased on February 1, 1952. The $800 loss sustained upon the closing of the short sale is, by application of rule (2), however, the holding period of the 100 shares of X stock purchased on February 1, 1952, and sold on August 2, 1952, is considered to begin on August 1, 1952, the date of the closing of the short sale. The $800 gain realized upon the sale of such stock is, therefore, a short-term capital gain.

Example (3). A buys 100 shares of X stock at $10 per share on February 1, 1952, sells short 100 shares of X stock at $18 per share on September 1, 1952, sells on October 1, 1952, at $18 per share the 100 shares of X stock purchased on February 1, 1952, and closes the short sale on August 1, 1953, with 100 shares of X stock purchased on that date at $16 per share. The $800 gain realized upon the closing of the short sale is, by application of rule (2), however, the holding period of the 100 shares of X stock purchased on February 1, 1952, is a long-term capital gain to which section 117 (1) has no application. By application of rule (2), however, the holding period of the 100 shares of X stock purchased on February 1, 1952, is a long-term capital gain, to which section 117 (1) has no application. By application of rule (2), however, the holding period of the 100 shares of X stock purchased on February 1, 1952, is a long-term capital gain. The $100 gain realized upon the closing of the short sale is, by application of rule (2), a long-term capital gain.

Example (4). A sells short 100 shares of X stock at $18 per share on July 1, 1952. He buys 200 shares of X stock on March 1, 1952, at $10 per share and holds the latter stock until September 2, 1952 (more than 6 months), at which time, 100 of the 200 shares of X stock are delivered to close the short sale made on February 1, 1952. Since substantially identical property was acquired by A after the short sale and before it was closed, the $100 gain realized on the closing of the short sale is, by application of rule (2), a short-term capital gain. The holding period of the remaining 150 shares of X stock is not affected by this paragraph. Ordinarily, stocks or securities of one corporation are not considered substantially identical to stocks or securities of another corporation. In certain situations they may be substantially identical; for example, in the case of a reorganization the facts and circumstances may be such that the stocks and securities of predecessor and successor corporations are substantially identical property. Similarly, bonds or preferred stock of a corporation are not ordinarily considered substantially identical to stocks or bonds of another corporation. In certain situations, as for example, where the preferred stock or bonds of one corporation are convertible into the common stock of the same corporation, the relative values, price changes, and other circumstances may be such as to make such bonds or preferred stock and the common stock substantially identical property. Similarly, depending on the facts and circumstances, the term may apply to the stocks and securities to be received in a corporate reorganization or recapitalization, traded in on a when issued
basis, as compared with the stocks or securities to be exchanged in such re-organization or recapitalization.

(2) Commodity futures. (1) As pro-
vided in section 117 (1) (3) (B) (ii) in the case of futures transactions in any commodity on or subject to the rules of a board of trade or commodity ex-
change, a commodity future transaction and the delivery in one calendar month shall not be considered as property substantially identical to another commodity future requiring delivery in a different calendar month. For example, commodity futures in May wheat and July wheat are not con-
dered, for the purpose of section 117 (1) substantially identical property. Similarly, futures in different commodities which are not generally through custom of the trade used as hedges for each other (such as corn and wheat), are not con-
sidered substantially identical property. If commodity futures are otherwise sub-
stantially identical property, the mere fact that they were procured through different brokers does not remove them from the scope of the term “substan-
tially identical property.” Commodity futures procured on different markets may come within the term “substantially identical property” even though the facts and circumstances in the case, with the historical similarity in the price movements in the two markets as the primary factor, considered.

(ii) Since section 117 (1) applies only to sales or exchanges of capital assets, bona fide hedging transactions in commodity futures entered into by flour millers, produce operators of grain elevators, etc., for the purpose of their business, and which do not give rise to capital gain or loss, are not within the scope of section 117 (1) (3) (B) (ii) (iii) Section 117 (1) (3) (C) relating to so-called “arbitrage” transactions in commodity futures, provides that where a taxpayer enters into two commodity futures transactions on the same day, one requiring delivery in the market and the other requiring delivery to him of the same or substantially identical commodity in the same calen-
dar month in a different market, the taxpayer subsequently closes both such transactions on the same day, section 117 (1) (i) shall have no application to so much of the commodity involved in either such transaction as does not exceed in quanti-
ty the commodity involved in the other.

(iv) The following example indicates the application of section 117 (1) (i) to a commodity futures transaction:

Example. A, who makes his return on the basis of the calendar year, on February 1, 1952, enters into a contract through broker X to purchase 10,000 bushels of December wheat on the Chicago market at $2.89 per bushel. On July 1, 1952, he enters into a contract through broker Y to sell 10,000 bushels of December wheat on the Chicago market at $2.25 per bushel. On August 2, 1952, he closes both transactions at $2.50 per bushel. The closing of the short sale is a short-term capital loss to which section 117 (1) (i) has no application, and the holding period of the futures contract ent-
ered into on February 1, 1952, is considered to begin on August 2, 1952, the date of the closing of the short sale. The $6,000 gain described in paragraph (a) of this section is, therefore, a short-term capital gain.

(3) Husband and wife. Section 117 (1) (3) (B) (iii) provides that, in the case of a short sale of property by an individual, the term “taxpayer” shall be con-
strued to include his spouse. Thus, if the spouse of a taxpayer holds or ac-
quires property substantially identical to that sold short by the taxpayer, and the conditions of this section are met, then the rules set forth herein are applicable to the same extent as if the taxpayer held or acquired the substan-
tially identical property. For this pur-
pose, an individual who is legally sep-
arated from the taxpayer under a decree of divorce or of separate maintenance shall not be considered as the spouse of the taxpayer.

§ 39.111 (m) Statutory provisions; capital gains and losses; collapsible corpo-

rations.

Sec. 117. Capital gains and losses. * * * *

(m) Collapsible corporations—(1) Treatment of gain to shareholders. Gain from the sale or exchange (whether by substitution or otherwise) of stock of a collapsible corpo-
ration, to the extent that it would be con-
considered as gain from the sale or exchange of capital stock held for more than 6 months, shall, except as provided in para-
graph (3), be considered as gain from the sale or exchange of property which is not a capital asset.

(2) Definitions. (A) For the purposes of this subsection, the term “collapsible corpo-
ration” means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property de-
scribed in subsection (a) (1) (A), or for the holding of stock in a corporation so formed or availed of, with a view to—

(i) The sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its share-
holders (whether by custom of the trade used as

in the same manner as a gain from the sale or exchange of property, shall be considered as gain from the sale or exchange of property which is not a capital asset.

(b) Determination of collapsible corpo-

corporation. (1) A collapsible corporation is defined by section 117 (m) (2) (A) to be a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in section 117 (m) (3) (A) or for the holding of stock in a corporation so formed or availed of, with a view to—

(i) The sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its share-
holders, prior to the realization by the corporation manufacturing, constructing, producing, or purchasing the property of, or for the corporation manufacturing, constructing, producing, or purchasing the property of, the corporation and the proceeds of which become to be derived from such property, and

(ii) The realization by such shareholders of gain attributable to such property.

(2) See paragraph (d) of this section for a description of the facts which will ordinarily be considered sufficient to estab-
lish whether or not a corporation is a collapsible corporation under the rules of this section. See paragraph (e) of this section for examples of the application of section 117 (m).

(3) Under section 117 (m) (2) (A) the corporation must be formed or

§ 39.117 (m-1)
In determining whether a corporation is a collapsible corporation or not, the property to which the regulations apply is to be construed as follows:

1. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (A) or (B), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

2. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (B) or (C), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

3. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (A) or (B), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

4. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (B) or (C), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

5. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (A) or (B), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

6. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (B) or (C), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

7. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (A) or (B), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.

8. If the property to which the regulations apply is property of a kind described in section 117 (a) (1) (B) or (C), the corporation is collapsible in a case where the property is transferred to another person or to a corporation in exchange for all of the stock of such corporation.
(ii) For the purpose of this limitation, the gain attributable to the portion referred to in subdivision (2) (A) is the excess of the recognized gain of the shareholder during the taxable year upon the stock in the corporation over the recognized gain of the shareholder which would have been realized had the property not been manufactured, constructed, produced, or purchased. Where, for example, a corporation owns a tract of land and develops two-thirds of the tract into an apartment house, the one-half of the tract increases the value to the corporation which manufactured, constructed, produced, or purchased such property.

The property referred to in subdivision (2) (A) of this subparagraph is property described in subdivisions (iv) and (v) of this subparagraph, and

(iii) At the time of the manufacture, construction, production, or purchase of the property described in subdivisions (iv) and (v) of this subparagraph, such activity was substantial in relation to the other activities of the corporation which manufactured, constructed, produced, or purchased such property.

The property referred to in subdivisions (ii) and (iii) of this subparagraph is that property or the aggregate of those properties which meet the following two requirements:

(iv) The property is manufactured, constructed, or produced by the corporation or by another corporation stock of which is held by the corporation, or is property purchased by the corporation or by such other corporation which is property described in subdivision (2) (A) (i) and (ii) of this subparagraph, or is property held primarily for sale to customers and

(v) At the time of the sale, exchange, or distribution described in subdivision (2) (A) (i) of this subparagraph the corporation, having

(a) Examples. The following examples will illustrate the application of this section:

Example (1), (1) On January 2, 1952, A formed the W corporation and contributed $50,000 each in exchange for all of the stock of the corporation. W then purchased a two-story apartment house for $90,000 from a bank, the loan being guaranteed by the Federal Housing Authority, and used $80,000 of such funds in the construction of an apartment house which it later purchased for $59,000. The apartment house was completed on December 31, 1952. On December 31, 1952, the corporation, having determined that the fair market value of the apartment house, separate and apart from the land, was $290,000, made a distribution (permitted under the applicable State law) to A of $100,000. At this time, the fair market value of the land was $300,000. As of December 31, 1952, the corporation has not realized any earnings and profits. In 1953, the corporation began the operation of the apartment house, having

(iii) Since A received a distribution and realized a gain attributable to the building constructed by the corporation, since, at the time of such distribution, it has not realized any earnings and profits from the construction of such building, and since the construction of a substantial activity of the corporation, the W corporation is considered a collaborative corporation under paragraph (d) (2) of this section.
The provisions of section 117 (m) (3) do not prohibit the application of section 117 (m) (1) to A. Therefore, the distribution, if add to the extent that it may be considered capital gain with the proceeds of the sale of property, the amount of the unrealized net income from such property ($500,000) is not substantial in relation to the amount of the net income from the sale of the property to be considered a capital asset.

(ii) The event in the existence of additional facts and circumstances in the above case, the corporation has been identified in the above facts and therefore shall not be considered a collapsible corporation. See paragraphs (b) and (d) (1) of this section.

Example (3). The facts in this example are as in example (3), except that the corporation has completed the construction of a second office building in June 1953. In August 1953, the corporation sold all of its stock to B for $12,000, which gain is not taxed to the corporation. In view of the fact that B sold stock of the X corporation and realized a gain attributable to the sale of the building, the time of such sale, the corporation had not realized a substantial part of the net income from the sale of the property stock, and the construction of such building during the time of such construction was a substantial part of the net income from the sale of the property stock. The corporation is considered a collapsible corporation under paragraph (d) (2) of this section. See the definitions of section 117 (m) (3) do not preclude the application of section 117 (m) (1) to B, the gain of $12,000 to B is, accordingly, considered ordinary income.

Example (4) (i) On January 2, 1948, C formally incorporated and became the sole shareholder thereof. The incorporation has been engaged solely in the business of producing motion pictures and licensing their exhibition. On January 2, 1948, C sold all of the stock of the Y corporation at a gain. The Y corporation has produced one motion picture each year since its organization and before January 2, 1948, it has realized a substantial part of the net income from the sale of its motion pictures except the last one made in 1952. This last motion picture was completed September 1952, and the fair market value on January 2, 1953, of this last motion picture exceeds the cost of its production $50,000. A material part of the production of this last picture was completed on January 1, 1952, and between January 1, 1952, and January 2, 1952, the corporation had realized net income of $500,000 from other motion pictures produced by it. The corporation has contributed to its shareholder its net income when received (after adjustment for taxes).

(ii) Although the corporation is within paragraph (d) (2) of this section with respect to the production of property, the amount of the unrealized net income from such property ($500,000) is not substantial in relation to the amount of the net income from the sale of the property to be considered a capital asset unless the security has been properly identified in the 30-day period in the dealer's records as being held for investment and such security is not at any time after the expiration of the 30-day period held by the dealer primarily for sale to customers in the ordinary course of its business or trade.

(3) This provision is applicable only in the case where gain from the sale or exchange of a security would, for such provision, be considered capital gain unless the security has been properly identified in the 30-day period in the dealer's records as being held for investment and such security is not at any time after the expiration of the 30-day period held by the dealer primarily for sale to customers in the ordinary course of its business or trade. However, the mere fact that a security which is actually held by a dealer for sale to customers in the ordinary course of its business or trade is identified as a security held for investment will not in and of itself result in a gain from the sale of the security to be treated as capital gain unless the security is sold within the 30-day period or other event which would be considered to be capital gain unless the security has been properly identified in the 30-day period in the dealer's records as being held for investment and such security is not at any time after the expiration of the 30-day period held by the dealer primarily for sale to customers in the ordinary course of its business or trade.
§ 39.117 Statutory provisions; gain from sale of certain property between spouses or between an individual and a controlled corporation.

1. Capital gains and losses.
   - Gain from sale of certain property between spouses or between an individual and a controlled corporation. The gain from the sale or exchange of such property shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property of a character subject to the allowance for depreciation provided in section 23 (1).

2. Subsection applicable only to sales or exchanges of property between spouses or between an individual and a controlled corporation. This subsection shall be applicable only in the case of a sale or exchange of property by a transferor in the hands of the transferee which is property of a character which is subject to the allowance for depreciation provided in section 23 (1).

§ 39.117 (o) Gain from sale or exchange of certain property between spouses or between an individual and a controlled corporation. Section 117 (o) provides that any gain recognized on the transferor from the sale or exchange, directly or indirectly, between a husband and wife or between an individual and a controlled corporation, of property which in the hands of the transferee is property of a character subject to the allowance for depreciation provided in section 23 (1) (including such property with respect to which a deduction for amortization is allowable under section 23 (b) shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 117 (k) for the purpose of section 117 (o) a corporation is controlled when more than 80 percent in value of all outstanding stock of the corporation is owned (whether legal ownership or beneficial ownership) by the taxpayer, his spouse, and his minor children and minor grandchildren; such purpose of the rule, the terms "children" and "grandchildren" include step-children and legally adopted children. The provisions of section 117 (o) are applicable whether the property be transferred from the corporation to the shareholder or from the shareholder to the corporation.

§ 39.117 (p) Statutory provisions; treatment of termination payments to employee.

Sec. 117. Capital gains and losses.
   - (o) Gain from sale of certain property between spouses or between an individual and a controlled corporation. The gain from the sale or exchange of capital assets held for more than six months, if such rights were included in the terms of the employment of such employer for a period of not less than five years (or for a period ending with his death), or if the total of the amounts received for such assignment or release are [as] received in one taxable year and after the termination of such employment. [Sec. 117 (p) as added by sec. 323, Rev. Act 1951]

§ 39.117 (p)–1 Capital gains treatment of certain termination payments. Certain amounts received by an employee pursuant to the assignment or release by the employee of all his rights to receive, after termination of his employment and for a period of not less than five years or for a period ending with his death, in the case of future profits or receipts of his employer, that is, profits or receipts attributable to a period subsequent to termination of employment, and if the provisions of section 117 (p) shall have application to such payments only if the following conditions are met:
   - (a) The employee was employed by the employer, in whose future profits or receipts the employee has an interest, for a period of more than 20 years before the assignment or release by the employee of his rights to such future profits or receipts.
   - (b) The full rights of the employee to the percentage of the future profits or receipts of such employer which (or the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of by the employee, and for a period of not less than five years from the date of such sale or disposition and ending 20 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 him), or has entered into a contract or option to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (3) (b); nor shall such deduction be allowed 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.
   - (c) If the amount of stock or securities acquired (or the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of by the employee, and for a period of not less than five years 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.
   - (d) If the amount of stock or securities acquired (or the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the parties to the sale or other disposition of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the non deductibility of the loss shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

§ 38.118–1 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 beginning 30 days before the date of such sale or disposition and end-
The stock or securities acquired will be matched in accordance with the order of their acquisition (beginning with the earliest acquisition) with an equal number of the shares of stock or securities sold or otherwise disposed of, or otherwise disposed of, beginning with the earliest acquisition.

(c) Where the amount of stock or securities acquired within the 61-day period is not less than the amount of stock or securities sold or otherwise disposed of, the particular shares of stock or securities acquired shall be those with which the stock or securities disposed of are matched in accordance with the following rule: The stock or securities sold or otherwise disposed of will be matched with an equal number of the shares of stock or securities acquired in accordance with the order of acquisition (beginning with the earliest acquisition) of the stock or securities acquired.

(d) The acquisition of any share of stock or any security which results in the nondeductibility of a loss under the provisions of this section shall be disregarded in determining the deductibility of any other loss.

(1) The word "acquired" as used in this section means acquired by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law, and comprehends cases where the taxpay-er has entered into a contract or option within the 61-day period to acquire by purchase or by such an exchange.

The following examples illustrate the application of this section:

Example (1). A, whose taxable year is the calendar year, on September 15, 1951, purchased 100 shares of common stock in the M Company for $6,000. On December 1, 1951, he purchased 100 additional shares for $9,600. On January 3, 1952, he sold the 100 shares purchased on December 1, 1951, for $9,600. Because of the provisions of section 118 no loss from the sale is allowable as a deduction.

Example (2). A, whose taxable year is the calendar year, on September 21, 1951, purchased 100 shares of the common stock of the M Company for $5,000. On December 21, 1951, he purchased 50 shares of substantially identical stock for $2,760, and on December 27, 1951, he purchased 25 additional shares of such stock for $1,125. On January 3, 1952, he sold for $4,000 the 100 shares purchased on September 21, 1951. There is an indicated loss of $1,000 on the sale of the 100 shares. Since, within the 61-day period, A purchased 75 shares of substantially identical stock, the loss on the sale of 75 of the shares ($3,750 -- $3,000, or $750) is not allowable as a deduction because of the provisions of section 118. The loss on the sale of the remaining 25 shares ($1,250 -- $1,000, or $250) is deductible subject to the limitations provided in sections 21 (b) and 117. The basis of the 60 shares purchased December 21, 1951, the acquisition of which resulted in the nondeductibility of the loss ($750) sustained on 60 of the 100 shares sold on January 3, 1952, is $2,500 (the cost of 60 of the shares sold on January 3, 1952) -- $750 (the difference between the purchase price ($2,760) of the 50 shares acquired on December 21, 1951, and the selling price ($2,000) of 60 of the shares sold on January 3, 1952) -- $3,250. Similarly, the basis of the 26 shares purchased on December 27, 1951, the acquisition of which resulted in the nondeductibility of the loss ($250) sustained on 25 of the shares sold on January 3, 1952, is $3,250 + $126, or $3,376. See § 39.118 (a) (10) -- 1.

Example (3). A, whose taxable year is the calendar year, on September 15, 1950, purchased 100 shares of the stock of the M Company for $6,000. He sold these shares on February 1, 1952, for $4,000. On each of the four days from February 15, 1952, to February 18, 1952, inclusive, he purchased 50 shares of substantially identical stock for $2,000. There is an indicated loss of $1,000 from the sale of the 100 shares on February 1, 1952, but, since within the 61-day period A purchased not less than 100 shares of substantially identical stock, the loss is not deductible. The particular shares of stock the purchase of which resulted in the nondeductibility of the loss are the first 100 shares purchased within such period, that is, the 50 shares purchased on February 15, 1952, and the 50 shares purchased on February 18, 1952. In determining the period for which the 50 shares purchased on February 15, 1952, and the 50 shares purchased on February 18, 1952, were held, there is to be included the period for which the 100 shares purchased on September 15, 1950, and sold on February 1, 1952, were held.
TITLE 26, PART 39—Continued

§39.119 (a) Statutory provisions; income from sources within the United States; gross income.

Sec. 119. Income from sources within United States—(a) Gross income from sources in United States. The following items of gross income shall be treated as income from sources within the United States:

1. Interest. Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—
   (A) Interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States, or
   (B) Interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of that period as may be applicable, or
   (C) Interest paid on deposits with persons carrying on the banking business in the United States.

2. Dividends. The amount received as dividends—
   (A) From a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation less than 20 per centum of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, shall be included in the gross income of such domestic corporation for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or
   (B) From a foreign corporation unless less than 20 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States, as determined under provisions of this section, or
   (C) From a foreign central bank of issue from bankers' acceptances.

3. Sale of real property. For gains, profits, and income from the sale of real property, see subsection (e).

4. Sale of personal property. For gains, profits, and income from the sale of personal property, see subsection (e).

5. any taxpayer who excludes from gross income from sources within the United States income of the type specified in paragraph (a) (1) (2) or (3) of this section shall file with his return a statement setting forth the amount of such income and such information as may be necessary to show that the income is of the type specified therein.

(c) Interest received from the United States by a foreign corporation or a nonresident alien on a refund of Federal income taxes is taxable as income from sources within the United States;

(d) As to the inclusion of gross income of items received in the United States even though representing income from sources without the United States, in the case of citizens of the United States and domestic corporations entitled to the benefits of section 251, see §39.251 (b)–1.

§39.119 (a)–2 Dividends. (a) Gross income from sources within the United States includes dividends, as defined by section 115:

(1) From a domestic corporation other than one entitled to the benefits of section 251, and other than a corpora-

No. 189—Pt. II—Sec. 2—1—1

Part II of this issue is divided into two sections. Section 1 contains §§39.1 through 39.115–1 of Part 39, Chapter I, Title 26, and Section 2 contains §§39.119 (a) through 39.6999–1.
§ 39.119 (a)–4 Rentals and royalties. Gross income from sources within the United States includes rentals or royalties from property located within the United States or from any interest in such property, under which the royalty is payable for the use or the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade marks, franchises, and other like property. The income arising from the rental of property, whether tangible or intangible, located within the United States, or from the use of property whether tangible or intangible, within the United States, is from sources within the United States.

§ 39.119 (a)–5 Sale of real property. Gross income from sources within the United States includes gain, computed under the provisions of sections 111 to 115, inclusive, derived from the sale or other disposition of real property located in the United States. For the treatment of capital gains and losses, see section 117.

§ 39.119 (a)–6 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 purchase of personal property within the country in which 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 United States. Hence, income derived from the purchase of personal property within the United States and its sale within a possession of the United States shall be treated as derived entirely from within a possession of the United States. The word "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 and sold within the United States. See § 39.119 (e)–1.

§ 39.119 (a)–7 Other income from sources within the United States. (a) Items of gross income other than those specified in section 119 (a) and (c) shall be allocated or apportioned to sources within or without the United States, as provided in section 119 (e).

(b) The income derived from the ownership or operation of any farm, mine, oil or gas well, deposit of coal, sand, gravel, or timber, located within the United States, and from the sale of the products thereof either 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 or provision of property, or sale in a specific case or for other reasons all of such gross income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in § 39.119 (e)–1.

(c) Where items of gross income are separately allocated to sources within the United States, there shall be allocated therefrom, in computing net income, the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

§ 39.119 (b)–1 Apportionment of deductions. (a) From the items specified in section 119 (a) as being derived specifically 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 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 is the calendar year derived gross income from all sources for 1962 of $180,000, one-fifth of which ($36,000) was nonincome within the United States as follows:

<table>
<thead>
<tr>
<th>Item of Gross Income</th>
<th>Source within the United States</th>
<th>Source without the United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on bonds of a domestic corporation</td>
<td>$40,000</td>
<td></td>
</tr>
<tr>
<td>Dividends on stock of a domestic corporation</td>
<td>$4,000</td>
<td></td>
</tr>
<tr>
<td>Royalty for the use of patents within the United States</td>
<td>$12,000</td>
<td></td>
</tr>
<tr>
<td>Gain from sale of real property located within the United States</td>
<td>$11,000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$65,000</td>
<td>$115,000</td>
</tr>
</tbody>
</table>

The remainder of the gross income was from sources without the United States, determined under § 39.119 (e)–1.
The expenses of the taxpayer for the year amounted to $78,000. Of these expenses the amount of $26,000 is properly allocable to income from sources without the United States and the amount of $40,000 is properly allocated to income from sources within the United States. The remainder of the expenses ($30,000) cannot be definitely allocated to any class of Income. A ratable part thereof, being a part of the expenses of the taxpayer, is not allocable to income from sources within the United States, and the amount of $6,000, a ratable part (one-fifth) of the expenses which could not be allocated to any item or class of gross income, is the net income from sources without the United States.

The deductions provided for in chapter I shall be allowed to nonresident alien individuals and foreign corporations engaged in business within the United States, and to citizens of the United States and domestic corporations entitled to the benefits of section 251, only if and to the extent provided in sections 251, 263, 282, 234, and 251.

§ 39.119 (c) Statutory provisions; income from sources within the United States; gross income from sources without the United States.

Sor. 119. Income from sources within the United States.

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

(1) Interest other than that derived from sources within the United States as provided in subsection (a) (1) of this section.

(2) Dividends other than those derived from sources within the United States as provided in subsection (a) (2) of this section.

(3) Compensation for labor or personal services performed without the United States.

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, trademarks, trade-marks, trade brands, franchises, and other like property (see § 39.119 (a) (4)).

§ 39.119 (d)—(e) Statutory provisions; income from sources within the United States; net income from sources without the United States; income from sources partly within and partly without the United States.

Sor. 119. Income from sources without the United States. *

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

(e) Income from sources partly within and partly without the United States. This section shall apply to any item of gross income, expenses, losses, and deductions, other than those specified in subsections (a) and (d) of this section, which is partly within and partly without the United States, under rules and regulations prescribed by the Commissioner, with the approval of the taxpayer, and where the items of gross income are separately allocated to sources within the United States, there shall be computed a ratable part of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

§ 39.119 (e) (1) Income from sources without the United States; and the portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary.
to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property both within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property both within the United States and the denominator of which consists of the value of the taxpayer’s gross sales for the taxable year or period both within the United States and within the foreign country. The term “gross sales of the taxpayer within the United States” means the gross sales made during the taxable year or period which were principally secured, negotiated, or effected by employees, agents, or solicitors of the taxpayer resident or located in the United States, and the value of the property which the amount of the taxpayer’s business for the taxable year or period both within the United States and within the foreign country is determined shall be apportioned on the same basis as above prescribed, at the beginning and end of the taxable year or period ordinarily may be unproductive or productive, the taxable year or period changes during the taxable year or period such average does not fairly represent the average for such period, in which case the average shall be determined upon a monthly or daily basis. Bills and accounts receivable of the sales, if any, shall be appraised at the gross prices satisfactory reason for a different treatment is shown, shall be apportioned to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agent in the United States.

Case A. Application for permission to transport from one point to the other the personal property of the United States. Revenue from operations incidental to transportation service. (A) A foreign corporation doing business in the United States and partly outside the United States derives income partly from sources within and partly from sources without the United States. The gross income from sources within the United States, and the portion attributable to such sources, shall be apportioned according to the following rules and cases:

(c) Class B. The portion of class B income which is attributable to sources within the United States shall be determined according to the following rules and cases:

(1) 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 partly from sources within the United States and partly from sources within the possession of the United States under one of the following cases:

Case B4. The net income shall first be computed by deducting from such gross income the expenses, and other deductions properly apportioned or allocated thereto and a rateable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The amount of net income so determined shall be apportioned in accordance with the value of the taxpayer's business within the United States and within the possession of the United States.

§ 39.119 (e)-2 Transportation service. (A) A foreign corporation carrying on a transportation service between points in the United States and points outside the United States derives income partly from sources within the United States and partly from sources without the United States. The gross income from sources within the United States shall be apportioned in accordance with the value of the taxpayer’s business for the taxable year or period both within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer’s property both within the United States and within the possession of the United States. The remaining one-half of such net income shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States. Pictures and illustrations were removed for natural language understanding, and the text was retyped in a readable format.
and wages wholly incurred for services rendered to the taxpayer in the United States belong to this class. Costs and expenses incurred in connection with services rendered wholly 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 on the voyage, and fuel consumed on each voyage may be prorated on the basis of the proportion which the number of miles sailed within the territorial limits of the United States bears to the total number of miles sailed on 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 for such purpose, interest and other expenses for the use of borrowed capital should not be taken into the cost of services rendered, for the reason that the return upon the property used measures the extent to which borrowed capital is the source of the income. For other expenses entering into the cost of services, only such expenses as are allowable deductions under the Internal Revenue Code should be taken.

(d) The value of the property used should be determined upon the basis of cost less depreciation. Eight percent may ordinarily be taken as a reasonable rate of return to apply to such property. The property taken should be the average property employed in the transportation service between points in the United States and points outside 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 service rendered without the United States. The portion allocable to services rendered within the United States should be based on the proportion which the gross receipts from such services bear to the gross receipts from all services. The portion allocable 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 portion allocable to services rendered without the United States should be based on the proportion which the gross receipts from such services bear to the gross receipts from all services.

(e) 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 (b) of this section, (1) the expenses of the transportation business carried on within the United States as determined under paragraph (b) of this section, and (2) the expenses determined in accordance with paragraphs (f) and (g) of this section.

(f) Interest and income, war-profits, and excess-profits taxes should be excluded from the apportionment process, as explained in paragraph (b) of this section. If the ascertainable 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 ratable part (1) of all interest (deductible under section 23(b)) and (2) of all income, war-profits, and excess-profits taxes (deductible under section 119) paid or accrued in respect of the business of transportation service between points in the United States and points outside the United States. Such ratable 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.

(g) 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 and points outside the United States (other than that of providing transportation service between points in the United States and points outside the United States), the amounts of such corporation’s income (other than that of providing transportation service between points in the United States and points outside the United States) which is allocable to such other business should be excluded both from the deductions and from the apportionment process prescribed in paragraph (b) of this section; 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, a ratable part of all such general expenses shall be based on the ratio of gross income from sources within the United States to the total gross income. If a taxpayer has gross income from sources within the United States after the amount of such gross income has been determined, a ratable part of the general expenses, losses, and 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, a ratable part of such expenses, losses, and deductions shall be based on the ratio of gross income from sources within the United States to the total gross income.

(h) Application for permission to base the return upon the books of account will be considered by the Commissioner in the case of any taxpayer subject to this section, who, in good faith has used an accountant to compute his income under the provisions of an exchange of liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the process prescribed in paragraphs (b) to (g), inclusive, of this section the income derived from sources within the United States.

39.119 (e)–3 Telegraph and cable service—(a) In general. • 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. (b) Gross income. The gross income from sources within the United States derived from services described in paragraph (a) of this section, 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 sum amounts paid or accrued for transmission of messages beyond the company’s own circuit. Amounts received by the company in the United States with respect to messages originating without the United States shall be excluded from gross income. (c) 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 (b) of this section, (1) all expenses incurred in the United States (not including any general expenses, losses, itemized deductions, and depreciation of cables and not including any amount already deducted in computing gross income) (3) depreciation of property (other than cables) located in the United States and used in the trade or business therein, and (4) a proportionate part of the general overhead expenses (not including any items incurred abroad corresponding to those enumerated in clauses (1), (2), and (3) of this sentence) and of maintenance, repairs, and depreciation of cable plant and equipment and 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.

39.119 (e)–4 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) (i) or (c) (ii) 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 computed as if the taxpayer had separate businesses, and the net income from sources within the United States shall be separately computed therefrom.

39.119 (f) Statutory provisions; income from sources within the United States; definitions.

Section 119. Income from sources within the United States. • • •

(f) Definitions. As used in this section the words “cable” or “cold” include “exchange”
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Under the circumstances specified in section 226 (c) (or corresponding provisions of prior Revenue Acts) plus the amount of income (determined without regard to subsection (a) or to taxes paid during such taxable year, war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 20 percent paid during such year by section 226 (c) shall not be applicable.

Sec. 120. Unlimited deduction for charitable and other contributions. In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 226 (c) (or corresponding provisions of prior Revenue Acts) plus the amount of income (determined without regard to subsection (a) or to taxes paid during such year, war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the husband and wife together during each such year plus the amount of the income, war-profits, or excess-profits taxes paid by the husband and wife together during each such year (determined under the rules of paragraph (b) of this section) exceeds 90 percent of the net income of the husband and wife together during each such year, without the benefit of any deduction for contributions or gifts.

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Under the circumstances specified in section 226 (c) (or corresponding provisions of prior Revenue Acts) plus the amount of income (determined without regard to subsection (a) or to taxes paid during such taxable year, war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 20 percent paid during such year by section 226 (c) shall not be applicable.

Sec. 120. Unlimited deduction for charitable and other contributions. In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 226 (c) (or corresponding provisions of prior Revenue Acts) plus the amount of income (determined without regard to subsection (a) or to taxes paid during such year, war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the husband and wife together during each such year plus the amount of the income, war-profits, or excess-profits taxes paid by the husband and wife together during each such year (determined under the rules of paragraph (b) of this section) exceeds 90 percent of the net income of the husband and wife together during each such year, without the benefit of any deduction for contributions or gifts.

5998 RULES AND REGULATIONS

Under the circumstances specified in section 226 (c) (or corresponding provisions of prior Revenue Acts) plus the amount of income (determined without regard to subsection (a) or to taxes paid during such taxable year, war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 20 percent paid during such year by section 226 (c) shall not be applicable.

Sec. 120. Unlimited deduction for charitable and other contributions. In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 226 (c) (or corresponding provisions of prior Revenue Acts) plus the amount of income (determined without regard to subsection (a) or to taxes paid during such year, war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 20 percent paid during such year by section 226 (c) shall not be applicable.
on account of gains from such sales or exchanges. The deduction provided in section 29 (ee) shall be allowed.

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of such deductions derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed without regard to the exceptions and limitations specified in paragraphs (1) to (4) of this subsection. This paragraph shall not apply with respect to deductions for losses sustained after December 31, 1950, in respect of property, if the losses arise from fire, storm, shipwreck, or other casualty, or from theft.

(6) * * * [Not applicable to taxable years ending after June 30, 1950]

(a) No carry-back to year prior to 1941.* * *

[Sec. 122 as added by sec. 211 (b), Rev. Act 1939, amended by secs. 105 (e) (3), 150 (e), and 183 (a) (4), Rev. Act 1939; see secs. 304, (e), Excess-Profit Tax Act 1950; secs. 322 (c), 330, and 334, Rev. Act 1851.]

§ 39.122-1 Net operating loss deduction—(a) General. (1) Section 122 provides for the computation of the net operating loss deduction allowed by section 23 (a). The net operating loss deduction is the aggregate of the net operating loss carry-backs and carry-overs to the taxable year, reduced by certain adjustments to prevent the deduction of losses absorbed by income not taxed.

(2) Section 122 provides that the aggregate of the net operating loss carry-backs and carry-overs to a taxable year shall be the basis of the net operating loss deduction.

[For the taxable years from which a net operating loss may be carried over or carried back to the current taxable year. The amount of the net operating loss which may be carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed by the net income for the other taxable years, preceding such taxable year, to which it may be carried back or carried over. If the net operating losses for several taxable years are carried back or carried over to one taxable year, they are considered to be applied in reduction of the net income for such taxable year and 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.

(2) A fractional part of a year which is a taxable year under section 48 (a) is a preceding or a succeeding taxable year for the purposes of determining under section 122 the first second, or third, of such taxable year.

(4) Every taxpayer claiming a net operating loss deduction for any taxable year shall file with his return for such taxable year a concise statement setting forth the amount of the net operating loss deduction claimed and all material and pertinent facts relative thereto, including a detailed statement of the computation of the net operating loss deduction.

(b) Steps in computation of net operating loss deduction. There are three steps in the computation of the net operating loss deduction. The first step is the computation of the net operating loss deduction, if any, for any preceding or succeeding taxable year from which a net operating loss may be carried over or carried back to the current taxable year. This step shall be the computation of the aggregate of the net operating loss carry-backs to the taxable year from such preceding taxable years and the computation of the net operating loss carry-back to the taxable year from such succeeding taxable years. The second step is the computation of the aggregate of such net operating loss carry-backs and carry-overs to the net operating loss deduction.

§ 39.122-2 Computation of net operating loss in case of a corporation. (a) A net operating loss 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 2 over gross income, both computed with the following exceptions, additions, and limitations:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to recovery of discovery value or to percentage depletion under section 112 (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, decremented by the amount of interest paid or accrued which is not allowable 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) The deduction provided in section 23 (ce) and 117 (b) shall not be allowed;

(5) The amount deductible on account of business capital losses shall not exceed the amount includible on account of business capital gains, plus a portion of any nonbusiness capital gains, computed in accordance with paragraph (e) of this section.

(6) The amount deductible on account of nonbusiness capital losses shall not exceed the amount includible on account of nonbusiness capital gains.

(7) Ordinary nonbusiness deductions (i.e., exclusive of capital losses) shall be allowed only to the extent of the amount of ordinary nonbusiness gross income.
(1, e., exclusive of capital gains) plus the excess, if any, of nonbusiness capital gains over nonbusiness capital losses. For the purpose of computing the net operating loss deduction, any deduction allowable for a loss sustained after December 31, 1950, in respect of property, if the loss arises from fire, storm, shipwreck, or other casualty or from theft, shall not be considered to be an ordinary nonbusiness deduction but shall be treated as attributable to the operation of a trade or business regularly carried on by the taxpayer.

(b) Treatment of net capital loss carry-overs. (1) Because of the distinction between business and nonbusiness capital gains and losses, a taxpayer who has a net capital loss carry-over from preceding taxable years, includible among the short-term capital losses for the current taxable year by virtue of section 117 (a) must determine how much of such net capital loss carry-over is a business capital loss and how much a nonbusiness capital loss. In order to make this determination, the taxpayer must first ascertain what proportion of the net capital losses for such preceding taxable years is attributable to an excess of business capital losses over business capital gains for such years, and what proportion was attributable to an excess of nonbusiness capital losses over nonbusiness capital gains. The same proportion of the net capital loss carry-over from any such preceding taxable years shall be treated as a business capital loss and a nonbusiness capital loss, respectively.

(2) This rule may be illustrated by the following example:

Example. (1) A, an individual, has $8,000 ordinary net income for the calendar year 1952 and also has the following capital gains and losses for such year: Business capital gains of $5,000; business capital losses of $2,500; nonbusiness capital gains of $1,500; and nonbusiness capital losses of $1,200.

(b) A's net capital loss for the taxable year 1952 is $400, computed as follows:

Total capital losses $4,000
Total capital gains 5,000
Excess of total capital losses over total capital gains 1,000
Loss: $1,000 of ordinary net income 1,000

Net capital loss for 1952 400

(3) A's total capital losses for 1952 exceeded his total capital gains for each year by $1,200 ($4,000 minus $2,800). Since A's business capital losses for 1952 ($2,000) were attributable to an excess of his business capital losses over his business capital gains for such year. Similarly, 1/7th of the net capital loss is attributable to the excess of nonbusiness capital losses over nonbusiness capital gains. Since the net capital loss carry-over from 1952 to 1953 is $400, 6/7ths of $400, or $285.71, will be treated as a business capital loss in 1953, and 1/7th of $400, or $57.14, as a nonbusiness capital loss.

(c) Determination of portion of non-business capital gains available for the deduction of business capital losses. (1) In the computation of a net operating loss of a taxpayer other than a corporation must use his nonbusiness capital gains for the deduction of his nonbusiness capital losses. See paragraph (a) (vii), (viii) of this section. The portion not necessary for this purpose shall then be used for the deduction of any excess of ordinary nonbusiness deductions over ordinary nonbusiness gross income. See paragraph (a) (vii), (viii) of this section. The portion not necessary for this purpose shall then be used for the deduction of any excess of ordinary nonbusiness deductions over ordinary nonbusiness gross income. See paragraph (a) (vii), (viii) of this section.

(2) This principle may be illustrated by the following example:

Example. (1) A, an individual, has a total nonbusiness gross income of $29,500, computed as follows:

Ordinary gross income $7,500
Capital gains 15,000

(2) Total gross income 20,500

(i) He also has total nonbusiness deductions of $16,000, computed as follows:

Ordinary deductions $2,000
Capital losses 7,000

Total deductions 19,000

(3) In order to determine the portion of the nonbusiness capital gains available for the deduction of business capital losses which must first be deducted the amounts of the ordinary nonbusiness deductions over ordinary nonbusiness gross income by $1,500. Since the ordinary nonbusiness deductions exceed the ordinary nonbusiness gross income by $1,500, the portion not necessary for this purpose shall then be used for the purpose of determining the deductibility of business capital losses under paragraph (a) (vii), (viii) of this section.

(2) 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, has for 1952 gross income of $483,000 and deductions (exclusive of capital gains) plus the excess of business capital losses over nonbusiness capital gains of $1,200, computed as follows:

(1) Deductions for 1952 (exclusive of any deductions attributable to capital losses and exclusive of the net operating loss deduction) $540,000

Plus amount of capital loss ($60,000) to extent such amount does not exceed capital gains ($50,000) 50,000

(2) Sum of Item (1) and Item (ii) 590,000

(ii) Less excess of nonbusiness deductions over nonbusiness gross income ($12,000 minus $10,000) 2,000

(iii) Deductions for 1952 adjusted as required by section 122 (d) (item (vi) plus item (iv)) 588,000

(iv) Gross income for 1952 $488,000

(v) Plus tax-exempt interest 26,000

(vi) Gross Income for 1952 adjusted as required by section 122 (d) (item (vi) plus item (vii)) 604,000

(b) Net operating loss for 1952 (item (v) minus item (vi)) 80,000

(3) For treatment of depletion deductions, see example in § 30.122-2. For treatment of net capital loss carry-over, nonbusiness capital gains and losses, and the portion of the nonbusiness capital gains which may be used as a deduction of business capital losses, see examples in paragraphs (b) and (c) of this section.

(c) 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, additions, and limitations prescribed by section 122 (d) (item (vi) plus item (vii)) of this section.
preceding such taxable year, to which it was carried back or carried over. For the purpose of determining the net income for a taxable year which so absorbs the portion of the net operating loss that was carried back or carried over, the various net operating loss carry-overs and carry-backs to such taxable year are considered to be applied in reduction of net income 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 A net operating loss must first be carried to the earliest of the several taxable years to which such loss is allowable as a carry-back or a carry-over, and is then to be carried to the next earliest of such several taxable years, etc. See paragraph (a) of this section for computation of the net operating loss incurred in any particular taxable year which may be carried back or carried over. The entire net operating loss may be carried to such earliest year.

Example. A taxpayer on the calendar year basis has a net operating loss for 1952. The entire net operating loss for 1952 may be carried back to 1951. The amount of the carry-back to 1952 is the excess of the 1952 loss over the net income (computed as provided in paragraph (c) of this section) for 1951. Similarly, the amount of the carry-over to 1953, 1954, 1955, and 1956 is the excess of the 1952 loss over the aggregate of the net income (computed as provided in paragraph (c) of this section) for 1951 1955 and 1956.

Example. The taxpayer lists its income tax returns on the calendar basis. In computing the net operating loss deduction, for the taxable year to which a carry-over or carry-back is attributable, the net operating loss carry-over and a carry-back which is the basis for the deduction. The adjustment under subsection (c) of this section is recomputed upon the basis of determining the amount of the net operating loss carry-over and carry-back to any taxable year, so absorbed by the taxpayer in such excess over the aggregate of the net operating loss carry-overs and carry-backs to the current taxable year, which may be carried back or carried over. If the net income for any taxable year which is computed in accordance with the exceptions, additions, and limitations applicable in the computation of the net operating loss deduction of § 39.122-3, except that the net operating loss deduction shall be allowed to the extent provided in subparagraph (1) of this paragraph.

Example. The taxpayer is a corporation making its income tax return on the calendar basis. If the taxpayer sustained the net operating loss from which the net income is to be deducted, and (ii) by disregarding the adjustment provided in section 122 (c) and § 39.122-5 (relating to the conversion of the aggregate of the net operating loss carry-over and carry-back to the taxable year into the net operating loss deduction)

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(vii) For 1956, the carry-over is $140,000, that is, the excess of the $150,000 net operating loss over $10,000, the sum of the $90,000 net income for 1954 (such net income for 1955 being computed as the $30,000 income reduced by the carry-over of $60,000 from 1953) and the $10,000 net income for 1955 (such net income for 1955 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).

(iv) For 1955, the carry-over is $130,000, that is, the excess of the $150,000 net operating loss over $20,000, the sum of the $150,000 net income for 1954 (such net income for 1955 being computed as the $30,000 income reduced by the carry-over of $120,000 from 1953, the $10,000 net income for 1955 (such net income for 1955 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account) and the $20,000 income reduced by the carry-over of $100,000 from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).

(v) For 1954, the carry-over is $120,000, that is, the excess of the $150,000 net operating loss over $30,000, the sum of the $150,000 net income for 1953 (such net income for 1954 being computed as the $30,000 income reduced by the carry-over of $120,000 from 1953, the $10,000 net income for 1953 (such net income for 1954 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account) and the $30,000 income reduced by the carry-over of $100,000 from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).

(vi) For 1951, the carry-over is $65,000, that is, the excess of the $150,000 net operating loss over $85,000, the sum of the $85,000 net income for 1950 (such net income for 1951 being computed as the $30,000 income reduced by the carry-over of $60,000 from 1953, the $10,000 net income for 1951 (such net income for 1951 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account) and the $85,000 income reduced by the carry-over of $100,000 from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).

(vii) For 1950, the carry-over is $50,000, that is, the excess of the $150,000 net operating loss over $100,000, the sum of the $100,000 net income for 1949 (such net income for 1950 being computed as the $30,000 income reduced by the carry-over of $60,000 from 1953, the $10,000 net income for 1950 (such net income for 1950 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account) and the $100,000 income reduced by the carry-over of $100,000 from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).

(viii) For 1949, the carry-over is $35,000, that is, the excess of the $150,000 net operating loss over $115,000, the sum of the $115,000 net income for 1948 (such net income for 1949 being computed as the $30,000 income reduced by the carry-over of $60,000 from 1953, the $10,000 net income for 1948 (such net income for 1949 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account) and the $115,000 income reduced by the carry-over of $100,000 from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).

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RULES AND REGULATIONS

(iii) For 1952, the carry-over is $40,000, that is, the excess of the $150,000 net operating loss over $110,000, the sum of the $110,000 net income for 1951 (such net income for 1952 being computed as the $30,000 income reduced by the carry-over of $80,000 from 1953, the $10,000 net income for 1952 (such net income for 1952 being computed as the $30,000 income reduced by the $10,000 carry-over from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account) and the $110,000 income reduced by the carry-over of $100,000 from 1953, the $150,000 carry-over from 1953 to 1956 not being taken into account).
(II) The net operating loss carry-over of H from 1952 to 1953 is $4,000, that is, his $4,000 net income for 1953 which is not reduced by any part of the net income for 1951, since none of such net income is attributable to W. The portion attributable to W is entirely offset by her separate net operating loss deduction for her taxable year 1952, which taxable year begins on the same date as H's taxable year. The determination of the amount (90) of net income for 1951 which reduces H's net operating loss for any taxable year beginning before January 1, 1952, is the date of the beginning of the taxable year in which he sustained net operating losses in both such years. This net operating loss deduction is computed without taking into account any net operating loss sustained in a taxable year beginning on or after January 1, 1952.

(III) The combined net income of $9,500 for 1951 is reduced to $1,000 by the net operating loss of $8,500 for 1951, which is attributable to W. The net income for 1951, which is not reduced by any part of the net income for 1951, is computed as follows:

(1) The combined net income of $9,500 for 1951, computed with the net operating loss deduction for such year, which is the amount of H's separate carry-over and the net operating loss deduction for his taxable year, is $1,000.

(2) The $1,000 net income attributable to W is used to reduce H's net operating loss for 1952 since such net income attributable to W must first be reduced by W's $1,000 net operating loss for 1952, her taxable year beginning on the same date as H's taxable year 1952, in which he sustained the net operating loss from which the net income is subtracted.

(iv) The net operating loss carry-over of W from 1952 to 1953 is $500, her $1,000 loss reduced by the $600, net income for 1951, computed in the manner prescribed in subparagraph (iii) of this example, since all of her net income is attributable to H.

Example (3). (i) Assume the same facts as in example (2), except that for 1953 the net operating loss of W is $200 instead of $1,000.

(ii) The net operating loss carry-over of H from 1952 to 1953 is $200, that is, his $4,000 net operating loss reduced by $800 of the net income for 1953.

(iii) The combined net income of $9,500 for 1951, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, of which $800 is attributable to H. To the $0 net income attributable to H, there is added $800, the excess of the $1,000 net income attributable to W over the $200 net operating loss sustained in 1952, a taxable year beginning on the same date (January 1, 1952) as the taxable year 1952 in which he sustained the $4,000 net operating losses from which the net income is subtracted.

(iv) W has no net operating loss carry-over from 1952 to 1953 since her net operating loss of $200 for 1952 is completely offset by her $2,000 income for 1953.

Example (4). (i) Assume the same facts as in example (3), except that W changes her accounting period in 1953 to a fiscal year ending on January 31, and has no net income for the taxable year ending January 1, 1952, to January 31, 1953, but has a net operating loss of $200 for the fiscal year ending January 31, 1953.

(ii) The net operating loss carry-over of H from 1952 to 1953 is $8,000, that is, his net operating loss of $8,500 for the fiscal year ending January 31, 1953, computed as follows:

The separate net operating loss carry-over of the husband from the fiscal year ending June 30, 1952, and from the short taxable year ending December 31, 1952, is consid-ered the husband's separate carry-over. The joint net operating loss carry-over is also computed from the husband's and wife's joint return.

§ 39.122-5 Conversion of net operating loss carry-backs and net operating loss carry-overs into net operating loss deduction. (a) The net operating loss deduction for any taxable year is the aggregate of the net operating loss carry-over and carry-back to such taxable year computed as prescribed in § 39.122-4, reduced by the excess of the net income for such taxable year (computed in the manner prescribed in § 39.122-3) over the aggregate of the net operating loss carry-backs and carry-overs which were not allowed, as determined in the manner described in example (2) and subparagraph (iv) of this paragraph. Such net operating loss deduction shall be taken into account over—

(1) In the case of a person who is not a corporation, the net income computed without regard to the exceptions, additions, and limitations specified in paragraph (a) of § 39.122-3 except that no portion of the net operating loss deduction shall be taken into account; or

(2) In the case of a corporation, the normal-tax net income computed without regard to the exceptions, additions, and limitations specified in § 39.122-2 except that no net operating loss deduction shall be taken into account over any part of the normal-tax net income for the taxable year ending December 31, 1952.

(b) The application of this section may be illustrated by the following example:

Example. The aggregate of the net operating loss carry-over and the net operating loss carry-back to the X Corporation is $35,000. Its net income is computed with the adjustments required by this section, is $450,000 and its normal-tax net income, computed without additions, additions, and limitations except that no net operating loss deduction is allowed and the credits provided in section 26 (b) and section 29 (1) are not allowed, is $445,000. The net operating loss deduction allowed to the X Corporation for the year 1952 is $39,000, computed as follows:

Aggregate of the net operating loss carry-overs and the net operating loss carry-back to 1952: $35,000

Less: Excess of net income for 1952 over that computed with adjustments, over normal-tax net income for 1952, without additions, additions, and limitations: $450,000 minus $445,000

Net operating loss deduction allowed: $5,000

(c) If the same facts are assumed for an individual, except that, instead of having a normal-tax net income for 1952
of $445,000, he has a net income for such year of $445,000, computed without adjustments except that no net operating loss deduction shall be allowed, his net operating loss deduction for 1952 will likewise be $445,000, computed in the same manner.

(d) In the case of a husband and wife making a joint return for any taxable year, the computation of the net operating loss deduction (as set forth in paragraph (a) of this section) is to be made upon the basis of the aggregate of the joint net operating loss carry-overs and the joint net operating loss carry-backs of the spouses to such year (computed as prescribed in paragraph (e) of § 39.122–4) and the combined net income of the spouses.

§ 39.123 Statutory provisions; commodity credit loans.

Sec. 123. Commodity credit loans. (a) Amounts received as loans from the Commodity Credit Corporation shall, at the election of the taxpayer, be considered as income and shall be included in gross income for the taxable year in which received.

(b) If a taxpayer exercises the election provided for in subsection (a) that any amount be considered as income to the taxpayer, any deduction for the deficiencies on such loan must be allowed with respect to the commodity pledged by the taxpayer to the Commodity Credit Corporation for an amount $100 and $200 less than the loan with respect to the commodity pledged in 1952 and 1953, respectively, and for an amount $150 greater than the loan with respect to the commodity pledged in 1954. A taxpayer may make his election for 1956, shall include in gross income the sum of $100 if it is received during that year, but will not be allowed a deduction for the deficiencies on $100 and $200 unless he is required to satisfy such deficiencies and does satisfy them during that year.

§ 39.124 Statutory provisions; amortization deduction.

Sec. 124. Amortization deduction. [No longer applicable]

§ 39.124A (a) Statutory provisions; amortization deduction, general rule.

Sec. 124A. Amortization deduction—(a) General rule. Every person, at his election, shall be entitled to have respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (d)), based on a period of sixty months.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, a taxpayer who elected for his taxable years 1952, 1953, and 1954 to include in gross income amounts received during those years as loans from the Commodity Credit Corporation, received as loans $500 in 1952, $700 in 1953, and $800 in 1954. The certificate covering $240,000 of such loan was sold by the Commodity Credit Corporation for an amount $100 and $200 less than the loans with respect to the commodity pledged in 1952 and 1953, respectively, and for an amount $150 greater than the loan with respect to the commodity pledged in 1954. A, in making his return for 1956, shall include in gross income the sum of $100 if it is received during that year, but will not be allowed a deduction for the deficiencies on $100 and $200 unless he is required to satisfy such deficiencies and does satisfy them during that year.

§ 39.124B (d)–1. The tax year in which a facility is complete or acquired after December 31, 1956, and before September 23, 1958, unless certified on or before September 23, 1951, or before September 1, 1962, will be determined for the purpose of determining an election to amortize the adjusted basis of the facility as of the month following the month in which it was complete or acquired. For the purpose of computing the amortization deduction with respect to such facility, the taxpayer may, with respect to an emergency 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 succeeding that in which the taxpayer received the amount described in paragraph (a) of this section. The date on which, or the month within which, an emergency facility is completed or acquired is to be determined upon the facts in the particular case.

Ordinarily, the taxpayer is in possession of all the facts and, therefore, in a position to ascertain such date. A statement made by the taxpayer, certified 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.

(b) In no event shall an amortization deduction be allowed with respect to an emergency facility for any taxable year unless such facility has been certified prior to the date of filing of the taxpayer's return for such taxable year, or, in the case of an emergency facility completed or acquired after December 31, 1949, and before September 23, 1951, unless certified on or before September 23, 1951, or the date on which the return is filed, whichever is later. See section 124A (d)–1.

(c) In general, with respect to each month of the 60-month period which falls within the taxable year, the amortization deduction is an amount equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the particular month for which the deduction is computed) remaining in the 60-month period. The adjusted basis of the facility at the end of any month shall be the adjusted basis at the end of the month for which the deduction is computed without regard to the amortization deduction above provided with respect to such facility.

(d) This section may be illustrated by the following examples:

Example (1). On July 1, 1952, the X Corporation, which makes its income tax returns on the calendar year basis, begins the construction of an emergency facility for which it is completed on September 30, 1962, at a cost of $200,000. The certificate covers the entire construction. The X Corporation elects to amortize the deduction with respect to the facility and to begin the 60-month amortization period with October, the month following its completion. The adjusted basis of the facility is $200,000. The allowable amortization deduction with
respect to such facility for the taxable year 1952 is $12,000, computed as follows:

<table>
<thead>
<tr>
<th>Month</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>$2,000</td>
</tr>
<tr>
<td>February</td>
<td>$108,000 (at $108,000 minus $2,000) divided by 59</td>
</tr>
<tr>
<td>March</td>
<td>$2,000</td>
</tr>
<tr>
<td>April</td>
<td>$2,000</td>
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<tr>
<td>May</td>
<td>$21,410</td>
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<tr>
<td>June</td>
<td>$21,410</td>
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<td>July</td>
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<td>August</td>
<td>$21,410</td>
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<tr>
<td>September</td>
<td>$21,410</td>
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<tr>
<td>October</td>
<td>$21,410</td>
</tr>
<tr>
<td>November</td>
<td>$21,410</td>
</tr>
</tbody>
</table>

Total amortization deduction for 1953 = $12,000

Example (2). The Z Corporation, which makes its income tax return on the calendar year basis, purchases an emergency facility (No. 1) on July 1, 1953, for a cost of $30,000. Since the Z Corporation elected in its return for 1952 to take amortization deductions with respect to such facility and began the 60-month amortization period with July 1, 1953, it must compute its amortization deductions for the 12 months in the taxable year 1953 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

§ 39.124A (b) Statutory provisions; amortization deduction; election.

Sec. 12A. Amortization deduction. • • •

(b) Election of amortization. The election of the taxpayer to take the amortization deduction with respect to such facility for the taxable year in which such facility was completed or acquired, shall be made by filing with the Secretary, in such manner, in such form, and within such time as the Secretary may by regulations prescribe, a statement of election.

Example (b). The Z Corporation, which makes its income tax return on the calendar year basis, purchases an emergency facility (No. 1) on July 1, 1953, for a cost of $30,000. Since the Z Corporation elected in its return for 1952 to take amortization deductions with respect to such facility and began the 60-month amortization period with July 1, 1953, it must compute its amortization deductions for the 12 months in the taxable year 1953 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

Monthly amortization deductions:

<table>
<thead>
<tr>
<th>Month</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>$2,000</td>
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<td>October</td>
<td>$21,410</td>
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<tr>
<td>November</td>
<td>$21,410</td>
</tr>
</tbody>
</table>

Total amortization deduction for 1953 = $12,000

Since the Z Corporation elected in its return for 1952 to take amortization deductions with respect to such facility and began the 60-month amortization period with July 1, 1953, it must compute its amortization deductions for the 12 months in the taxable year 1953 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

§ 39.124A (c) Statutory provisions; amortization deduction; termination.

Sec. 12A. Amortization deduction. • • •

(c) Termination of amortization deduction. A taxpayer which has elected under subsection (b) to take the amortization deduction provided to sub-sec. 39.124A (b) at any time after making such election, may discontinue the amortization deductions with respect to such facility for the taxable year or any part thereof, by a notice in writing filed with the Secretary before the beginning of such month. The deduction provided under section 23 (1) shall be allowed beginning with the first month as to which the amortization deduction is not applicable, and the taxpayer shall not be entitled to any further amortization deductions with respect to such emergency facility.

Example (c). The Z Corporation, which makes its income tax return on the calendar year basis, purchases an emergency facility (No. 2) on August 15, 1953, for a cost of $54,000. Since the Z Corporation elected in its return for 1952 to take amortization deductions with respect to such facility and to begin the 60-month amortization period with August 15, 1953, it must compute its amortization deductions for the 12 months in the taxable year 1953 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

§ 39.124A (c--1) Termination of amortization deduction.

(c) Termination of amortization deduction. A taxpayer which has elected under subsection (b) to take the amortization deduction provided to sub-sec. 39.124A (b) at any time after making such election, may discontinue the amortization deductions with respect to such facility for the taxable year or any part thereof, by a notice in writing filed with the Secretary before the beginning of such month. The deduction provided under section 23 (1) shall be allowed beginning with the first month as to which the amortization deduction is not applicable, and the taxpayer shall not be entitled to any further amortization deductions with respect to such emergency facility.

Example (c). The Z Corporation, which makes its income tax return on the calendar year basis, purchases an emergency facility (No. 2) on August 15, 1953, for a cost of $54,000. Since the Z Corporation elected in its return for 1952 to take amortization deductions with respect to such facility and to begin the 60-month amortization period with August 15, 1953, it must compute its amortization deductions for the 12 months in the taxable year 1953 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

Monthly amortization deductions:

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<th>Month</th>
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<td>October</td>
<td>$21,410</td>
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<tr>
<td>November</td>
<td>$21,410</td>
</tr>
</tbody>
</table>

Total amortization deduction for 1953 = $12,000

Since the Z Corporation elected in its return for 1952 to take amortization deductions with respect to such facility and to begin the 60-month amortization period with August 15, 1953, it must compute its amortization deductions for the 12 months in the taxable year 1953 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.
the 60-month amortization period with the taxable year 1953. Depreciation of the building in the amount of $6,000 is deducted since the taxable year 1953. On March 25, 1954, the corporation files notice with the Commissioner of its election to discontinue the amortization deduction beginning on the date of December 31, 1954. The adjusted basis of the facility on January 31, 1955, is $500,000, or the cost of the facility ($500,000) less the depreciation allowed for 1953 ($50,000). The amortization deductions for the taxable year 1953 and the months of January, February, and March 1954, amount to $75,000, or $5,000 per month for 15 months. Since, at the beginning of the amortization period, the adjusted basis of the entire amortization deduction, and the adjusted basis of the land is one-fifth of the adjusted basis of the entire facility and since $15,000 is allocable to the land and $45,000 is allocable to the land.

§ 39.124A (d) Statutory provisions; amortization deduction, definitions.

Sec. 124A. Amortization deduction. (a) Definition of emergency facility. As used in this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof, constructed, reconstructed, erected, or installed after December 31, 1949, and before the expiration of six months after the date of enactment of the Revenue Act of 1950, at a cost of $2,300,000, of which $3,600,000 is allocable to the land.

(b) Definition of emergency period. The term "emergency period" means the period beginning on the date on which the President proclaims that the utilization of a substantial portion of the certified emergency facility is no longer required in the interest of national defense.

Sec. 124A. Amortization deduction. (a) Determination of adjusted basis of emergency facility. (1) There shall be included only such portion of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by Executive order, has certified as necessary in the interest of national defense.

(c) 'Emergency period' means the period beginning on January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the certified emergency facility is no longer required in the interest of national defense.

§ 39.124A (e) Statutory provisions; amortization deduction, adjusted basis of emergency facility.

Sec. 124A. Amortization deduction. (a) Determination of adjusted basis of emergency facility. (1) In general. (1) The adjusted basis of an emergency facility for the purpose 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 of the emergency facility. It will be only a portion of such other adjusted basis if only a portion of the basis (unadjusted) is attributable to the construction, reconstruction, erection, installation, or acquisition taking place after December 31, 1949. Also, it will be only a portion of what would otherwise constitute the adjusted basis of the emergency facility if only a portion of the basis (unadjusted) is certified as attributable to defense purposes. It is therefore necessary first to determine the unadjusted basis of the emergency facility from which the adjusted basis for amortization purposes is derived.

(b) The unadjusted basis for amortization purposes is the same as the unadjusted basis otherwise determined only when the entire construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1949, and is certified in its entirety by the certifying authority.

(3) In cases in which only a portion of the construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1949, that portion is certified by the certifying authority, the unadjusted basis for the purpose of amortization is that portion of the entire unadjusted basis as is attributable to the certified construction, reconstruction, erection, installation, or acquisition which takes place after December 31, 1949. For example, the X Corporation begins the construction of a facility on November 16, 1949, and such facility is completed on April 1, 1952, at a cost of $5,000,000 of which $4,600,000 is attributable to construction after December 31, 1949. The complete construction after December 31, 1949, is certified by the certifying authority, the unadjusted basis of the emergency facility for amortization purposes is therefore $4,600,000. For depreciation of the remaining portion of the cost ($400,000) see § 39.124A (f)-1.

(4) If the certifying authority certifies a portion of the construction, reconstruction, erection, installation, or acquisition of property which takes place after December 31, 1949, the unadjusted basis for amortization purposes is limited to such portion so certified. Assuming the same facts as in the example in subparagraph (3) of this paragraph, except that only 50 percent of the construction, reconstruction, erection, installation, or acquisition after December 31, 1949, is certified, the unadjusted basis for amortization purposes is 50 percent of $4,600,000, or $2,300,000.

(5) The adjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes less the adjustments properly applicable thereto. Such adjustments are those specified in section 115 (b), except that no adjustment is taken into account which increases the adjusted basis. (See paragraph (b) of
acquires an emergency facility pursuant 
basis of an emergency facility for amor-
ination of a government contract or 
in a capital receipt. However, amounts re-
reimbursement shall be treated as 
reimbursement, and the amount received 
shall not include that part of the cost 
of such facility, the unadjusted basis of 
structures, reconstructs, erects, installs, or 
structs, as of January 
The $297,000. 

Example (1). The X Corporation elects to begin amorti-
pletes an emergency facility on July 1, 1952, 
liquidation of the basis of such facility. 
As of January 1, 1953, the only ad-
justment of its basis for the period July 1, 
1952 to January 31, 1953, other than de-
preciation or amortization for January 1953, 
is $5,000 for depreciation during the base 
months of 1952. The adjusted basis for the 
purpose of amortization is therefore $300,000 less $3,000 
(200,000/500,000 X $5,000), or $297,000.

Example (2). On July 31, 1956, the Y Corporation has an emergency facility (a building) which was completed on July 1, 1952, the entire basis of which is $500,000, and the unadjusted basis of which for the purpose of amortization is $300,000. The Corporation elected to begin amortization as of January 1, 1953. The only adjustment to its basis for the period July 1, 1952 to January 31, 1953, other than de-
preciation or amortization for January 1953, is $5,000 for depreciation during the base 
months of 1952. The adjusted basis for the 
purpose of amortization is therefore $300,000 less $5,000 
(200,000/500,000 X $5,000), or $295,000.

The §39.000,000 fire loss is applied against the 
adjusted basis for the purpose of amortiza-
tion. Hence, the adjusted basis for amorti-
depreciation in the proportion that each 
such adjusted basis at the time of the fire 
occurred (e.g., $316,195/272,100 X $300,000 or $295,000, or $314,749.18, against the depreciation basis.

(b) Capital additions. (1) If, after 
the completion or acquisition of an emer-
gency facility which has been certified by the certifying authority, further expendi-
ures are made for construction, recon-
struction, erection, installation, or acquis-
tion of property attributable to such 
deduction shall be treated as capital receipts but are to be 
taken into account in computing income, and 
are therefore not to be applied in 
reduction of the basis of such facility.

(6) The following examples will illus-
strate the computation of the adjusted 
basis of an emergency facility for amor-
tization purposes.

Example (f). The X Corporation completes an emergency facility on July 1, 1952, the entire unadjusted basis of which is $500,000, and the unadjusted basis of which for the purpose of amortization is $300,000. The X Corporation elects to begin amortization as of January 1, 1953. The only ad-
justment to its basis for the period July 1, 1952 to January 31, 1953, other than de-
preciation or amortization for January 1953, is $5,000 for depreciation during the base 
months of 1952. The adjusted basis for the 
purpose of amortization is therefore $300,000 less $5,000 
(200,000/500,000 X $5,000), or $295,000.

Example (2). On July 31, 1956, the Y Corporation has an emergency facility (a building) which was completed on July 1, 1952, the entire basis of which is $500,000, and the unadjusted basis of which for the purpose of amortization is $300,000. The Corporation elected to begin amortization as of January 1, 1953. The only adjustment to its basis for the period July 1, 1952 to January 31, 1953, other than de-
preciation or amortization for January 1953, is $5,000 for depreciation during the base 
months of 1952. The adjusted basis for the 
purpose of amortization is therefore $300,000 less $5,000 
(200,000/500,000 X $5,000), or $295,000.
tracts involving the use of the facility, which future costs may be reimbursable under section 23 (1) (or paragraph)

In the case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility at a cost of $600,000. The certificate covers the entire acquisition. The X Corporation elects to take the amortization deduction with respect to such facility and to begin the 60-month amortization period which must start following the month of acquisition. On July 15, 1955, as a result of the cancellation of certain contracts with the X Corporation, the United States makes a payment of $300,000 to the corporation as compensation for the unamortized cost of such facility. The $300,000 payment is includible in gross income, as a deduction, for the taxable month in which such amount is so paid. Accordingly, the corporation is entitled to take an amortization deduction of $300,000 for such month, in lieu of the $10,000 amortization deduction which is otherwise allowable.

Example (2). On November 30, 1952, the X Corporation purchases an emergency facility, consisting of land with a building thereon, at a cost of $500,000, of which $300,000 is allocable to the land and $200,000 to the building. The certificate covers the entire acquisition. The X Corporation does not elect to take amortization deductions with respect to such facility. As it is entitled to a depreciation deduction with respect to the building at the rate of 3 percent per annum, or $750 per month. On August 15, 1954, due to certain contracts, the United States makes a payment of $400,000 to the corporation as compensation for the unamortized cost of such facility. The $400,000 payment is includible in the Y Corporation's gross income for August 1954. The adjusted basis of the facility as of the end of August 1954, computed without regard to any amortization deduction for such month, is $485,000, of which amount $200,000 is allocable to the land and $285,000 to the building. Accordingly, the corporation is entitled to increase the $750 depreciation deduction for August 1954 by the full amount of the $400,000 payment.

§ 39.124A (h) Statutory promissory, amortization deduction, life tenant and remainderman.

SEC. 124A. Amortization deduction. * * * (h) Statutory promissory, amortization deduction, life tenant and remainderman.

In the case of property held by one person for life with remainder to another person, the amortization deduction shall be allowable to the life tenant as of the end of the month in which such property is so paid and to the remainderman.

Example (2). As used in section 125, the term "bond" means any bond, note, debenture, debenture stock, stock in trade or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof) with interest coupons or in registered form, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included 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 to customers in the ordinary course of his trade or business. Since bonds owned by dealers in securities are excluded from the foregoing definition, section 125 has no application to such dealers. See, however, § 39.23 (o)–1.

(b) Operation. (1) In the case of a fully-tax-exempt bond, the amortizable bond premium for the taxable year is simply an adjustment to the basis of the bond.
method of accounting and is not allowable as a deduction for the estate or legatee; and

(ii) In the case of a partially tax-exempt bond:

(a) The interest accruing thereon for such period is similarly included upon its receipt in the gross income of the estate or legatee, as the case may be;

(b) The estate's or legatee's credit for such interest is not reduced on account of the amortizable bond premium for such period; and

(c) The deduction on account of the amortizable bond premium for such period is allowable as a deduction in the return for the decedent as in the case of a fully taxable bond.

(2) The application of the provisions of subparagraph (1) of this paragraph relating to a partially tax-exempt bond may be illustrated by the following example:

Example. At the time of his death in 1952, D owns a partially tax-exempt bond to which section 125 applies. For the period beginning January 1, 1952, and ending with December 31, 1952, the amount of interest included in D's gross income is $25 ($30 minus $5). In the case of a taxpayer whose tax is computed under Supplement T (section 400) or who elects to take the standard deduction (section 400) or who elects to take the standard deduction, an adjustment in the amount of $5, is allowable as a deduction, an adjustment in the amount of $5 is made to the basis or adjusted basis of the bond; and (ii) as a deduction; and (iii) as a deduction for the interest on the bond, provided section 25 (a) (1) or (2) or section 26 (a) accordingly. If the interest on such a partially tax-exempt bond for the taxable year is $30 and the amortizable bond premium thereon for such taxable year is $5, the $30 is included in the gross income, the $5 is allowable as a deduction, an adjustment in the amount of $5 is made to the basis or adjusted basis of the bond in accordance with the provisions of section 125, that the deduction for amortization of amortizable bond premium has been allowed for the purpose of determining the adjusted basis of the bond.

(3) In the case of a trust the income of which is distributable to the beneficiaries in whole or in part, where the trustee elects to amortize bond premium by deducting the amount thereof in the return filed for the trust on Form 1041, the distributable income of the trust determined in accordance with the provisions of sections 25 (a) (1) and 26 (a) (1) and thus no specific deduction is permitted under section 125 (a) (1) for amortization of bond premiums as such, it shall be deemed, if the taxpayer has elected to amortize bond premium in accordance with the provisions of section 125, that the deduction for amortization of amortizable bond premium has been allowed for the purpose of determining the adjusted basis of the bond.

§ 39.125 (a)-2 Bonds owned by decedents—(a) Cash basis decedents. (1) If a decedent on his income tax returns takes the cash basis for determining his income, the amortizable bond premium included in his gross income under section 125 shall be subtracted from his gross income, with each and every adjustment required under paragraphs (a) (1) and (2) of section 113 (a) (2) of the cost of the bond to the decedent. When the bond is redeemed on January 1, 1962, for $103, only the $10 attributable to the second 10 years will actually have been amortized. While the $10 attributable to the first 10 years will have been treated as an adjustment to the original bond premium but will not have been amortized. Consequently T will have a capital loss in the year of redemption on account of the $10 attributable to the period January 1, 1942, to January 1, 1952.

Example (2). On January 1, 1952, X's father gave him a fully taxable bond maturing on January 1, 1962. X's father had purchased the bond on January 1, 1942, for $103. X's father received no interest on the bond during the prior 10 years under this section, and to make the proper adjustments in the original bond premium, taxable income for the period January 1, 1942, to January 1, 1952, T would treat $10 as having been amortized during the first 10 years and would be required to amortize the remaining $10 over the following 10 years. When the bond is redeemed on January 1, 1962, for $103, only the $10 attributable to the second 10 years will actually have been amortized. The $10 attributable to the first 10 years will have been treated as an adjustment to the original bond premium but will not have been amortized. Consequently T will have a capital loss in the year of redemption on account of the $10 attributable to the period January 1, 1942, to January 1, 1952. 

§ 39.125 (b) Statutory provisions; amortizable bond premium, amount.

Sec. 125. Amortizable bond premium. * * *

(a) Amortizable bond premium—(1) Amount of bond premium. For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or, as an adjustment proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date of such redemption. 

(b) Method of determination. The determinations required under paragraphs (1) and (2) shall be made:

(A) In accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) In all other cases, in accordance with regulations prescribing the method of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary.

§ 39.125 (b)-1 Bond premium and amortizable bond premium. (a) Bond premium on any bond to which section 125 applies is the excess of the amount of the basis of the bond (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date. For determination of section 125, see § 39.125 (b) (2). 

(2) The application of the rule relating to adjustments set forth in paragraphs (a) and (b) of this section may be illustrated by the following examples:

Example (1). On January 1, 1932, T, who makes his income tax returns on the calendar year basis, owns a fully taxable $103 bond, maturing on January 1, 1952, T purchased this bond on January 1, 1942, for $120. T elects to have $120 applied to the bond. On January 1, 1942, T elects to have $120 applied to the bond. Thus, T owns a fully taxable bond for the period ending with his death. The bond with reference to a convertible bond include any such premium with respect to the bond.

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cost is lower than the fair market value of the bond at the time of the sale, and under section 117 (b) (2) X's holding period is deemed to include the 10 years during which his father held the bond. X is required to treat the bond as if the bond premium thereon had been amortized during his father's holding period, and the amount so amortized, $10 over the period January 1, 1952, to January 1, 1963, and in the year of redemption will have a capital loss on account of the $10 attributable to his father's holding period.

Example (3). Y, who makes his income tax returns on the calendar year basis, owns a tax-exempt $100 bond, maturing on January 1, 1961. He purchased this bond on January 1, 1941, for $100. On December 31, 1964, Y sells the bond for $108 and thereby realizes a gain of $8, computed as follows: (1) Total bond premium ($120 - $110) $20

(2) Amount of bond premium attributable to maturity (total bond premium minus unamortized bond premium attributable to 1941, $20 - $11) 9

(3) Amount of bond premium attributable to interest paid through Dec. 31, 1954 ($1 for each such year) 13

(4) Adjustment of bond at close of 1954 ($120 - $103) 17

(5) Gain ($108 - $107) 1

(c) Amortizable bond premium on any bond to which section 125 applies is that part of the bond premium on the bond as is attributable to the taxable years beginning before January 1, 1952.

§ 39.125 (b)-3 Callable and convertible bonds. (a) The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of section 125. For the purposes of such section, in the case of a callable 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 a bond is required to be spread over the period from the call date of which the basis for loss of the bond is established down to the earlier call date, rather than the maturity date. The earlier call date may be an intangible date specified in the bond as a day 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. A taxpayer who deducts amortizable bond premium with reference to a particular call date may thereafter use a different date in the calculation of amortization deductions with respect to such premium.

(b) A convertible bond is within the scope of section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof. However, for the purpose of determining the amount of amortizable bond premium on a convertible bond for the taxable year, the amount of bond premium shall not include any amount attributable to the conversion features of the bond. For the purposes of this rule, the term “convertible bond” includes a bond issued with detachable stock-purchase warrants.

(c) The value of the conversion features of a particular bond shall be determined by ascertaining the assumed price at which such bond would be purchased on the open market if without conversion features the bond was a basic bond and at such assumed price the yield on bonds of similar character, not having conversion features, are sold on the open market and adjusting the price of the bond in question to the assumed yield. This adjustment may be made by the use of standard bond tables. In selecting quotations for comparative purposes, bonds of the same classification and grade shall be used.

(2) The application of the principles set forth in this paragraph may be illustrated as follows: Example. T purchased for $115 a $100 bond, maturing in five years, on which interest is payable semiannually at the rate of 5.5 percent per year. This bond is convertible into common stock at the option of the holder. It is found that the cost of T's premium subject to amortization is $1.20. If, by reason of a standard bond table, it is found that the cost of a 13/2 percent 5-year $100 bond to yield 6.50 percent would have been $101.25, since the taxpayer paid $115 for the convertible bond, the difference between $115 and $101.25, or $13.75, represents the value of the conversion features of the bond at the time of the purchase. The balance of $3.50 represents the bond premium subject to amortization under section 125.

(d) If a convertible bond acquired on or before June 15, 1950, is held during the taxable year, the amortizable bond premium shall be computed as if the premiums for the determination of the bond premium without the inclusion of any amount attributable to the conversion features of the bond were applicable for each year in which the bond was held prior to such taxable year. If T, in the example in paragraph (c) (2) of this section, had acquired the bond on January 1, 1949, and if T makes his income tax returns on the basis of the calendar year, the amortizable bond premium for 1952 would be $9.55, determined as follows:

Bond premium not attributable to conversion feature $3.25

Amortizable bond premium for 1949 and 1950, determined as if the bond were not convertible $1.70

Amortizable bond premium attributable to conversion feature $1.05

§ 39.125 (b)-5 Methods of amortization. (a) The determinations of the bond premium and amortizable bond premium on any bond to which section 125 applies shall be made in accordance with:

(1) The method of amortization regularly employed by the taxpayer, if such method is reasonable; or

(2) 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 before January 1, 1952, or if for taxable years beginning on or after such date a taxpayer who has
The bond premium on any bond to which section 125 applies shall be determined with respect to the interest on which the credit provided in section 125 (a) (1) or (2) is allowable; and shall be computed as of the end of the taxable year (or of the date of disposition or redemption of the bond, if it was disposed of or redeemed in the taxable year, and if it was disposed of or redeemed in the taxable year by a taxpayer, bonds the interest on which is not excludible from gross income but with respect to which the credit provided in section 26 (a) (1) or (2), or section 26 (a) (8), as the case may be, is not allowable.

Text continues...
In the hands of the decedent if the decedent had lived and received such amounts.

(See Sec. 126 (a) as added by sec. 124 (e), Rev. Act 1941)

§ 39.126 (a) - 1. Inclusion in gross income of income in respect of a decedent.

(a) The gross income for the taxable year of a decedent in which falls the date of his death shall be 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 includible under such method in computing for such taxable year or any prior taxable year. See § 39.42-1. Such amounts include all the accrued income of a decedent who reported his income on the basis of cash receipts and disbursements, and, in the case of a decedent who reported his income under the accrual method of accounting, such amounts include contingent items which were not accrued by the decedent and, under § 39.42-1, all items (except the amount of partnership income includible under section 163) which were either accrued or included in his gross income for the taxable year of the decedent solely by reason of his death. For example, if the decedent who reported income on the basis of the accrual method of accounting was a member of the partnership, in computing his income for the taxable year, the partnership books would show such amounts as cash receipts, and disbursements, the decedent would be entitled at the date of his death to his distributive share of the accrued income of the partnership, although there would be included in his gross income only his distributive share of the partnership income computed on the basis of cash receipts and disbursements.

(b) 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 in lieu of the decedent or by a person entitled to such amounts by bequest, devise, or inheritance from the decedent on the reason of the death of the decedent. These amounts are included in the income of the estate and such persons when received by them, regardless of whether or not they report income on the basis of cash receipts and disbursements.

(c) The persons who are placed with respect to such amounts 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. If the application of this provision is the case of a decedent who owned a defense bond, with his wife as co-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 the amount accruing after the death of the decedent, would be treated as income to his widow when the bond is paid. Another example is the case of a partner whose partnership agreement provided that upon his death his interest in certain partnership assets would be transferred 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 which amount by which the widow's income to the extent they are attributable to the earnings of the partnership accrued only by reason of his death. The income reflected by the payments to the widow as trustee for minor children, and if the right to receive such payments is transferred to the children upon their majority, the children are within the provisions of section 126 (a) (2) 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 are attributable to the earnings of the partnership accrued only by reason of the death of the decedent.

Example. Suppose that A and the decedent B were equal partners in a business possessed of tangible assets having a present value considerably in excess of cost; suppose that certain current partnership business was well advanced toward completion before the death of B; suppose that the partnership agreement provided that, upon the death of one of the partners, all partnership assets, including unfinished business, shall pass to the surviving partner, and that the surviving partner should make certain payments to the estate of the decedent. To the extent that the payments by A are attributable to B's interest in the business which had appreciated in value, no gain on the sale of the assets held by A in his partnership interest would be recognized in A's hands. If the right to such payments is transferred to the surviving partner A, and the surviving partner is entitled to such payments, the fair market value of such right at the time of the transfer shall be included in the income of the estate of the decedent or of such person, plus the income which is included in its income as gross income under section 22 (b) or section 116 are not within the provisions of section 126.

(d) If the right to receive an amount of income in respect of a decedent is transferred by the estate or the person entitled to such amount by bequest, devise, or inheritance, or by reason of the death of the decedent, and the fair market value of such right at the time of such transfer exceeds the fair market value of such right at the time of such disposition must be included in the income of the donor, testator, or other transferor. Also placed in the same position with respect to such amounts as income to the extent they are attributable to the earnings of the partnership accrued only by reason of the death of the decedent. If the payments are to be made to the widow as trustee for minor children, and if the right to receive such payments is transferred to the children upon their majority, the children are placed in the same position or the provisions of section 126 (a) (2) 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 are attributable to the earnings of the partnership accrued only by reason of the death of the decedent.

Example. If the payments are attributable to the earns of the partnership accrued only by reason of the death of the decedent, and must include such payments when received in their income to the extent the payments are attributable to the earnings of the partnership accrued only by reason of the death of the decedent.

Example. Suppose that A and B were equal partners in a business possessed of tangible assets having a present value considerably in excess of cost; suppose that certain current partnership business was well advanced toward completion before the death of B; suppose that the partnership agreement provided that, upon the death of one of the partners, all partnership assets, including unfinished business, shall pass to the surviving partner, and that the surviving partner should make certain payments to the estate of the decedent. To the extent that the payments by A are attributable to B's interest in the business which had appreciated in value, no gain on the sale of the assets held by A in his partnership interest would be recognized in A's hands. If the right to such payments is transferred to the surviving partner A, and the surviving partner is entitled to such payments, the fair market value of such right at the time of the transfer shall be included in the income of the estate of the decedent or of such person, plus the income which is included in its income as gross income under section 22 (b) or section 116 are not within the provisions of section 126.

(e) If the right to receive an amount of income in respect of a decedent is transferred by the estate or the person entitled to such amount by bequest, devise, or inheritance, or by reason of the death of the decedent, and the fair market value of such right at the time of such transfer exceeds the fair market value of such right at the time of such disposition must be included in the income of the donor, testator, or other transferor. Also placed in the same position with respect to such amounts as income to the extent they are attributable to the earnings of the partnership accrued only by reason of the death of the decedent.
his death 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 received such amount. The estate or such person is placed in the same position with respect to the nature of this income as the position the decedent enjoyed. Thus, if the income would have been capital gain to the decedent if he had lived and had received it, from the sale of property held for more than six months, the income when received, or its fair market value if transferred, shall be treated in the hands of the estate or of such person as gain from the sale of the property, held for more than six months, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale. Similarly, if the income is interest on United States obligations owned by the decedent, such income shall be treated in the hands of the estate or of such person as interest on United States obligations in the hands of the person receiving it, for the purpose of determining the credit provided by sections 25 (a) (1) and (2) as if such person owned the obligations and it was the person to which such interest is paid. If the amount would have constituted earned income to the decedent, in the case of the accrued wages of a decedent who reported income on the basis of cash receipts and disbursements, such amount shall constitute earned income to the person including such amount in his gross income, as if he had been engaged in place of the decedent in the transaction in which the amount was earned. If the amounts received would be subject to special treatment under section 107 if the decedent had lived and included such amounts in his gross income, section 107 applies. Similarly, the provisions of sections 105 and 106, relating to the surtax attributable to foreign source income, applicable to a foreign source of gas property and to certain claims against the United States, apply to any amount included in gross income, the right to which was obtained by the decedent by reason of the death of a member of his family or of his household in accordance with the provisions of those sections. The surtax attributable to the inclusion in the gross income of the person receiving the amount referred to in the preceding sentence shall not exceed 30 percent of such amount.

§ 39.126 (b) Statutory provisions; income in respect of decedents; allowance of deductions and credit.

Sec. 126. Income in respect of decedents.

(a) Under section 126 (b) the expenses, interest, and taxes described in section 23 (a) (b) and (c) for which the decedent was liable, which were not properly allowable as a deduction in his last taxable year or any prior taxable year, are allowed when paid (1) as a deduction from the gross income of the estate or person described in subsection (a), (A), (B), or (C) who, in the manner described in this section, receives the income to which the deduction relates, in the taxable year in which such income is received.

[b] If the estate of the decedent is not liable to discharge the obligation to which the deduction or credit relates, to the person in whose hands the income in respect of the decedent was liable, by reason of the death of the decedent or by bequest, devise, or inheritance, subject to such obligation, from the decedent an interest in property of the decedent.

(c) Deduction for estate tax—(1) Allowance of deduction. A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a) (1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person includes such 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) (1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b).

(2) Method of computing deduction. For the purposes of paragraph (1)

(A) The term "estate tax" means the tax imposed upon the estate of the decedent under section 810 or 665, reduced by the credits against such tax, plus the tax imposed upon the estate of the decedent under section 833, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a) (1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a) (1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b).

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value.

§ 39.126 (c) Deduction for estate tax attributable to income in respect of decedent.

(a) 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. This deduction 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 that section, that is, the excess of the value 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 claims which represent the deductions and credit in respect of the decedent described in section 126 (b).

The portion of the estate tax (the sum of the basic estate tax and the additional estate tax, reduced by the credits against such tax) attributable to the inclusion in the gross estate of such net value is the excess of the estate tax over the estate tax computed without including such items in the gross estate.
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tax computed without including 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 shall be determined as the amount attributable to such portion as the value in the gross estate of the right to the income included by the estate or such person in gross income bears to the value in the gross estate of all the items of gross income in respect of the decedent.

(b) Section 126 (c) is illustrated by the following example:

Example. X, an attorney who kept his books on the basis of the cash receipts and disbursements method of accounting, was entitled at the date of his death to a fee for services rendered in a case not completed at the time of his death, which fee was valued in his estate at $1,000, and to accrued bond interest which was valued at $800. In all, $1,800 was included in his gross estate in respect of income described in section 126 (a) (1). There were deducted as claims against his estate for business expenses for which his estate was liable, and $60 for taxes accrued on certain property he owned. In all, $1,860, which represent the deductions described in section 126 (b) (which are allowable as deductions to his estate or to the beneficiary of the income) His gross estate is $185,600 and his net estate, computed without deducting any specific exemption, which is determined as the total basic and additional estate tax (reduced by credits against such tax) is $23,625. In the year following the death of X, his estate collected the fee in the amount of $1,000, which amount is included in the income of the estate. The estate may deduct, in computing its income for the year, $900 on account of the estate tax attributable to such income; computed as follows:

(1) Value of income described in section 126 (a) (1) included in computing gross estate $1,500

(2) Deductions in computing gross estate for claims against estate representing deductions described in section 126 (b) 200

(3) Net value of items described in section 126 (a) (1) 1,300

(4) Estate and additional estate taxes, less credits against such taxes 23,625

(5) Less: Estate tax computed without including $1,500

Item (1) (II) in gross estate 22,235

(6) Part of estate tax attributable to net value of income items 390 1,000

(7) Value in gross estate of income received by estate in taxable year 1,000

(8) Value in gross estate of all income items described in section 126 (a) (1) (Item (1) (II) (III)) 1,500

(9) Part of estate tax deductible on receiving the $1,200

$0.80 on $900 200

Although $200 was later collected as the fee, only the $1,000 actually included in the gross estate is taxable for estate tax purposes.

May elect to determine the worthlessness of its interest, described in this 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) (2) (A) (2) (1) or (2) (2) (B) (1) and the adjusted basis of the assets of the corporation for the purposes of subsection (e), but such amount shall be treated under subsection (c) (2) (2) (B) (1) as a recovery by the taxpayer in the taxable year with respect to such interest.

(c) Recoveries. The taxpayer's choice of a date under paragraph (1) or (3) shall be effective only if made within such time and in such manner as may be prescribed by regulations prescribed by the Commissioner with the approval of the Secretary.

[Sec. 127 (a) as added by sec. 156 (a), Rev. Act 1942]

§ 39.127 (a) (1) War losses generally.

For regulations governing the treatment of war losses, see § 39.127 (a) (1) to 39.127 (a) (4), inclusive, 29.127 (b) (1), and 26.127 (c) (1) of Regulations 111 (26 CFR, 1949 ed., Supps.)

§ 39.127 (b) (c) Statutory provisions; war losses; amount of loss; recoveries.

§ 39.127 (b) (c) General rule. Upon the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized, the amount of such recovery shall be included in gross income to the extent provided in paragraph (3), unless the provisions of paragraph (3) are revoked as applicable to the taxpayer by the election made by the taxpayer under the provisions of paragraphs (5).
Amount of recovery. The amount of the recovery of any money or property in respect of property considered under subsection (a) as destroyed or seized shall be an amount equal to the aggregate of such money and the fair market value of such property, determined as of the date of the recovery.

Amount of gain includable. To the extent that the aggregate of the amounts of previous such recoveries do not exceed that part of the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a) which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income and shall not be deemed 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 the amounts of previous such recoveries exceeds that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2 and do not exceed that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income but shall not be deemed 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 the amounts of previous such recoveries 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 and shall be recognized or not recognized as provided in section 112 (f).

Adjustment for prior tax benefits. (1) If for any previous taxable year the taxpayer chooses under subsection (b) to treat any obligations and liabilities as discharged or satisfied out of the property or interest described in subsection (a), and if such obligations and liabilities were not so discharged or satisfied, the amount of such obligations and liabilities treated as discharged or satisfied under subsection (b) shall be considered in determining the amount of gross income to which the provisions of subsection (a) as destroyed or seized, which is not in excess of the allowable deductions in prior taxable years with respect to any prior year which would result in the aggregate of the amounts of previous such recoveries do not exceed that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income and shall not be deemed 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 the amounts of previous such recoveries exceeds that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2 and do not exceed that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income but shall not be deemed 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 the amounts of previous such recoveries 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 and shall be recognized or not recognized as provided in section 112 (f).

The amount to be added to the tax for such taxable year under the provisions of paragraph (b), (2),

Any deficiency for such taxable year or for any other taxable year, to the extent of the amount of the recovery determined under this subsection or in respect of property considered under subsection (a) as destroyed or seized, which is not in excess of the allowable deductions in prior taxable years with respect to any prior year which would result in the aggregate of the amounts of previous such recoveries do not exceed that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income and shall not be deemed 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 the amounts of previous such recoveries exceeds that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2 and do not exceed that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income but shall not be deemed 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 the amounts of previous such recoveries 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 and shall be recognized or not recognized as provided in section 112 (f).

Gain upon recovery. The amount of any recovery of money or property considered under subsection (a) as destroyed or seized, which is not excluded from gross income for any taxable year by reason of this section which resulted in the recovery of the same interest, considered under subsection (a) as destroyed or seized, the fair market value of such property, determined as of the date of the recovery. For the purpose of this paragraph, in the case of the recovery of the same property or interest considered under subsection (a) as destroyed or seized, the fair market value of such property or interest included in gross income for any taxable year shall not be deemed a gain upon the involuntary conversion of property as a result of its destruction or seizure.

Restoration of property. Restoration in whole or in part of the value of property considered under this subsection or in respect of property considered under subsection (a) as destroyed or seized shall be considered as destruction of such property for the purposes of this subsection. Such restoration shall be treated as the recovery of the same interest considered under subsection (a) as destroyed or seized.

Restoration of property in respect of property considered under section 127 (a) as destroyed or seized shall be considered as destruction of such property for the purposes of this subsection. Such restoration shall be treated as the recovery of the same interest considered under subsection (a) as destroyed or seized.
recovered under such provisions, and the manner of making such election, see paragraphs (c) and (d) of this section.

(2) Except as provided in section 127 (c) (3) (A) and in this paragraph, the amount of the recovery in respect of a war loss in a previous taxable year is determined in the same manner for the purpose of section 127 (c) (2) or (3) as for the purpose of section 127 (a) (2) or (3) as of the date of the recovery, but in case of such property both determined as of the date of the recovery and as of the date of the determination of the amount of the obligations or liabilities as discharged or satisfied out of such property, and such deduction was claimed beginning in the order of the taxable years in which such deduction was allowed in respect of any such recoveries, as follows:

The amount of the recoveries for any taxable year are not includible in gross income under subdivision (1) of this subdivision if

any such tax under chapter 1 or chapter 2 of the Internal Revenue Code, as determined under § 39.112 (f) (1), exceeds the amount of all previous recoveries in the same and prior taxable years. Similarly, the only losses allowable but not actually allowed as a deduction, and second on account of war losses allowed as a deduction but which did not result in a reduction of any such tax for two or more taxable years which did not result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2. Any further recoveries in excess of the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which was not included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).

The determination as to whether and to what extent any recoveries are to be included in gross income is made upon the basis of the amount of all the recoveries in respect of any taxable year and if such recovery are included in gross income, such gain is recognized or not recognized under the provisions of section 112 (1). See § 39.112 (f) (1).

Such gain, if recognized, is included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).

(2) The amount of the recoveries for any day is not included in gross income under subdivision (1) of this subdivision if such recovery is included in gross income as ordinary income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of the allowable deductions in prior taxable years on account of war losses which did not result in a reduction of any tax of the taxpayer under chapter 1 or chapter 2 of the Internal Revenue Code, as determined under § 39.127 (f) (1), exceeds the amount of all previous recoveries in the same and prior taxable years. Similarly, the only losses allowable but not actually allowed as a deduction, and second on account of war losses allowed as a deduction but which did not result in a reduction of any such tax for two or more taxable years which did not result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) (1) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2. Any further recoveries in excess of the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) (1) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which was not included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).

The determination as to whether and to what extent any recoveries are to be included in gross income is made upon the basis of the amount of all the recoveries in respect of any taxable year and if such recovery are included in gross income, such gain is recognized or not recognized under the provisions of section 112 (1). See § 39.112 (f) (1).

Such gain, if recognized, is included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).

(2) The amount of the recoveries for any day is not included in gross income under subdivision (1) of this subdivision if such recovery is included in gross income as ordinary income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of the allowable deductions in prior taxable years on account of war losses which did not result in a reduction of any tax of the taxpayer under chapter 1 or chapter 2 of the Internal Revenue Code, as determined under § 39.127 (f) (1), exceeds the amount of all previous recoveries in the same and prior taxable years. Similarly, the only losses allowable but not actually allowed as a deduction, and second on account of war losses allowed as a deduction but which did not result in a reduction of any such tax for two or more taxable years which did not result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) (1) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2. Any further recoveries in excess of the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) (1) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which was not included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).

The determination as to whether and to what extent any recoveries are to be included in gross income is made upon the basis of the amount of all the recoveries in respect of any taxable year and if such recovery are included in gross income, such gain is recognized or not recognized under the provisions of section 112 (1). See § 39.112 (f) (1).

Such gain, if recognized, is included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).

(2) The amount of the recoveries for any day is not included in gross income under subdivision (1) of this subdivision if such recovery is included in gross income as ordinary income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of the allowable deductions in prior taxable years on account of war losses which did not result in a reduction of any tax of the taxpayer under chapter 1 or chapter 2 of the Internal Revenue Code, as determined under § 39.127 (f) (1), exceeds the amount of all previous recoveries in the same and prior taxable years. Similarly, the only losses allowable but not actually allowed as a deduction, and second on account of war losses allowed as a deduction but which did not result in a reduction of any such tax for two or more taxable years which did not result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) (1) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2. Any further recoveries in excess of the amount of all such recoveries in respect of any war loss which did result in a reduction of any such tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See § 39.127 (f) (1) for the determination of the amount of such deductions.

Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of all such recoveries in respect of any war loss which was not included in gross income as ordinary income unless section 127 (f) (1) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 39.112 (f) (1).
if any, of the amount of the recoveries for such day which is not included in gross income under subdivision (i) of this subparagraph.

(iii) The amount of the recoveries for any day which is not included from gross income under subdivision (i) of this subparagraph may be allocated among all such recoveries on account of the property considered under section 127 (a) as destroyed or seized in any previous taxable year or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered to be derived from property described in seizure, and is not recognized.

The total gain described in this section, and the nonrecognized gain for such day, and the extent the recovery for such day is so expended.

If such gain is recognized, it is included in gross income as ordinary income, or, if it is not recognized, the taxpayer may apply the provisions of section 112 (f) and (j) to the extent of the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. The remaining $1,800 of the recovery is considered gain on the involuntary conversion of property relating in service or otherwise attributable to the destruction or seizure of such property. Under the provisions of section 117 (d), the amount included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of $700, the amount by which the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.

The tax imposed under chapter 1, as follows:

Example (1). The taxpayer sustained war losses on the involuntary conversion of property A, B, and C. The amount of $1,000 did not result in a reduction of any income tax of the taxpayer, as determined under the provisions of section 112 (f) and (j). The aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. The remaining $1,800 of the recovery is considered gain on the involuntary conversion of property relating in service or otherwise attributable to the destruction or seizure of such property. Under the provisions of section 117 (d), the amount included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of $700, the amount by which the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.

The total gain described in this section, and the nonrecognized gain for such day, and the extent the recovery for such day is so expended.

If such gain is recognized, it is included in gross income as ordinary income, or, if it is not recognized, the taxpayer may apply the provisions of section 112 (f) and (j) to the extent of the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. The remaining $1,800 of the recovery is considered gain on the involuntary conversion of property relating in service or otherwise attributable to the destruction or seizure of such property. Under the provisions of section 117 (d), the amount included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of $700, the amount by which the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.

The tax imposed under chapter 1, as follows:

Example (1). The taxpayer sustained war losses on the involuntary conversion of property A, B, and C. The amount of $1,000 did not result in a reduction of any income tax of the taxpayer, as determined under the provisions of section 112 (f) and (j). The aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.

The total gain described in this section, and the nonrecognized gain for such day, and the extent the recovery for such day is so expended.

If such gain is recognized, it is included in gross income as ordinary income, or, if it is not recognized, the taxpayer may apply the provisions of section 112 (f) and (j) to the extent of the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. The remaining $1,800 of the recovery is considered gain on the involuntary conversion of property relating in service or otherwise attributable to the destruction or seizure of such property. Under the provisions of section 117 (d), the amount included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of $700, the amount by which the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.

The tax imposed under chapter 1, as follows:

Example (1). The taxpayer sustained war losses on the involuntary conversion of property A, B, and C. The amount of $1,000 did not result in a reduction of any income tax of the taxpayer, as determined under the provisions of section 112 (f) and (j). The aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.

The total gain described in this section, and the nonrecognized gain for such day, and the extent the recovery for such day is so expended.

If such gain is recognized, it is included in gross income as ordinary income, or, if it is not recognized, the taxpayer may apply the provisions of section 112 (f) and (j) to the extent of the aggregate of the allowable deductions for prior taxable years on account of war losses which did not exceed the aggregate of the allowable deductions for prior taxable years on account of war losses, and the nonrecognized gain for such day is not included in gross income. Therefore, the provisions of section 117 (d) apply to this gain: for prior taxable years on account of war losses, or any taxable year which begins after the date of the recovery. The portion of any such recovery which is not included in gross income is considered derived from property described in seizure, and is not recognized.
gross income of such year and is not considered gain on an involuntary conversion to the extent that such income does not exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of such property (whether or not such deduction was reduced by the tax of the taxpayer) reduced by the aggregate amount of any recoveries in intervening taxable years in respect of the same property. See § 38.3801 (d)-1.

However, the computation of the excess profits credit under chapter 2E for any taxable year shall be determined by the adjustment provided in this subparagraph. All credits allowable against the tax for any year shall be taken into account in computing the increase in the tax for such taxable year. The increases referred to above shall be added. After the tax previously determined has been ascertained, such tax shall be recomputed by disregarding such allowable deduction (to the extent that it does not exceed the sum of the amount of such deduction and the increase in such gross income for the taxable year of such recovery, plus the aggregate amount of any recoveries in intervening taxable years in respect of the same property and any other deductions allowable on account of other war losses or any other losses, expenditures or accruals in such prior taxable year in respect of which, and to the extent that, recoveries in intervening taxable years have been excluded from gross income under section 127 (a) (3), section 22 (b) (12) or otherwise. The increase, if any, in the tax previously determined and the tax as recomputed will be the increase in the tax previously determined for the taxable year.

(b) If recognized as used in the provisions of section 112 (f) relating to gain upon the destruction or seizure of property (as used in section 112 of the Code). In computing the amount of the increase in the tax previously determined under chapter 1 or chapter 2 for any taxable year which is not excluded from gross income under subdivision (b) of this subparagraph, the increase shall be included in the tax as recomputed will be the increase in the tax previously determined for the taxable year. The increase, if any, in the tax previously determined for any taxable year (including the taxable year of recovery) in which an unused excess profits credit was allowed of in computing the excess profits credit for such taxable year, if all or a part of such adjustment was attributable to the carry-over or carry-back to such taxable year of an unused excess profits credit from another taxable year in which a deduction was allowable on account of the destruction or seizure of the property in respect of which there was a recovery in the taxable year to which such increase is to be added. After the tax previously determined has been ascertained, such tax shall be recomputed by disregarding such allowable deduction (to the extent that it does not exceed the sum of the amount of such deduction and the increase in such gross income for the taxable year of such recovery, plus the aggregate amount of any recoveries in intervening taxable years in respect of the same property and any other deductions allowable on account of other war losses or any other losses, expenditures or accruals in such prior taxable year in respect of which, and to the extent that, recoveries in intervening taxable years have been excluded from gross income under section 127 (a) (3), section 22 (b) (12) or otherwise. The difference between the tax previously determined and the tax as recomputed will be the increase in the tax previously determined for the taxable year. In case there is an increase in the excess profits tax carry-over or carry-back in any taxable year in which an unused excess profits credit was allowed of in computing the excess profits credit adjustment, and a decrease in the tax under chapter 1 for such taxable year, the increase in the tax previously determined shall be considered to be an amount equal to the excess of the increase in the excess profits tax over the decrease in the income tax.

(iv) The increase, if any, in the tax previously determined for any taxable year in which an unused excess profits credit was allowed of in computing the excess profits credit adjustment for such taxable year, if all or a part of such adjustment was attributable to the carry-over or carry-back to such taxable year of an unused excess profits credit from another taxable year in which there was a net operating loss deduction attributable to the carry-over or carry-back to such taxable year of a net operating loss, and such net operating loss resulted in whole or in part from the deduction allowable on account of the destruction or seizure of the property in respect of which there

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is a recovery in the taxable year to which such increase is to be added. After the tax previously determined has been as-
certained, such recovery is added to the basis of the property by disregarding such allowable war loss deduction and such unused excess profits credit carry-over or carry-back. In the redetermination of such net operating loss deduction and such unused excess profits credit carry-over or carry-back shall be recomputed by disregarding such allowable war loss deduction (to the extent that such deduction does not exceed the unused excess profits credit carry-over or carry-back) and by disregarding any other deduc-
tions allowable on account of other war losses or any other losses, expenditures, or accruals in the taxable year in re-
spect of which, and to the extent that, such recovery in intervening taxable years in respect of the same property) and by disregarding any other deduc-
tions allowable on account of other war losses or any other losses, expenditures, or accruals in the taxable year in re-
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tions allowable on account of other war losses or any other losses, expenditures, or accruals in the taxable year in re-
spec...
§ 59.127 (d)–1. Basis of recovered property.—(a) General rule. (1) Under section 127 (d) (1) the unadjusted basis of any property treated as a war loss under section 127 shall be the unadjusted basis of any property which is recovered in lieu of or on account of any such war loss. The application to the Commissioner for the allocation of the aggregate of the allowable deductions for prior taxable years on account of war losses, shall be in the unadjusted basis of any property which is recovered in lieu of or on account of any such war loss. The unadjusted basis of any property which is recovered in lieu of or on account of any such war loss is considered the fair market value of the property recovered upon the date of its recovery. The fair market value of the property is reduced by the total gain, if any, for such day derived from such recovered property as determined under § 59.127 (c)–1 (b).

(b) Property recovered in taxable year to which section 127 (e) (3) is applicable. If, pursuant to an election made by the taxpayer under section 127 (e) (5) and § 39.127 (c)–1 (d), the provisions of section 127 (e) (3) are applicable to any tax year in which property is recovered in respect of a war loss under section 127, the unadjusted basis of such property shall be the fair market value of such property as determined under section 127, and a statement as to whether there has been any substantial change in the use or nature of the property chosen for the allocation of the recovery from its nature or use immediately before its treatment as destroyed or seized. Such application will be allowed unless there has been such a substantial change in the nature or use of such property that the allocation of the adjusted basis would produce an arbitrary result, or unless the taxpayer has obtained such tax benefits by reason of the basis determined under subparagraph (1) of this paragraph and it is equitable to change his basis. Thus, for example, if it would be inequitable to change his basis, the allocation will not be allowed if it would give the taxpayer an unadjusted basis with respect to such property which is less than the amount of the adjustments in reduction of the basis of such property which are allowable after its recovery. For example, when property A is recovered it has an unadjusted basis of $100. After $70 depreciation has been allowed on A, an allowance is sought which would give A an unadjusted basis of $80. Since this is a basis which is less than an adjusted basis against such basis, the allocation will not be permitted.

(2) The amount of any adjustments to the unadjusted basis determined under subparagraph (1) of this paragraph shall, upon the allocation of the property, be taken as an adjustment to the allocated unadjusted basis. Thus, if $30 depreciation was allowed upon an asset in his hands which is then an adjustment against such basis, the allocation will not be permitted.

(3) The taxpayer may choose any group of properties recovered for allocation except that if any such properties form one economic 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 property, nor may one block of stock in a corporation be separated from other stock in such corporation or from other property which are also treated as a recovery. If the taxpayer has once been 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.

§ 59.127 (d)–1
which such loss is allocable. Such part of the stock or other interest of the taxpayer shall be treasurized tax-deductions (b), (c), and (d) as property described in subsection (a) (2).

(3) Application of paragraph (4). For the purposes of paragraph (1) —
(A) In determining the adjusted basis of all the property of the corporation, there shall be excluded monetary the United States or in a territory of the United States with respect to such tax-loss to a carry-over or carry-back of net losses on account of war losses — are all the deductions on account of the case of recoveries of war losses and the deductible provision of section 22 of any later date falling within or before the taxable period.

(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

[Sec. 127 (e) as added by sec. 159 (a), Rev. Act 1942]

§ 39.127 (1). Determination of tax benefits from allowable deductions. (a) 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, tax-loss, or loss on account of war deposits, the right to receive money from any person not situated in a country at war with the United States or in a territory of the United States except that there shall not be excluded any such property which is destroyed or seized as described in subsection (a) within or before the taxable period.

(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

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(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

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(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

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(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

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(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

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(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

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§ 39.127 (1). Determination of tax benefits from allowable deductions. (a) 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, tax-loss, or loss on account of war deposits, the right to receive money from any person not situated in a country at war with the United States or in a territory of the United States except that there shall not be excluded any such property which is destroyed or seized as described in subsection (a) within or before the taxable period.

(3) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

[Sec. 127 (e) as added by sec. 159 (a), Rev. Act 1942]
(a) The term “allowance” refers to anything in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among other things, a disallowance, an adjustment, an exemption, or an exclusion.

(b) The phrase “evasion or avoidance” means any case involving a willful failure to pay, collect, or pay over any tax due, or to timely file any return or statement required under the internal revenue laws, and includes an attempt, or conspiring with another to effectuate, an evasion or avoidance of Federal income or excess profits tax. See § 39.129. The phrase “evasion or avoidance” is not limited to cases involving a willful failure to pay, collect, or pay over any tax due, or to timely file any return or statement required under the internal revenue laws, and includes an attempt, or conspiring with another to effectuate, an evasion or avoidance of Federal income or excess profits tax for which such person, or persons, would be liable. See § 39.129–3. Instances in which section 129 (a) disallows a deduction, credit, or other allowance. (a) Section 129 specifies two instances in which a deduction, credit, or other allowance is to be disallowed. These instances, described in clauses (1) and (2) of section 129 (a), are those in which:

(1) Any person or persons acquire, directly or indirectly, on or after October 8, 1940, property of another person or persons or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances as and when determined, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(2) To exercise his powers In part under paragraphs 1 and 2 in part under paragraph 2.

[Sec. 129 as added by sec. 128 (a), Rev. Act 1941]

§ 39.129–1 Meaning and use of terms. As used in section 129 and the regulations thereunder—
with clause (1) of section 129 (a) are the following:

(1) A corporation (or the interest controlling such a corporation) with large profits acquires control of another corporation with current, past, or prospective credits, net operating losses, unused excess profits credits, or other allowances and the acquisition is followed by such transfers or other action as is necessary to bring the deduction, credit, or other allowance into conjunction with the income; or

(2) A corporation with large profits transfers the assets of each of its branches or of any newly organized corporations in order to secure a larger fair market value at the time of such acquisition in order to secure a larger fair market value at the time of such acquisition than those for interest and taxes) exceed the gross income derived from such trade or business.

(3) A corporation with high earning assets transfers them to a newly organized subsidiary retaining assets likely to produce losses or to be disposed of at a loss for the purpose of securing refunds through a utilization of the unused excess profits carry-back or the net operating loss carry-back.

(e) If the requisite acquisition and purpose exist, among the transactions within clause (a) (3) is the following: A corporation acquires property having in its hands a substituted basis which is materially greater than its fair market value at the time of such acquisition in order to secure a larger excess profits credit or to utilize the property to create tax-reducing losses.

§ 39.130-4 Power of Commissioner to allocate deduction, credit, or allowance in part. The Commissioner is authorized by section 129 (a) to allocate the amount disallowed by section 129 (a) but he may allow such part only if and to the extent that he determines that the amount allowed will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made. The Commissioner is also authorized to use other methods to give effect to part of the amount disallowed under section 129 (a) but only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made. Whenever appropriate to give proper effect to the deduction, credit, or other allowance, or such part of it which may be allowed, this authority includes the distribution, apportionment, or allocation of both the gross income and the deductions, credits, or other allowances the benefit of which was sought, between or among the corporations, or properties, or parts thereof, involved, and includes the disallowance of any such deduction, credit, or other allowance to any of the taxpayers involved.

§ 39.130-1 Limitation on deductions allowable to individuals in certain cases—(a) Recomputation of net income. Section 130 serves to limit the deductions, other than those for interest and taxes, attributable to a trade or business carried on by an individual, to only such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made.

(b) Redetermination of tax. Upon the basis of the net income computed under the provisions of subsection (a) of this section, and subject to the provisions of section 1261, the tax imposed by this chapter shall be recomputed for each such taxable year.

(c) Extension of statute of limitations. Notwithstanding any law or rule of law (other than section 3671, relating to compromises) any increase in the tax previously determined for such taxable year shall be considered a deficiency for the purposes of this section. For the purposes of this section the term "deficiency as determined" shall have the meaning assigned to such term by section 3801 (d).

§ 39.130-1 Limitation on deductions allowable to individuals in certain cases—(a) Recomputation of net income. If any net operating loss carry-over from a year which falls within the provisions of section 129 to a year which does not fall within such provisions, the amount of the net operating loss carry-over specified in section 129 shall be recomputed by the net income (computed as provided in § 39.122-4) and, in the case of any taxable year which falls within the provisions of section 129, determined after the application of section 19431 to any net operating loss preceding or succeeding the taxable year of the net operating loss to which such loss must first be carried back or carried over under the provisions of section 129 (b) even though the net operating loss deduction is not an allowable deduction for such preceding or succeeding taxable year.

(2) If an individual carries on several trades or businesses, the deductions attributable to such trades or businesses, and the gross income derived from such trades or businesses, shall not be aggregated in determining whether the deductions (other than those for interest and taxes) exceed the gross income derived from such trades or businesses by more than $50,000 in any taxable year. Each trade or business shall be considered separately. The trade or business carried on by the individual must be the same in each of the five consecutive taxable years in which the deductions attributable to such trades or businesses, and the gross income derived from such trades or businesses, exceed the gross income derived from such trade or business by more than $50,000.

§ 39.130 Statutory provisions; limitation on deductions allowable to individuals in certain cases—(a) Recomputation of net income. If the deductions (other than taxes and interest) attributable to a trade or business carried on by an individual, or other allowances which are attributable to such trade or business, are other than those for interest and taxes, such deductions, credits, or other allowances shall each be recomputed for each of such taxable years. In recomputing the net income for each of the five taxable years, deductions (other than those for interest and taxes) attributable to the trade or business, and otherwise allowable under the provisions of chapter 1, shall be recomputed for each of such taxable years. For purposes of this section, a given taxable year may be part of two or more different periods of five consecutive taxable years. Thus, if the deductions, other than those for interest and taxes, attributable to a trade or business carried on by an individual exceed the gross income from such business by more than $50,000 for each of six consecutive taxable years, the fifth taxable year shall be considered to be a part both of a five-year period beginning with the first and ending with the fifth taxable year and of a five-year period beginning with the second and ending with the sixth taxable year.

(b) Redetermination of tax. The tax imposed by chapter 1 for each of the five consecutive taxable years specified in paragraph (2) of this section shall be recomputed upon the basis of the net income of the individual recomputed in...
the manner described in paragraph (a) of this section. If the assessment of a deficiency is prevented (except for the provisions of sections 3601, relating to limitation of time for determination of deficiency and other provisions in income tax cases, or 3807, relating to period of limitation in case of related taxes under chapter 276, relating to the operation of any provision of law (e. g., sections 275 and 276, relating to the period of limitation upon assessment and collection) except section 275(b) of this title, or by any rule of law (e. g., res judicata) then the excess of the tax for such year as recomputed over the tax previously determined for such year shall be considered a deficiency for purposes of section 130. The term "tax previously determined" shall have the same meaning as the term "tax determined" relating to period of limitation upon assessment of tax previously determined for such year or in the case of a series of such exchanges or transfers of stock, as described in section 271, relating to the period of limitation upon the assessment of tax). (b) The fair market value of the stock at the time of the granting of the option or, if no disposition of such stock by him, in the event of his death (whenever occurring) shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income for the taxable year in respect of which the option price is exceeded by the lesser of— (1) The fair market value of the stock at the time of the granting of such option; or (2) The fair market value of the stock at the time the option was granted. (c) Treatment of restricted stock options. If the option price is at least 115 per centum of the fair market value of the stock at the time such option is granted, does not own stock possessing more than 10 per centum of the total combined voting power of all classes of stock in one of the other corporations in such chain. (1) Restricted stock option. The term "restricted stock option" means an option granted after February 1, 1945, to an individual, at the time such option is granted, if it is an option (A) at the time such option is granted the option price is at least 85 per centum of the fair market value of the stock subject to the option; and (B) Such option by its terms is not transferable except in accordance with such restrictions as may be imposed by the corporation; and (C) Such option, at the time the option is granted, does not own stock possessing more than 10 per centum of the total combined voting power of all classes of stock of the employer corporation or of a parent or subsidiary corporation. For the purposes of this paragraph: (i) Such individual shall be considered as owning the stock referred to if the word or words of ownership refer to the person or corporation who, if the word or words of ownership were the word or words of ownership of the individual, would have such right of ownership; and (ii) Such individual shall be considered as owning the stock referred to if the word or words of ownership refer to the person or corporation who, if the word or words of ownership were the word or words of ownership of the individual, would have such right of ownership; and 

§ 39.130A

Statutory provisions; employee stock options.

Sec. 130A. Employee stock options—(a) Treatment of restricted stock options. If a share of stock is transferred to an individual pursuant to the exercise of a restricted stock option, and no disposition of such share is made by him within two years from the date of the granting of the option nor within six months after the transfer of such share to him— (1) such option shall result at the time of the transfer of such share to the individual upon the exercise of the option with respect to such share; (b) No deduction under section 23 (a) shall be allowable at any time to the employer corporation of such individual or its parent or subsidiary corporation in respect of any amount other than the option price actually paid by such individual for such stock; (c) Stock owned, directly or indirectly, by (i) a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, beneficiaries, or for its shareholders, partners, or beneficiaries, unless it appears from the record of the corporation or partnership, or the books of the trust, for which it was owned, that it was owned for the benefit of any person other than its shareholders, partners, or beneficiaries; (d) Parent corporation. The term "parent corporation" means any corporation (other than the employer corporation) in which the employer corporation owns stock possessing more than 50 per centum of the total combined voting power of all classes of stock in one of the other corporations in such chain, or in the case of related taxes under chapter 276, relating to the period of limitation upon the assessment of tax). (e) Subsidiary corporation. The term "subsidiary corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing more than 50 per centum of the total combined voting power of all classes of stock in one of the other corporations in such chain, or in the case of related taxes under chapter 276, relating to the period of limitation upon the assessment of tax). (f) Disposition. The term "disposition" includes a sale, exchange, gift, or any transfer of legal title, but does not include— (A) A transfer from an estate or a transfer by bequest or inheritance; (B) An exchange which is within the provisions of subsection (c); or (C) A mere pledge or hypothecation, or (g) Stockholder approval. If the grant of an option is subject to the approval of the shareholders, the date of grant of the option shall be determined as if the option had not been subject to such approval. (h) Modification, extension, or renewal of option. For the purposes of subsection (d), if the terms of any option to purchase stock are not modified, extended, or renewed, the following rules shall be applied with respect to transfers of stock made upon an exercise of the option after the making of such modification, extension, or renewal— (1) Such modification, extension, or renewal shall be considered as the granting of a new option; (2) The fair market value of such stock at the time of the granting of such option shall be considered as the fair market value of such stock on the date of the original granting of the option; (3) Such option shall be considered as not being an option referred to in subsection (c) to the extent of any intervening modification, extension, or renewal, whichever is the highest. [Sec. 130A as added by sec. 218 (a), Rev. Act 1950; amended by sec. 331, Rev. Act 1951] § 39.130A-1 Meaning and use of certain terms—(a) Option. (1) For the purposes of section 130A, the term "option" includes the right or privilege of an individual to purchase stock from a corporation by virtue of an offer of the corporation containing for a stated period of time, whether or not irrevocable, to sell such stock at a stated price, such individual being under no obligation to purchase. Such right or privilege, if unexercised, may be sold or transferred. While no particular form of words is necessary, the written option should express, among other things, an offer to sell at a stated option price and the period of time dur-
(2) An option may be granted as part of a plan or in conjunction with an employee stock purchase plan or subscription contract.

(3) An arrangement between a corporation and an employee may involve more than one alternative option for the purchase of stock of the corporation on June 1, 1952, grants to an employee the right to purchase 1,000 shares of its stock on or after June 1, 1953, and a further alternative option for the purchase of 1,000 shares on or after June 1, 1955, all shares to be purchased before June 1, 1956, provided the employee at the time of exercise of any of the purchase rights is employed by the corporation, such an arrangement will be construed as the grant to the employee on June 1, 1952, of three options, each for the purchase of 1,000 shares.

Similarly, if a corporation grants to an employee on January 1, 1953, the right to purchase 1,000 shares of its stock at $85 per share during 1953, at $75 per share during 1954, and at $65 per share during 1955, such an arrangement will be construed as the grant to the employee on January 1, 1953, of three alternative options, one option for the purchase of 1,000 shares at $85 per share during 1953, an alternative option for the purchase of 1,000 shares at $75 per share during 1954, and a third alternative option for the purchase of 1,000 shares at $65 per share during 1955.

(b) Time and date of granting of option. (1) For the purpose of section 130A, the words “the date of the granting of the option” and “the date such option is granted” and similar phrases refer to the date or time when the corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a restricted stock option. Ordinarily, if the corporate action contemplates an immediate offer of stock for sale to an individual, including such individual, or contemplates a particular date on which such offer is to be made, the time or date of the granting of the option is the time or date on which such corporate action is to be completed or the date contemplated as the date of the offer, as the case may be. However, an unreasonable delay in the giving of notice of such offer to the individual or to the class will be taken into account as indicating that the corporation contemplated that the offer was to be made at the subsequent date on which such notice is given. If the terms of the offer do not specify the amount of the option price, the option will not be considered granted before the date on which the offer price becomes fixed or determinable.

(2) If the corporation imposes conditions on the granting of an option (as distinguished from conditions governing the exercise of the option) such conditions shall be given effect in accordance with the intent of the corporation. A special rule is provided by section 130A (d) for options subject to stockholder approval. If the grant of an option is subject to approval by the board of directors and the date of grant of the option shall be determined as if the option had not been subject to such approval. A condition which is not considered to be a condition of the option, such as the approval of some regulatory or governmental agency, for example, a stock exchange or the Securities and Exchange Commission, is ordinarily considered to be a condition of the option unless the corporate action clearly indicates that the option is not to be granted until such condition is satisfied. If the corporation grants to an individual upon the condition that such individual will become an employee of the corporation granting the option or of its parent or subsidiary corporation, such option is not granted prior to the date the individual becomes such an employee.

(3) In general, conditions imposed upon the exercise of an option will not operate to make ineffective the granting of the option. For example, on June 1, 1952, the A Corporation grants to X, an employee, an option to purchase 5,000 shares of the corporation stock, exercisable at $70 per share, provided he is employed by the corporation on June 1, 1953. Such an option is granted to X on June 1, 1952.

(c) Stockholder. For the purpose of section 130A, the term “stock” means capital stock of any class, including voting or nonvoting common or preferred stock. The term includes both treasury stock and stock of original issue. Special classes of stock authorized to be issued to and held by employees are within the scope of the term “stock” as used in section 130A, provided such stock otherwise possesses all rights and characteristics of capital stock.

(d) Option price. For the purpose of section 130A, the term “option price” means the consideration in money or property which, pursuant to the terms of the option, is the price at which the stock subject to the option is purchased.

(e) Exercise. For the purpose of sections 130A and 130B, when used in reference to an option, means the act of acceptance by the optionee of the offer to sell contained in the option. In general, the time of exercise is the time such option expires or becomes exercisable by the employee to make payments under a stock purchase plan does not constitute the exercise of an option so long as the payments made remain subject to withdrawal by the employee. If the terms of the offer do not specify the amount of the option price, the option will not be considered exercised prior to the date on which the amount of the option price becomes fixed or determinable.

Transfer. For the purpose of section 130A, the term “transfer” when used in reference to the transfer to an individual of a share of stock pursuant to his exercise of a restricted stock option, means the transfer of ownership of such share, or the transfer of substantially all the rights of ownership. Such transfer must, within a reasonable time, be evidenced on the books of the corporation.

§ 39.130A-2 Restricted stock option—
(a) In general. (1) A “restricted stock option” is an option granted after February 28, 1952, to an individual, for any or all shares of stock of any corporation, granted by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if the aggregate market value of the stock subject to the option on the date of grant is at least 85 percent of the fair market value at such time of the stock subject to the option; and (ii) such stock is not transferable by such individual otherwise than by will or by the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and (iii) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock either of the employer corporation or of its parent or subsidiary corporation.

(2) At the time the option is granted, the relationship between the individual to whom an option is granted and the employer corporation (which is a parent or subsidiary thereof) must be the legal and bona fide relationship of employer and employee. For purposes of determining whether the employer-employee relationship exists, see § 405.104 of this chapter (Regulations 116) relating to collection of income tax at source on employment or after termination of employment is not a restricted stock option. As to the granting of an option conditioned upon employment, see paragraph (b) of § 39.130A-1. The option must be granted for a reason connected with the individual’s employment by the corporation or by its parent or subsidiary corporation. An option may qualify as a restricted stock option only if, under the terms of the option, it is not transferable (other than by will or by the laws of descent and distribution) by the individual to whom it is granted during the individual’s lifetime or is exercisable, during the lifetime of such individual, only by him. Accordingly, an option which is transferable by the individual to whom it is granted during the individual’s lifetime or is exercisable by another person, is not a restricted stock option.

(b) Ownership of 10 percent of stock. In determining the amount of stock owned by an individual, for the purpose of applying the 10 percent test of section 130A (d) (1) (C) stock of the employer corporation or of its parent or subsidiary owned (directly or indirectly) by or for such individual’s brothers and sisters (whether by the whole or half blood) spouse, ancestors, and lineal descendants, shall be considered as owned by such individual. For the purpose of section 130A, if a corporation, partnership, estate, or trust owns (directly or indirectly) stock of the employer corporation or of its parent or subsidiary, such stock shall be considered as being owned proportionately or for the shareholders, partners, or beneficiaries of the corporation, partnership, estate, or trust.

§ 39.130A-3 Exercise of restricted stock option. (a) The special rules of

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income tax treatment provided in section 130A (a) and (b) are applicable only if the following conditions exist with respect to the grant of a share of stock to an individual:

1. The share of stock is transferred to the individual pursuant to his exercise of a restricted stock option; and

2. At the time the option is exercised by him, the individual is an employee of the corporation granting such option (whether principal or subsidiary thereof) or was an employee of any such corporations within three months prior to the date the option is exercised.

(b) The special treatment provided in section 130A (a) and (b) shall apply only if the restricted stock option is exercised by the individual to whom it was granted. Such special treatment shall not be applicable with respect to stock transferred pursuant to the exercise of the option by the individual’s executor, administrator, heir, or legatee. Under the provision of section 130A (d) (1) (B) an option may qualify as a restricted stock option although it is transferable at death to the individual’s executor, administrator, heir, or legatee. Thus, the restricted stock option may be exercised by an executor, administrator, heir, or legatee, to deprive the individual who exercises such option during his lifetime of the special treatment provided in section 130A.

c) At the time of exercise of a restricted stock option, the status of the individual exercising such option must be that of a bona fide employee of a parent or subsidiary of such corporation, or such individual must have been a bona fide employee of any such corporation within three months previous to the date of exercise.

d) (1) The determination whether an option ultimately exercised is a restricted stock option is made as of the date such option is granted. An option which is a restricted stock option when granted does not lose its character as such and it remains a restricted stock option, even though the corporation granting the option or that of a bona fide employee of its parent or subsidiary of such corporation, or such individual must have been a bona fide employee of any such corporation within three months previous to the date of exercise. See, however, § 39.130A-4, relating to modification, extension, or renewal of an option.

(2) The application of subparagraph 1 of this paragraph may be illustrated by the following examples:

Example (1). S-C Corporation is a subsidiary of P Corporation which, in turn, is a subsidiary of S Corporation. On June 1, 1952, P grants to an employee of P a restricted stock option to purchase a share of stock of S-1. On January 1, 1953, S sells a portion of the S-1 stock which it owns to an unrelated corporation that, as of that date, S-1 ceases to be a subsidiary of S. On May 1, 1953, while still employed by P, the optionee exercises the option to purchase a share of S-1 stock. The employee has exercised a restricted stock option.

Example (2). P grants an option to an employee under the same facts as in example (1) above, except that on June 1, 1952, S-1 is not a subsidiary of either S or P. Such option is not a restricted stock option on June 1, 1952. On January 1, 1953, P purchases from an unrelated corporation a sufficient number of shares of S-1 stock to make S-1, as of that date, a subsidiary of S. On May 1, 1953, while still employed by P, the employee exercises the option to purchase a share of S-1 stock. The employee has not exercised a restricted stock option.

§ 39.130A-4 Modification, extension, or renewal. (a) Section 130A (e) provides rules with respect to the modification of a share of stock transferred to an individual upon his exercise of an option, after the terms thereof have been modified, extended, or renewed, if transferred to an employee or a restriction on the exercise of a restricted stock option. For the purpose of such determination, the statute provides that:

1. Any modification, extension, or renewal of the terms of an option to purchase stock shall be considered as the granting of a new option; and

2. The fair market value of the stock subject to the option at the time of the modification of the option is considered as the fair market value of such stock (i) on the date of the original granting of the option, (ii) on the date of the modification, extension, or renewal, whichever is the highest.

(c) A restricted stock option may, as a result of a modification, extension, or renewal, thereafter become a restricted stock option.

(d) The rule stated in section 130A (e) may be illustrated by the following examples:

Example (1). On June 1, 1953, the X Corporation grants to an employee an option to purchase 100 shares of X Corporation at $80 per share, such option to be exercised on or before June 1, 1954. At the time that the option is exercised, the fair market value of the X Corporation stock is $100 per share. On February 1, 1953, before the employee exercises the option, X Corporation modifies the option, X Corporation modifies the option to provide that the price at which the employee may purchase the stock shall be $90 per share. On February 1, 1953, the fair market value of the X Corporation stock is $90 per share. Under section 130A (e), the X Corporation is deemed to have granted a new option to the employee on February 1, 1953, to purchase at $80 per share 100 shares of stock having a fair market value of $100 per share, that is, the higher of the fair market value of the stock on June 1, 1952, and on February 1, 1953. The exercise of such option by the employee on February 1, 1953, is not the exercise of a restricted stock option.

Example (2). On June 1, 1953, the X Corporation grants to an employee an option to purchase 100 shares of X Corporation stock at $80 per share, exercisable after December 31, 1953, and on or before June 1, 1954. On June 1, 1953, the fair market value of X Corporation’s stock is $100 per share. On February 1, 1953, X Corporation modifies the option to provide that the option shall be exercisable on or after February 1, 1953, and on or before June 1, 1954. The exercise of such option by the employee after February 1, 1953, is not the exercise of a restricted stock option.

Example (3). The facts are the same as in example (1), except that the employee exercised the option to the extent of 50 shares on January 1, 1953, and on January 1, 1953, exercised the option to the extent of the modification of the option. Any exercise of the option after February 1, 1953, the date of the modification, is not the exercise of a restricted stock option. See example (1) in this paragraph. The exercise of the option on January 15, 1953, pursuant to which 99 shares subject to the option are purchased, is the exercise of a restricted stock option.

Example (4). On June 1, 1953, the X Corporation grants to an employee an option to purchase 100 shares of the stock of X Corporation at $80 per share, such option to be exercised on or before June 1, 1954. At the time the option is granted, the fair market value of the X Corporation stock is $100 per share. On February 1, 1953, before the employee exercises the option, X Corporation modifies the option to provide that the number of shares of stock which the employee may purchase at $80 per share will be 250. On February 1, 1953, the fair market value of the X Corporation stock is $120 per share. Under these facts, X Corporation has granted two options, one option (not a restricted stock option) with respect to 100 shares of stock having a fair market value of $80 per share on February 1, 1953, and the other option (a restricted stock option) with respect to the additional 100 shares having a fair market value of $120 per share on February 1, 1953. In the absence of facts identifying which option is exercised first, the employee will be deemed to have exercised the options in the order in which they were granted.
§ 39.130A—5 Operation of section 130A—(a) Rules applicable to all restricted stock options—(1) In general. If a share of stock is transferred to an individual pursuant to his timely exercise of a restricted stock option and is not disposed of by him within two years from the date of the granting of the option, or if such share is retransferred to such individual, or is retransferred from such individual to another individual, the individual has made a disposition of such share. Likewise, if a share of stock held in the joint names of such individual and another individual is disposed of by the other individual, there is a disposition of such share by the individual. If an individual exercises a restricted stock option and a share of stock is transferred to another or is transferred to such individual in his name as trustee for another, the individual has made a disposition of such share.

(ii) Disposition of stock. (1) For the purpose of section 130A, the term “disposition” includes a sale, exchange, gift, or any transfer of legal title, but does not include a transfer from a decedent to his estate or a transfer by bequest or inheritance, an exchange which is within the provisions of section 112 (b) (2) or (3) or a mere pledge or hypothecation. However, a disposition of the stock pursuant to a pledge or hypothecation is a disposition by the individual, even though the pledge or hypothecation is not such a disposition.

(ii) If an individual exercises a restricted stock option, a share of stock acquired pursuant to such exercise is not considered disposed of by the individual if such share is taken in the name of the individual and another person jointly with right of survivorship, or is subsequently transferred to such person, or is retransferred from such joint ownership to the sole ownership of the individual. However, if such individual transfers such share to another person, the individual has made a disposition of such share. Likewise, if a share of stock held in the joint names of such individual and another individual is disposed of by the other individual, there is a disposition of such share by the individual. If an individual exercises a restricted stock option and a share of stock is transferred to another or is transferred to such individual in his name as trustee for another, the individual has made a disposition of such share.

(iii) The rules of section 130A (a) may be illustrated by the following examples:

Example (1). On June 1, 1952, the X Corporation grants to E, an employee, a restricted stock option to purchase a share of X Corporation stock at $50 per share. On that date, the fair market value of X Corporation stock is $100 per share. On June 12, 1953, while employed by X Corporation, E exercises the option in full and pays X Corporation the option price of $50 per share. On the date of such transaction transfers to 100 shares of X Corporation stock having a fair market value of $12,000. Prior to June 1, 1954, if the employer corporation grants him a restricted stock option, the option price shall be considered as received by either of such corporations for the shares so transferred.

(2) Holding period. The special rules provided in section 130A (a) are not applicable if the individual disposes of the share of stock within two years from the date the option is granted or within six months after the transfer of such share to him. If the option is not disposed of by a transfer within the 2-year or 6-month period if such transfer is not a disposition of the stock as defined in subparagraph (2) of this paragraph, for example, the decease of the employer corporation, the basis of the stock obtained upon the later exercise of the option are not determined under section 130A.

(3) Disposition of stock. (1) For the purpose of section 130A, the term “disposition” includes a sale, exchange, gift, or any transfer of legal title, but does not include a transfer from a decedent to his estate or a transfer by bequest or inheritance, an exchange which is within the provisions of section 112 (b) (2) or (3) or a mere pledge or hypothecation. However, a disposition of the stock pursuant to a pledge or hypothecation is a disposition by the individual, even though the pledge or hypothecation is not such a disposition.

(ii) If an individual exercises a restricted stock option, a share of stock acquired pursuant to such exercise is not considered disposed of by the individual if such share is taken in the name of the individual and another person jointly with right of survivorship, or is subsequently transferred to such person, or is retransferred from such joint ownership to the sole ownership of the individual. However, if such individual transfers such share to another person, the individual has made a disposition of such share.

(iii) The rules of section 130A (a) may be illustrated by the following examples:

Example (1). On June 1, 1952, the X Corporation grants to E, an employee, a restricted stock option to purchase a share of X Corporation stock at $50 per share. On that date, the fair market value of X Corporation stock is $100 per share. On June 12, 1953, while employed by X Corporation, E exercises the option in full and pays X Corporation the option price of $50 per share. On the date of such transaction transfers to 100 shares of X Corporation stock having a fair market value of $12,000. Prior to June 1, 1954, if the employer corporation grants him a restricted stock option, the option price shall be considered as received by either of such corporations for the shares so transferred.

(2) Holding period. The special rules provided in section 130A (a) are not applicable if the individual disposes of the share of stock within two years from the date the option is granted or within six months after the transfer of such share to him. If the option is not disposed of by a transfer within the 2-year or 6-month period if such transfer is not a disposition of the stock as defined in subparagraph (2) of this paragraph, for example, the decease of the employer corporation, the basis of the stock obtained upon the later exercise of the option are not determined under section 130A.

(3) Disposition of stock. (1) For the purpose of section 130A, the term “disposition” includes a sale, exchange, gift, or any transfer of legal title, but does not include a transfer from a decedent to his estate or a transfer by bequest or inheritance, an exchange which is within the provisions of section 112 (b) (2) or (3) or a mere pledge or hypothecation. However, a disposition of the stock pursuant to a pledge or hypothecation is a disposition by the individual, even though the pledge or hypothecation is not such a disposition.

(ii) If an individual exercises a restricted stock option, a share of stock acquired pursuant to such exercise is not considered disposed of by the individual if such share is taken in the name of the individual and another person jointly with right of survivorship, or is subsequently transferred to such person, or is retransferred from such joint ownership to the sole ownership of the individual. However, if such individual transfers such share to another person, the individual has made a disposition of such share.

(iii) The rules of section 130A (a) may be illustrated by the following examples:

Example (1). On June 1, 1952, the X Corporation grants to E, an employee, a restricted stock option to purchase a share of X Corporation stock at $50 per share. On that date, the fair market value of X Corporation stock is $100 per share. On June 12, 1953, while employed by X Corporation, E exercises the option in full and pays X Corporation the option price of $50 per share. On the date of such transaction transfers to 100 shares of X Corporation stock having a fair market value of $12,000. Prior to June 1, 1954, if the employer corporation grants him a restricted stock option, the option price shall be considered as received by either of such corporations for the shares so transferred.
equal to the amount includible as compensation in his gross income under section 130A (b) if the special rules provided in section 130A (b) are applicable to a share of stock upon the death of an individual, the basis of such share in the hands of a surviving joint owner receiving the stock by bequest or inheritance shall be determined under section 113, and shall not be increased by reason of the inclusion upon the decedent's death of any amount in respect of any such individual in exchange for such stock, if the exchange is within the provisions of section 113 (a) (2) or (3) and (d) (i) new stock, as described in section 113 (a) (19) acquired upon a distribution with respect to such stock. Such stock and such stock or securities so acquired shall, for the purpose of section 130A, be considered as having been transferred to the individual upon his exercise of the option to receive such option, and the same rule shall be applied in the case of a series of such exchanges or acquisitions.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. If new stock, as described in section 113 (a) (19), is acquired upon a distribution with respect to stock transferred to him upon the exercise of a restricted stock option, and if such new stock is disposed of within two years from the date of acquisition, the tax imposed on the disposition of such new stock, if the disposition occurs after the 2-year and 6-month period, section 130A is applicable.

SUPPLEMENT C—CREDITS AGAINST TAX

§ 39.131 (a) Statutory provisions; taxes of foreign countries and possessions of United States; allowance of credit.

Sec. 131. Taxes of foreign countries and possessions of United States—(a) Allowance of credit. If the taxpayer chooses to have the benefits of this chapter, the tax imposed under section 102 and except the additional tax imposed for the taxable year to any foreign country or to any possession of the United States; and

(2) Resident of the United States or Puerto Rico. In the case of a resident of the United States and in the case of an alien who is a bona fide resident of Puerto Rico during the taxable year, the amount of any such taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(3) Alien resident of the United States or Puerto Rico. In the case of an alien resident of the United States and in the case of an alien who is a bona fide resident of Puerto Rico during the entire taxable year, 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 lieu of such taxes, allows similar credit to citizens of the United States residing in such country; and

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

Such choice may be made or changed at any time, in the case of a partnership or the estate or trust, prescribed for making a claim for credit or refund of the tax imposed by this chapter.

[Subsec. (a) as amended by sec. 210 (a), Rev. Act 1939; sec. 128 (a), Rev. Act 1942; sec.
§ 39.131 (a)--1 Analysis of credit for taxes.

The taxpayer chooses to claim a credit for taxes, the basis of such credit, in the case of a citizen of the United States, whether resident or nonresident, and in the case of a domestic corporation, (1) the total amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country; (2) the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any possession of the United States; and (3) 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, as the case may be.

(b) In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year who chooses to claim a credit for the taxes referred to in paragraph (a) of this section, 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 of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to any possession of the United States, or to any foreign country, as the case may be, 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.

(c) If the 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.

(d) The choice available to the taxpayer with respect to claiming such credit may be exercised (or changed if previously exercised) by the taxpayer at any time before 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 in the event such choice is made, see § 39.23 (c)--1.

(e) In a husband and wife making a joint return, credit 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 taxes so paid by or accrued against the spouses.

§ 39.131 (a)--2 Countries which do or do not satisfy the similar credit requirement.

A country satisfies the similar credit requirements of section 39.131 (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 or accrued, 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 requirements of section 39.131 (a) (3) if it does not allow any credit to citizens of the United States residing in such country for the amount of income taxes paid to the United States, or if such country does not impose any income taxes. If the country of which a resident is a citizen or subject does not allow to a United States citizen residing in such country a credit for taxes paid by such citizen to another foreign country, no credit is allowed to such resident alien for taxes paid by him to such other foreign country.

§ 39.131 (b) Statutory provisions; taxes of foreign countries and possessions of United States; limit on credit.

§ 39.131 (a) No credit for taxes shall be allowed against the tax imposed under section 102 (relating to the excess profits of corporations improperly accumulating surplus) against the additional tax imposed under the provisions of section 127 (c) (2) (relating to war loss recoveries), or against the tax on certain income imposed by section 480. Credit for taxes shall be allowed against the excess profits tax imposed by subchapter D of chapter 1 for income, or, in the case of a corporation, which the taxpayer's normal-tax net income from sources within such country or possession bears to his entire net income, or, in the case of a corporation, which the taxpayer's normal-tax net income from sources within such country or possession bears to its entire net income, for the same taxable year, the tentative credit for the purpose of the income tax under chapter 1 for income or profits taxed paid or accrued to foreign countries or possessions of the United States. There must be excluded, in computing the tax against which the credit is taken, the tax imposed by section 480, and, except to the extent provided in section 131 (j) and § 39.131 (j)--1, the excess profits tax imposed by subchapter D of chapter 1.

The operation of the limitations on the credit for foreign taxes paid by individuals may be illustrated by the following examples:

Example (1). In 1953, A, a citizen of the United States, had a net income for services within Great Britain of $50,000 and a net income from sources within Great Britain of $250,000. He is entitled to a credit under section 39 for both normal tax and surtax of $23,000. This credit for foreign taxes allowable to A in his return for the calendar year 1953 is $10,023,38, computed as follows:

Income from sources within the United States.............. $50,000
Less credit from sources within the United States........ $23,000

Total net income.............................................. $27,000

United States income tax on net income of $27,000 as computed above is $3,387,50, and a United Kingdom tax of $3,670,30. The income as computed above are exempt from the United States income tax.
Limitation on British income and profits taxes paid or accrued under section 131 (b) (1) and (2) to determine tentative credit

Credit for British income and profits taxes (total British income and profits taxes, reduced in accordance with the limitations under section 131 (b) (1) and (2)) $16,089.33

Example (2). If, in example (1), above, A, a citizen of Great Britain, had a net income from sources within Canada of $10,000 and the income and profits taxes paid or accrued to foreign countries or possessions of the United States,$10,000 and $4,500, respectively, the credit for foreign taxes allowable to A would be $14,153.60, computed as follows:

Income from sources within the United States...
Income from sources within Great Britain...
Income from sources within Canada...
Total net income...

British income and profits taxes...

Limitation on British income and profits taxes under section 131 (b) (1) to determine tentative credit

Tentative credit for British income and profits taxes (total British income and profits taxes, reduced in accordance with the limitation under section 131 (b) (1))...

Canadian income and profits taxes...

Limitation on Canadian income and profits taxes under section 131 (b) (2) to determine tentative credit

Tentative credit for Canadian income and profits taxes (total Canadian income and profits taxes, reduced in accordance with the limitation under section 131 (b) (1))...

Sum of tentative credits...

Total amount of credit allowable (sum of tentative credits, since such sum is within the limitation under section 131 (b) (2))...

(c) In the case of a husband and wife making a joint return, the limitations prescribed by section 131 (b) (2) upon the credit for taxes paid or accrued to any foreign country or to any possession of the United States shall be applied with respect to the aggregate net income from sources within each such country or possession, the aggregate net income from all sources without the United States, and the aggregate net income from all sources, of the spouses.

(d) It is provided in section 131 (b) (2) that in the case of a domestic corporation the amount of the credit for any taxable year with respect to the tax paid or accrued to any foreign country or possession of the United States shall not exceed the same proportion of the tax imposed by chapter 1 which the corporation's normal-tax net income from sources within such foreign country or possession of the United States bears to the entire normal-tax net income for the same taxable year.

The total amount of the credit shall not exceed the same proportion of the tax imposed by chapter 1 which the corporation's normal-tax net income from sources without the United States bears to the entire normal-tax net income for the same taxable year.

The operation of the limitations provided in section 131 (b) (2) on the credit for foreign taxes paid by corporations may be illustrated by the following example:

Example. The following facts exist for the calendar year 1952 with respect to the A Corporation which makes its income tax returns on the calendar year basis:

Net income from all sources...
Net income from foreign country X...
Foreign tax paid on country X income...
Total normal tax and surtax...
Computation of foreign tax credit for purposes of normal tax and surtax...
Amount allowable as a credit...

(f) In the event that normal-tax net income is derived from more than one foreign country or possession of the United States, the limitation provided in section 131 (b) (2) shall be applied based upon the taxpayer's normal-tax net income from sources without the United States and the entire normal-tax net income of the corporation and such limitation is in addition to the limitation provided in section 131 (b) (1).

(g) The application of paragraph (f) of this section may be illustrated by the following example:

Example. (1) The net income for the calendar year 1952 of the A Corporation is $108,750 (less United States bond interest exempt from normal tax $12,000). The income and profits taxes paid or accrued to foreign countries and possessions of the United States in the case of a domestic corporation are as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Net Income</th>
<th>Less</th>
<th>Income and profits taxes (paid or accrued)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$108,750</td>
<td></td>
<td>$86,750</td>
</tr>
<tr>
<td>Great Britain</td>
<td>40,000</td>
<td>40,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Canada</td>
<td>40,000</td>
<td>40,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Brazil</td>
<td>40,000</td>
<td>40,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>40,000</td>
<td>40,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Mexico</td>
<td>40,000</td>
<td>40,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>40,000</td>
<td>40,000</td>
<td>30,000</td>
</tr>
<tr>
<td>France (branch)</td>
<td>20,000</td>
<td>20,000</td>
<td>11,000</td>
</tr>
</tbody>
</table>

Total net income...

Income and profits taxes paid to foreign countries and possessions...

Net income less United States bond interest exempt from normal tax...

Normal-tax net income...

Surtax net income...

Total foreign net income...

United States tax (not including tax imposed under section 109):...

Normal tax...

Surtax...

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 on income distributed to them, the latter tax being withheld and paid at the source.

The credit is $70,450 computed as follows:

Great Britain...

Income and profits taxes paid or accrued...

Limitation under section 131 (b) (1)...

Tentative credit...

Canada...

Income and profits taxes paid or accrued...

Limitation under section 131 (b) (1)...

Tentative credit...

Brazil...

Income and profits taxes paid or accrued...

Limitation under section 131 (b) (1)...

Tentative credit...

Mexico...

Tentative credit...

Puerto Rico...

Income and profits taxes paid or accrued...

Limitation under section 131 (b) (1)...

Tentative credit...

France...

Dividend tax at source...

Income and profits taxes paid or accrued on branch operations...

Income and profits taxes paid...
Limitation on sum of tentative credits under section 131 (b) (2) to determine credit:

<table>
<thead>
<tr>
<th>Country</th>
<th>Credit Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great Britain</td>
<td>15,600</td>
</tr>
<tr>
<td>Canada</td>
<td>10,400</td>
</tr>
<tr>
<td>Brazil</td>
<td>5,000</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>2,250</td>
</tr>
<tr>
<td>France</td>
<td>36,450</td>
</tr>
<tr>
<td>Total</td>
<td>70,450</td>
</tr>
</tbody>
</table>

(a) In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereafter upon redetermination the amount of the tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the district director of internal revenue, and any amount shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 131 (d).

(b) Foreign tax imposed on foreign refund. Where the redetermination of the tax for a taxable year, or years, is occasioned by the refund to the taxpayer of any amount of tax described in subsection (a) imposed by the laws of the foreign country of possession of the United States, the amount of such refund except to the extent interest due upon any redetermination of the tax paid to a foreign country or possession of the United States shall be reduced by the amount of tax found due upon such redetermination shall be paid by the taxpayer upon notice and demand by the district director of internal revenue, and any amount shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 131 (d).

§ 39.131 (c) Statutory provisions; taxes of foreign countries and possessions of United States; adjustments on payment of accrued taxes.

Sec. 131. Taxes of foreign countries and possessions of United States. (c) Adjustments on payment of accrued taxes. If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer upon notice and demand, the amount thus paid shall be credited to the tax due for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer to the district director of internal revenue, and any amount shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 131 (d).

§ 39.131 (d) Statutory provisions; taxes of foreign countries and possessions of United States; year in which credit taken.

Sec. 131. Taxes of foreign countries and possessions of United States. (d) Year in which credit taken. The credits provided for in this section may, at the option of the taxpayer, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Com- missioner. The Commissioner will thereafter upon redetermination the amount of the tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the district director of internal revenue, and any amount shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 131 (d).

§ 39.131 (e) Statutory provisions; taxes of foreign countries and possessions of United States; adjustments on payment of accrued taxes.

Sec. 101. Taxes of foreign countries and possessions of United States. (e) Adjustments on payment of accrued taxes. If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer upon notice and demand, the amount thus paid shall be credited to the tax due for the year or years affected, and the amount of tax due upon such redetermination shall be paid by the taxpayer upon notice and demand by the district director of internal revenue, and any amount shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 131 (d).

§ 39.131 (f) Statutory provisions; taxes of foreign countries and possessions of United States; year in which credit taken.

Sec. 131. Taxes of foreign countries and possessions of United States. (f) Year in which credit taken. The credits provided for in this section may, at the option of the taxpayer, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Com- missioner. The Commissioner will thereafter upon redetermination the amount of the tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the district director of internal revenue, and any amount shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 131 (d).
for each such tax payment if credit is
must have attached to it
payer to furnish such evidence, the form
lished to the satisfaction of the Commis-
and the Commissioner with the ap-
power to determine from the accumulated profits of
and such dividends were paid; forty days
any year as having been paid from the
accumulated profits of the preceding year or
(unless to his satisfaction shown other-
other than dividends as having been paid from the
receipt for such foreign tax payment, (2)
the foreign tax return, or
1118.
§ 39.131 (d)-1. A

(b) Where it has been established to the
the satisfaction of the Commissioner that it is impossible to furnish (1) a recep-
for such foreign tax payment, (2) the foreign tax return, or (3) direct evi-
dence of the amount of tax withheld at the
source, the Commissioner may, in his
discretion and under such rules as he
may prescribe, accept secondary evi-
dence of the payment or accrual of the
tax or of the withholding of the tax.
(c) For credit available to a domestic
corporation with respect to taxes paid by
such foreign corporation, see § 39.121
(f)-1. A claim for credit in such a case
is also to be made on Form 1118. See
§ 39.131 (d)-1 with reference to the
op-
tion granted by section 131 (d).
(d) The term with respect to a par-
ticular taxable year, claim the ben-
efits of section 131 at any time before the
expiration of the period prescribed for
the making of claim for credit or refund
of the tax imposed under chapter 1 for
such taxable year.

§ 39.131 (f) Statutory provi-
sions; taxes of foreign countries and posses-
sions of United States; taxes of foreign
corporation.

Sec. 131. Taxes of foreign countries and
possessions of United States; taxes of foreign
corporation.  

Taxes of foreign corporation—(1) Treatment of
taxes paid by foreign corpo-
ration. For the purpose of this section a
domestic corporation which owns at least
10 percent of the voting stock of a foreign
corporation from which it receives divi-
dends in any taxable year shall be deemed to have paid the
same proportion of any income, war-
profits, and excess-profits taxes paid or
due to have been paid by such foreign corporation to any
foreign country or to any possession of the
United States, upon or with respect to the
accumulated profits from which such dividends were paid, which
the amount of such dividends bears to the
amount of such accumulated profits.

Illustration of principles. The
application of the principles of this sec-
tion in the determination of the amount
of the foreign tax available as a basis for
credit to the domestic corporation is
illustrated by the following example:

Example. The A Company, a domestic
corporation, owns a majority of the voting
stock of the B Company, Ltd., a foreign
corporation, which in turn owns all of the
stock except qualifying shares of the C Company, Ltd.,
another foreign corporation. The
accumulated profits of the B Company amount to $300,000
(including $35,000 dividend derived
from the C Company) and the foreign
income, war-profits, and excess-profits taxes due
in the foreign country, upon or with respect to
such accumulated profits amounts to
$80,000. The C Company has accumulated
profits of $60,000, and the foreign
income, war-profits, and excess-profits taxes in
respect to such accumulated profits amounts to
$46,000. A dividend of $60,000 is paid in 1952
by the B Company to the A Company and in the same year
a dividend of $25,000 is paid by the C
Company to the B Company. The amount of
the tax imposed on such dividends and excess-profits tax of the C
Company deemed to have been paid
by the B Company is $25,000 × 46%, or
$11,500. The proportion of the foreign
income tax deemed to have been paid
by the A Company with respect to the
accumulated profits of the B Company
from which the dividend of $60,000 was
paid by the B Company to the A Company equals
$80,000 × 50%, or $40,000.

$60,000 = 25,000
$25,000 = 46%

$80,000 = 46%

$300,000 = 46% × 100%

$46,000 = 46%

$11,500

§ 39.131 (g) (h) Statutory provi-
sions; taxes of foreign countries and
possessions of United States; corpora-
tions treated as foreign, credit for taxes
paid or accrued on income, etc.

Sec. 131. Taxes of foreign countries and
possessions of United States.

Corporations treated as foreign. For
the purpose of determining the amount
of foreign corporation taxes such corporations shall be treated as foreign
corporations:

1. A corporation entitled to the benefits
of section 131, by reason of receiving a large

§ 39.131 (f)
percentages of its gross income from sources within a possession of the United States;

(2) A corporation organized under the laws of a foreign country, but not a possession of the United States, whose principal place of business is within a possession of the United States shall be subject to the income tax provided in section 263.

(b) Credit for taxes in lieu of income, etc., taxes. For the purpose of sections 131 and 132, the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of income, war-profits, and excess-profits taxes otherwise generally imposed by any foreign country or by any possession of the United States.

[Subsec. (b) as added by sec. 158 (f), Rev. Act 1943.]

§ 39.131 (b)–(1) Meaning of terms.

(a) The term "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means the amount of such tax paid or accrued during the taxable year on behalf of the taxpayer claiming credit.

(b) For the purposes of sections 131 and 132 (c) (1) (C) the term "income, war-profits, and excess-profits taxes" includes a tax imposed by statute or decree by a foreign country or by any possession of the United States. If (1) such country or possession has in force a general income tax law, (2) the taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax, and (3) such general income tax is not imposed upon the taxpayer thus subject to such substituted tax. For example, the A Corporation does business in the X country, which imposes an income-tax upon substantially a net income base. The ascertainment of net income, though not the determination of income base. The ascertainment of net income and profits taxes paid or accrued during the taxable year to each foreign country or to any possession of the United States. To the extent pertinent, the provisions of section 131 and the regulations thereunder are applicable for the purpose of claiming credit for taxes under this section, except that for such purpose the amount of income and profits taxes paid or accrued by the taxpayer to any foreign country or possession shall be deemed to be the amount of such taxes actually paid or accrued reduced by the amount of such taxes allocable as a credit under section 131 against the tax imposed by chapter 1 without regard to the excess profits tax imposed by subchapter D. See § 39.131 (b)–(1) as to the amount of such credit allowable and as to the computation of the tax against which such credit may be taken.

(b) The amount of the income and profits taxes (determined under paragraph (a) of this section) paid or accrued including the taxes which, in accordance with the provisions of section 131 (f) are deemed to have been paid) during the taxable year to each foreign country or possession of the United States, limited under section 131 (f) (1) so as not to exceed that proportion of the excess profits tax which the taxpayer's excess profits net income from sources within such country or possession bears to its entire excess profits net income for the same taxable year, is the tentative credit for the purpose of this section in respect of the taxes paid or accrued to such country or possession.

The sum of these tentative credits, limited under section 131 (j) (2) so as not to exceed the amount of such excess profits tax for the same taxable year, is the amount allowable as a credit against the excess profits tax for income or profits taxes paid or accrued to foreign countries or possessions of the United States. For the determination of the excess profits net income, see §§ 40.453 (a)–1 and 40.453 (a)–2 of this chapter (Regulations 130). For the determination of the source of such net income, see section 119 and the regulations thereunder.

(c) The application of this section may be illustrated by the following examples involving the calendar year 1952.

Example (1). In this example it is assumed that the taxpayers income or less from any foreign country other than Country X. Accordingly, the limitation under section 131 (j) (1) will not change the tax determined after applying section 131 (j) (1).

(A) Normal tax net income from all sources ............................................. $100,000

(B) Total income and excess profits taxes (before section 131 credit) ....... 46,500

(C) Normal tax net income from foreign country X ................................ 60,000

(D) Foreign tax paid on Country X income ............................................ 49,500

(E) Limitation of section 131 (b) (1) and (2) to determine section 131 (a) credit allowable against normal tax and surtax .................................. 320,000

(F) Foreign tax credit allowable against normal tax and surtax (foreign tax, but not in excess of above limitation of 408,500 .......................................................... 41,500

(G) Excess profits net income from all sources .............................................. 60,000

(H) Excess profits net income from foreign country X ................................ 75,000

(I) Excess profits credit (before section 131 credit) .................................... 63,000

(J) Foreign tax paid on Country X income for the purpose of section 131 (j) ........................................ 649,500–418,500

(K) Limitation on foreign tax under section 131 (j) (1) and (2) to determine section 131 (j) (1) credit allowable against excess profits tax .... 7,650

(L) Foreign tax credit allowable against excess profits tax (foreign tax for purposes of section 131 (j), but not in excess of above limitation of 65,625) ........................................... 6,525

(M) Total income and excess profits taxes (before section 131 credit) ......... 649,500+65,625

(N) Total credit under section 131 .......................................................... 47,475

(O) Total income and excess profits taxes at credit under section 131 ......... 656,025+47,475

5 § 39.131 (j)–(1)
Example (2). The facts are assumed to be the same as those under example (1), except that there is a net loss of $10,000 allocable to foreign country X, which net loss was taken into account in the computation of the normal tax net income from all sources of $80,000 (item A, example (1)) and the excess profits net income from all sources of $60,000 (item C, example (1)). The total income and excess profits tax after credit under section 131 is computed as follows:

(A) Tentative foreign tax credit under section 131 (b) (1) allowable against normal tax and surtax (foreign tax paid on ordinary X income, but not in excess of limitation under section 131 (b) (1))

$90,000 x 46,500 ------------ $41,850

(B) Limitation on foreign tax under section 131 (b) (2) to determine section 131 (a) credit allowable against normal tax and surtax:

$100,000 x $46,500 37,500

(C) Foreign tax credit allowable against such income (tentative credit under section 131 (b) (1), but not in excess of $80,000 limitation under section 131 (b) (2))

$37,500

(D) Foreign tax paid for the purpose of section 131 (j)

$75,000 x $6,000 5,625

(E) Tentative foreign tax credit under section 131 (j) (1) allowable against excess profits tax (foreign tax paid for the purpose of section 131 (j)), but not in excess of limitation under section 131 (j) (1))

$90,000 x $6,000 5,400

(F) Limitation on foreign tax under section 131 (j) (2) to determine section 131 (j) credit allowable against excess profits tax:

$5,400 x $6,000 4,750

(G) Foreign tax credit allowable against excess profits tax (tentative credit under section 131 (j) (1), but not in excess of $4,875, limitation under section 131 (j) (2))

$4,875

(H) Total income and excess profits tax after credit under section 131.

$37,500 + $4,875 42,375

As used in this subsection, the term "stock" does not include stock which is limited and preferred as to dividends.

(e) Definition of "foreign law."). As used in this section, the term "foreign law" means any foreign law or any foreign law or regulation or order of a foreign government or any foreign law, regulation, or order of a foreign government, or any foreign law, regulation, or order of a foreign government, or any foreign law, regulation, or order of a foreign government, or any foreign law, regulation, or order of a foreign government.
31, 1949. The determination, computation, assessment, collection, and adjustment of income and excess profits tax liabilities of the affiliated group and each member thereof both during and after the period of affiliation at least 95 percent of the voting power of all classes of stock and at least 95 percent of each class of the nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation. A corporation becomes a member of such an affiliated group at the time that one or more members of such group become the owners directly of stock possessing at least 95 percent of the voting power of all classes of 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 such an affiliated group at the time that the members directly of stock possessing at least 95 percent of the voting power of all classes of its stock, or at least 95 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) ceases to be members of such an affiliated group at the time that such corporation ceases to be a member of the affiliated group. If such corporation is a common parent corporation, the making and filing of a consolidated return shall constitute the making and filing of its consent under section 141 (e) (3). If such corporation is a common parent corporation and if such corporation is a regulated public utility corporation, which, without regard to the exception provided in section 141 (e) (7), would not be an includible corporation for such taxable year for which the consent is filed, it shall be treated as an includible corporation for such taxable year for which the consent is filed; however, the privilege described in section 141 (e) (7) cannot be withdrawn or revoked at any time after the consolidated return is filed for the first taxable year for which the consent is filed; however, such corporation shall not be treated as an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year, it is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year. It is not thereafter an includible corporation under section 141 (e) (6) unless another consent under subparagraph (d) (4) is filed by such a corporation for a subsequent taxable year.
nations. Similarly a domestic insurance company taxable under section 207 may be included in an affiliated group comprised solely of other domestic insurance companies taxable under section 207; it may not be included in an affiliated group with other corporations. An affiliated group of domestic insurance companies taxable under section 201, or a group of domestic insurance companies taxable under section 207, may not include a domestic insurance company taxable under section 204.

(e) Foreign corporations which may be treated as domestic corporations. In the case of a domestic corporation owning or controlling, directly or indirectly, the entire capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of such group of foreign corporations, if a tax shall be assessed against such corporation, may, at the option of the domestic corporation, be treated as a domestic corporation. The option to treat such foreign corporation as a domestic corporation may be exercised only by making the consolidated return and cannot be exercised at any time thereafter. If the foreign corporation is included or is required to be included in the consolidated return of the affiliated group of which it is a member for any taxable year, it must be included in the consolidated return for each consecutive taxable year thereafter for which such group makes or is required to make a consolidated return.

(f) Computation of tax. The surtax imposed by section 15 or section 204 upon an affiliated group making a consolidated income tax return shall be increased by 2 percent of the consolidated corporation surtax net income. For example, if the consolidated corporation surtax net income is $40,000, the increase in the surtax for each taxable year is $800, that is 2 percent of $40,000. If the affiliated group includes one or more Western Hemisphere corporations (as defined in section 109) the increase shall be applied in the manner provided in § 24.30 (b) (1) of this subchapter (Regulations 129).

(g) Consolidated returns of regulated public utilities computing excess profits credit under section 448. A regulated public utility which has made and filed a consent to compute its excess profits credit under section 448 only may be included in an affiliated group (within the meaning of section 141 (d)) comprised solely of regulated public utility corporations as has made and filed such a consent. If such consent of a regulated public utility corporation is filed for any taxable year ending after June 30, 1930, such corporation shall be an includible corporation within the meaning of section 141 (j) for the taxable year for which such consent is filed and for all consecutive subsequent taxable years for which such affiliated group of which such corporation is a member makes or is required to make a consolidated return. If such corporation is a common parent corporation, the making and filing of a consolidated return in which the consolidated excess profits credit is determined under the provisions of section 448 shall constitute the consent to be treated as an includible corporation under section 141 (j). If such corporation is a subsidiary, the filing of its authorization and consent on Form 1122, prescribed by § 24.12 (b) of this subchapter (Regulations 129) indicating thereon its consent to compute its excess profits credit with respect to section 449 only, shall constitute the consent to be treated as an includible corporation under section 141 (j) unless another consent under such section is made and filed.

§ 39.142 Statutory provisions; fiduciary returns.

Sec. 142. Fiduciary returns.—(a) Requirement of return. Every fiduciary except a receiver appointed by authority of law in possession of part of the property of an individual or a corporation for a subsequent taxable year in which such corporation is comprised solely of other domestic insurance companies taxable under section 201, or any beneficiary of such estate or trust is a nonresident alien, shall file such a return for any of the following individuals, estates, trusts, or for trusts for which he acts, stating specifically the items of gross income of the estate, the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe—

(i) Every individual having a gross income for the taxable year of $600 or over;

(ii) Every estate the gross income of which for the taxable year is $600 or over;

(iii) Every trust the net income of which for the taxable year is $100 or over, the gross income of which for the taxable year is $600 or over, regardless of the amount of net income;

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

(b) Joint fiduciaries. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, if the return of one of two or more joint fiduciaries and filed in the office of the collector of the district wherein such fiduciaries reside shall be sufficient compliance with the above requirement, such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate, or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, 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.

Sec. 142 as amended by sec. 7 (b), Rev. Act 1940; sec. 112 (b), Rev. Act 1941; sec. 151 (4), Title X, Pub. L. 80-431, as amended by sec. 6 (a), Title X, Pub. L. 80-431, Individual Income Tax Act 1944; sec. 202 (c), Rev. Act 1948.

§ 39.142-1 Fiduciary returns. (a) Every fiduciary, or at least one of joint fiduciaries, must make a return of income—

(1) Returns for individuals. For the individual whose income is in his charge, if the gross income of such individual is $600 or over. The return shall be on Form 1040.

(2) Returns for estates and trusts. For the estate for which he acts if the gross income of such estate is $600 or over, and for the trust for which he acts if the gross income of such trust is $600 or over, or the net income of such trust, as computed under section 162, is $100 or over.

(b) In cases in which the gross income of the estate or trust is $5,000 or over, a copy of the return, together with a statement by the fiduciary indicating the provisions of the will or trust instrument which, in his opinion, determine the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiary, or the grantor, respectively.

(c) A copy of the will or trust instrument, and statement relating to the provisions of the will or trust instrument, have once been filed, a copy of the amendment, together with a statement by the fiduciary, indicating the effect, if any, in his opinion, of such amendment on the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiaries, or the grantor, respectively, must be filed with the return for the taxable year in which the amendment was made.

(d) See § 39.142-2 for returns in cases where any beneficiary is a nonresident alien. For returns on Form 900-T by certain trusts otherwise exempt from tax under section 101 (b), which trusts are subject to the tax imposed by section 421, see § 39.142-3. For information returns required to be made by fiduciaries under section 147, see § 39.142-1. As to further duties and liabilities of fiduciaries, see section 312.

§ 39.142-2 Return by guardian or committee. A fiduciary acting as the guardian of a minor, or as the guardian or committee of an insane person, having a gross income of $600 or more for the taxable year, must make a return for such person on Form 1040 and pay the tax unless, in the case of a minor, the minor himself makes a return or, in the case of an insane person, a return is sworn to by the fiduciary as a true and complete copy must be filed with the fiduciary return of the estate or trust, together with a statement by the fiduciary indicating the provisions of the will or trust instrument which, in the fiduciary's opinion, determine the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiary, or the grantor, respectively. If, however, a copy of the will or trust instrument, and statement relating to the provisions of the will or trust instrument, have once been filed, a copy of the amendment, together with a statement by the fiduciary, indicating the effect, if any, in the fiduciary's opinion, of such amendment on the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiaries, or the grantor, respectively, must be filed with the return for the taxable year in which the amendment was made.

§ 39.142-3 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 trustee acts, the trustee shall make 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 two or more trusts, he must make a separate return on Form 1041 for each trust separately.
§ 39.142-4 Return by receiver. A receiver who stands in the place of an individual, corporation, or partnership shall render a return for any beneficiary of the estate or trust for the last taxable year. See also sections 140 and 140A.

A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of property of an individual or corporation must make returns. See also sections 141 and 146 (a).

§ 39.142-5 Return for nonresident alien beneficiaries of United States business. If a citizen or resident fiduciary has the distribution of the income of an estate or trust any beneficiary of which is a nonresident alien engaged in trade or business within the United States at any time within the taxable year, the fiduciary shall make a return on Form 1040B for such nonresident alien and pay any tax shown thereon to the United States at any time within the taxable year. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040B. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the income of any nonresident alien beneficiary. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).

§ 39.142-6 Time for filing return upon death of custodian. (a) Under the provisions of section 47 (c), the return by a taxpayer which was in existence throughout a taxable period of 12 months is a return for the fractional part of the year in which death occurred. If a return is required to be filed for an individual, the return shall be on Form 1041. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040B. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the income of any nonresident alien beneficiary. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).

(b) The domiciliary representative is required to include in the return rendered by him as such domiciliary representative the entire income of the estate. Consequently, the only return required to be filed by the domiciliary representative is on Form 1041. Moreover, the tax liability of a nonresident alien beneficiary who is a citizen of a country other than the United States is determined by the foreign country in accordance with its laws, and the tax so paid is neither deductible nor refundable under the tax laws of the United States.

§ 39.143 Statutory provisions; withholding of tax at source.

§ 39.143-1 Taxpayer withholding of tax at source. In any case where bonds, mortgages, or deeds of trust, or other obligations of a corporation, a bank, or a nonresident alien individually or in the case of a foreign corporation not engaged in trade or business within the United States, the obligor agrees to pay any portion of the tax on the income paid by the obligor to the tax withholding agent or to pay the tax for which the withholding agent is liable, the obligor shall be relieved from the obligation to make a return for any portion of the tax owed to the withholding agent or to reimburse the obligor for any portion of the tax, or to pay the interest without deduction for any tax withheld. See also section 39.143-2. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040B. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the income of any nonresident alien beneficiary. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).

(b) Nonresident aliens. All persons in whatever capacity acting, including lessors or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, engaging in trade or business within the United States, or in possession or control of property within the United States, are required to deduct and withhold a tax equal to the amount prescribed by the Commissioner when the income is paid to persons not engaged in business as defined in section 762. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).

§ 39.143-2 Taxpayer withholding of tax at source. In any case where bonds, mortgages, or deeds of trust, or other obligations of a corporation, a bank, or a nonresident alien individually or in the case of a foreign corporation not engaged in trade or business within the United States, the obligor agrees to pay any portion of the tax on the income paid by the obligor to the tax withholding agent or to pay the tax for which the withholding agent is liable, the obligor shall be relieved from the obligation to make a return for any portion of the tax owed to the withholding agent or to reimburse the obligor for any portion of the tax, or to pay the interest without deduction for any tax withheld. See also section 39.143-1. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040B. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the income of any nonresident alien beneficiary. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).

(b) Nonresident aliens. All persons in whatever capacity acting, including lessors or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, engaging in trade or business within the United States, or in possession or control of property within the United States, are required to deduct and withhold a tax equal to the amount prescribed by the Commissioner when the income is paid to persons not engaged in business as defined in section 762. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).

§ 39.143-3 Amount of withholding. In any case where bonds, mortgages, or deeds of trust, or other obligations of a corporation, a bank, or a nonresident alien individually or in the case of a foreign corporation not engaged in trade or business within the United States, the obligor agrees to pay any portion of the tax on the income paid by the obligor to the tax withholding agent or to pay the tax for which the withholding agent is liable, the obligor shall be relieved from the obligation to make a return for any portion of the tax owed to the withholding agent or to reimburse the obligor for any portion of the tax, or to pay the interest without deduction for any tax withheld. See also section 39.143-1. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040B. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the income of any nonresident alien beneficiary. Such deduction and withholding provisions are contained in sections 147 and 148 (a) and (b) of the Code. See also sections 143 and 211 (a).
§ 39.143-1 Withholding tax at source—(a) Withholding in general.

(1) Withholding of a tax of 30 percent provided for in subsection (a) of this section shall be required in the case of interest, dividends, rents, or other income paid to a nonresident alien individual, except that the rate of withholding provided in this section shall not be applied to interest paid to a nonresident alien individual in the case of interest on bonds or other obligations of a corporation subject to the tax imposed by section 421 (a), in respect of which interest no deduction has been allowed for the tax-free covenant and issued before January 1, 1941.

(ii) Interest upon bonds or other obligations of a corporation subject to the tax imposed by section 421 (a), the provisions of section 143 (a) shall apply to distributions in respect of which dividends were paid to a nonresident alien individual after December 31, 1943, even though the stock or stock rights or distribution or proceeds thereof were received before January 1, 1944.

(2) The tax must be withheld on any income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading any tax.

(3) Every person required to deduct and withhold any tax under this section shall be liable for such tax and is hereby indemnified by the United States for any tax or interest assessed against the person for failure to deduct and withhold any tax required to be deducted and withheld under this section.

(b) Special rules relating to the taxation of such income paid to a nonresident alien individual.

(i) Income from sources without the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(ii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(iii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(iv) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(v) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(vi) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(vii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(viii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(ix) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(x) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xi) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xiii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xiv) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xv) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xvi) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xvii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xviii) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xix) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(xx) Income from sources within the United States. See section 22 (b) (7) Withholding on certain foreign tax-exempt organizations.

(2) The withholding agent shall be required to hold and pay over all the income tax withheld to the United States on or after January 1, 1934, and the liability assumed by the withholding agent, except where such interest or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading any tax.
beneficiaries of the estate or trust are citizens or residents of the United States, (10) The income of a trust created by a nonresident alien individual and taxable to the grantor under the provisions of section 143 (a) or (b) may be subject to withholding even though the beneficiaries of such trust are citizens or residents of the United States, and regardless of whether the beneficiaries are exempt from income tax.

(11) A debtor corporation having an issue of bonds or other similar obligations which appoints a duly authorized agent to act in its behalf under the withholding provisions of the Internal Revenue Code, is required to file notice of such appointment with the Commissioner of Internal Revenue, Washington, D. C., giving the name and address of the agent; except that, on and after July 19, 1953, such notice shall be filed with the District Director of Internal Revenue, Baltimore 2, Maryland.

(12) A bond or obligation sold with the sale of its property, payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, or corporation, and such bonds or other obligations shall be treated as though the assignor had sold such sale or transfer been made.

(13) For determining income from sources within the United States, see section 119.

(1) As to who are nonresident alien individuals, see §§ 39.121-2 and 39.379-7. For the purpose of section 143 (a) and (b) the term "nonresident alien individual" includes an alien resident of Puerto Rico. For classification of foreign corporations, see §§ 39.231-2 and 39.379-7. As to what partnerships are deemed to be nonresident partnerships, see § 39.379-7.

(15) For withholding in the case of dividends distributed by a corporation organized under the laws of the Panama Canal Zone Act, 1922 (15 U. S. C., c. 4) see §§ 39.142-3 and 39.262-4.

(b) Tax-free covenant bonds issued before January 1, 1934. (1) The withholding provisions of section 143 (a) and (b) are applicable only to bonds, mortgages, or deeds of trust, or other similar obligations of a corporation which were issued before January 1, 1934, and which contain a tax-free covenant. For the purpose of section 143 (a) and (b) "bonds," "mortgages," "deeds of trust," or "other similar obligations of a corporation," is defined to include any security, whether fixed or determinable annual or periodical income, whether the issuer is a citizen or resident, or to an alien or fiduciary, who is a citizen or resident of the United States, or to a partnership any member of which is a citizen or resident, or to an unknown owner.

(5) For withholding in the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant, and issued before January 1, 1934, are applicable to interest on such obligations issued by a domestic corporation or a foreign corporation with a substantial business or fixed place of business in the United States, withholding is not required in the case of interest payments on such bonds or obligations if such interest is not to be treated as income from sources within the United States under section 119 (a) (1) and (b) and the payments are made to a nonresident alien or a partnership composed wholly of nonresident aliens. A nonresident alien, or a partnership composed wholly of nonresident aliens, is nonresident for the purpose of withholding, even though the owner of the bond or obligation pays annual or periodical income, whether the issuer is a citizen or resident, or to an alien or fiduciary, who is a citizen or resident of the United States, or to a partnership any member of which is a citizen or resident, or to an unknown owner.

§ 39.143-2 Fixed or determinable annual or periodical income. (a) Only fixed or determinable annual or periodical income is subject to withholding. The Internal Revenue Code specifically includes in such income interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income are included, as for instance, royalties.

(b) Income is fixed when it is to be paid in amounts definitely predetermined. Income is fixed when there is fixed or determinable annual or periodical income. The Internal Revenue Code specifically includes in such income interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income are included, as for instance, royalties.

(1) As to who are nonresident alien individuals, see §§ 39.121-2 and 39.379-7. For the purpose of section 143 (a) and (b) the term "nonresident alien individual" includes an alien resident of Puerto Rico. For classification of foreign corporations, see §§ 39.231-2 and 39.379-7. As to what partnerships are deemed to be nonresident partnerships, see § 39.379-7.

(15) For withholding in the case of dividends distributed by a corporation organized under the laws of the Panama Canal Zone Act, 1922 (15 U. S. C., c. 4) see §§ 39.142-3 and 39.262-4.

(b) Tax-free covenant bonds issued before January 1, 1934. (1) The withholding provisions of section 143 (a) and (b) are applicable only to bonds, mortgages, or deeds of trust, or other similar obligations of a corporation which were issued before January 1, 1934, and which contain a tax-free covenant. For the purpose of section 143 (a) and (b) "bonds," "mortgages," "deeds of trust," or "other similar obligations of a corporation," is defined to include any security, whether fixed or determinable annual or periodical income, whether the issuer is a citizen or resident, or to an alien or fiduciary, who is a citizen or resident of the United States, or to a partnership any member of which is a citizen or resident, or to an unknown owner.

(5) For withholding in the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant, and issued before January 1, 1934, are applicable to interest on such obligations issued by a domestic corporation or a foreign corporation with a substantial business or fixed place of business in the United States, withholding is not required in the case of interest payments on such bonds or obligations if such interest is not to be treated as income from sources within the United States under section 119 (a) (1) and (b) and the payments are made to a nonresident alien or a partnership composed wholly of nonresident aliens. A nonresident alien, or a partnership composed wholly of nonresident aliens, is nonresident for the purpose of withholding, even though the owner of the bond or obligation pays annual or periodical income, whether the issuer is a citizen or resident, or to an alien or fiduciary, who is a citizen or resident of the United States, or to a partnership any member of which is a citizen or resident, or to an unknown owner.

§ 39.143-2 Fixed or determinable annual or periodical income. (a) Only fixed or determinable annual or periodical income is subject to withholding. The Internal Revenue Code specifically includes in such income interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income are included, as for instance, royalties.

(b) Income is fixed when it is to be paid in amounts definitely predetermined. Income is fixed when there is fixed or determinable annual or periodical income. The Internal Revenue Code specifically includes in such income interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income are included, as for instance, royalties.
periodical income. Such items as taxes,

§ 39.143-3 Exemption from withholding. (a) Withholding from interest on bonds or other obligations of corporations issued before January 1, 1934, containing a tax-exempt covenant, shall not be required if there is filed with the withholding agent when presenting coupons for payment, or not later than February 1 of the following year, an ownership certificate on Form 1098 stating—

(1) In the case of a citizen or resident of the United States, that his net income does not exceed his exemptions under section 25 (b) or

(2) In the case of an estate or trust, that the net income does not exceed the credit allowed under section 163 (a) or

To avoid inconvenience, a resident alien should file a certificate of residence on Form 1078 with withholding agents, who shall forward such certificates to the Commissioner of Internal Revenue, Washington 2, D. C., with a letter of transmittal; except that, on and after July 19, 1952, such certificates shall be forwarded to the District Director of Internal Revenue, Baltimore 2, Maryland.

(b) The income of domestic corporations and of resident foreign corporations is free from withholding.

(c) No withholding from dividends paid by a corporation organized under the China Trade Act, 1923 (15 U. S. C. c. 4) is required unless the dividends are treated as income from sources within the United States under section 119 and are distributed to—

(1) A nonresident alien other than a resident of China at the time of such distribution;

(2) A nonresident partnership composed in whole or in part of nonresident aliens (other than a partnership resident in China);

(3) A nonresident foreign corporation (other than a corporation resident in China);

(d) The salary or other compensation for personal services of a nonresident alien individual who enters or leaves the United States at frequent intervals shall not be subject to deduction and withholding of income tax at the source if—

(1) Such nonresident alien is a resident of Canada or Mexico, or

(2) Such nonresident alien is engaged in agricultural labor as defined in section 1256(b) of the Code and his only income is from agricultural labor as defined in section 1256(b)

(e) A nonresident alien individual not engaged in trade or business within the United States at any time within the taxable year as described in the first sentence of this paragraph shall not be entitled to the exemptions under section 25 (b) or

(f) In the case of interest payments on overdue coupon bonds, the interest coupons of which have been exhausted, ownership certificates are required to be filed when collecting the interest in the same manner as if interest coupons were presented for collection.

§ 39.143-3 Ownership certificates for bond interest. (a) In accordance with the provisions of section 119 of the Code and the regulations thereunder, resident partnerships and nonresident partnerships all of the members of which are citizens or residents, owning bonds, mortgages, or deeds of trust, or other similar obligations issued by a domestic corporation, a resident foreign corporation, or a nonresident foreign corporation having a fiscal agent or a paying agent in the United States, when presenting interest coupons for payment shall own ownership certificates, regardless of the amount of the coupons, for each issue of such obligations issued before January 1, 1934, and containing a tax-free covenant.

(b) In the case of interest payments on overdue coupon bonds, the interest coupons of which have been exhausted, ownership certificates are required to be filed when collecting the interest in the same manner as if interest coupons were presented for collection.

(c) In the case of interest payments on other similar obligations of a corporation to the District Director of Internal Revenue, Baltimore 2, Maryland. 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. 

(g) Ownership certificates are required in connection with interest payments made in case of coupon bonds, except that if ownership certificates are not furnished by the owner of such bonds, ownership certificates may be prepared by the withholding agent.

§ 39.143-5 Form of certificate for citizens or residents. For the purpose of § 39.143-4, Form 1000 shall be used in preparing ownership certificates of citizens or residents of the United States (individual or fiduciary), resident partnerships, and nonresident partnerships 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 that of the name and address of the debtor corporation.

§ 39.143-6 Form of certificate for nonresident aliens, nonresident foreign corporations, and unknown owners. For the purpose of § 39.143-4, Form 1001 shall be used in preparing ownership certificates (a) of nonresident aliens, (b) of nonresident partnerships composed in whole or in part of nonresident aliens, (c) of nonresident foreign corporations, and (d) where the owner is unknown.

§ 39.143-7 Return and payment of tax withheld. (a) 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 a nonresident foreign corporation to citizens or residents, or nonresident foreign corporations, and unknown owners. The return shall be made on Form 1013, or on Form 1012, showing the amount of tax required to be withheld in respect to such income and such estate or trust, whether by check or otherwise.

(b) Every person required to deduct and withhold any tax from income other than such bonds shall make such annual return thereof to the district director of internal revenue in which such person is located or before March 15 on Form 1042, showing the amount of tax required to be withheld from each nonresident alien, nonresident partnership, or nonresident foreign corporation, or nonresident foreign corporation in which income other than bond interest was paid during the previous taxable year. There shall be reported on Form 1042B not only such income, income for which tax was not withheld, or for which tax was not due because the tax has already been paid, and the amount of tax withheld from such income, and the amount of tax required to be withheld.

(c) Where the tax withheld has been paid over to the district director of internal revenue in the case of bonds, the tax withheld shall be paid over in the case of any other income, in addition to the tax paid over to the district director of internal revenue thereon. The tax shall be paid over by the withholding agent in the manner prescribed in § 39.143-4, with such form as may be prescribed by the Commissioner of the Public Debt for in- the case of fiduciaries, and of the fiduciary, including 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.

§ 39.143-9 Return of income from which tax was withheld. (a) A return of the income from which the tax was withheld shall be made by the recipient of the income to the extent that the tax was credited against the total income tax as computed in the taxpayer's return. See, however, § 39.145-5. If the tax is paid by the recipient of the income or by 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 assessed against either person for failure to re- turn or pay the tax where no fraud or purpose to evade payment is involved.

(b) Tax withheld at the source upon fixed or determinable annual or period- ical income paid to nonresident alien fiduciaries is deemed to have been paid by the persons ultimately liable for the tax upon such income. Accordingly, if a person subject to the taxes imposed by section 144 (relating to tax-free covenant bonds) the tax withheld on the income is to be credited against the amount of the income tax computed upon his return, and any excess shall be credited against any income, war-profit, or excess-profit tax, or any amount of tax payable thereon. In such case the 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-profit, or excess-profit tax, or any amount thereof, then due from such person, and any balance shall be refunded.

§ 39.144 Statutory provisions; payment of corporation income tax at source.

§ 39.144-1 Withholding in the case of nonresident foreign corporations. (a) A tax of 30 percent is required to be withheld in the case of fixed or deter- minable annual or periodical income paid to a nonresident foreign corporation, such tax to be reduced to such rate (not less than 10 percent) of the liability for withholding Is subject to taxation under this chapter where the liability for withholding is from any country in North, Central, South America, the debtors, which at the time of such withholding are deemed to have been paid over to the district director of internal revenue in the case of bonds, the tax withheld shall be paid over in the case of any other income, in addition to the tax paid over to the district director of internal revenue thereon. The tax shall be paid over by the withholding agent in the manner prescribed in § 39.143-4, with such form as may be prescribed by the Commissioner of the Public Debt for in- the case of fiduciaries, and of the fiduciary, including 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.

§ 39.143-9 Return of income from which tax was withheld. (a) A return of the income from which the tax was withheld shall be made by the recipient of the income to the extent that the tax was credited against the total income tax as computed in the taxpayer's return. See, however, § 39.145-5. If the tax is paid by the recipient of the income or by 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 assessed against either person for failure to re- turn or pay the tax where no fraud or purpose to evade payment is involved.

(b) Tax withheld at the source upon fixed or determinable annual or period- ical income paid to nonresident alien fiduciaries is deemed to have been paid by the persons ultimately liable for the tax upon such income. Accordingly, if a person subject to the taxes imposed by section 144 (relating to tax-free covenant bonds) the tax withheld on the income is to be credited against the amount of the income tax computed upon his return, and any excess shall be credited against any income, war-profit, or excess-profit tax, or any amount thereof, then due from such person, and any balance shall be refunded.

§ 39.144 Statutory provisions; payment of corporation income tax at source.

§ 39.144-1 Withholding in the case of nonresident foreign corporations. (a) A tax of 30 percent is required to be withheld in the case of fixed or deter- minable annual or periodical income paid to a nonresident foreign corporation, such tax to be reduced to such rate (not less than 10 percent) of the liability for withholding Is subject to taxation under this chapter where the liability for withholding is from any country in North, Central, South America, the debtors, which at the time of such withholding are deemed to have been paid over to the district director of internal revenue in the case of bonds, the tax withheld shall be paid over in the case of any other income, in addition to the tax paid over to the district director of internal revenue thereon. The tax shall be paid over by the withholding agent in the manner prescribed in § 39.143-4, with such form as may be prescribed by the Commissioner of the Public Debt for in- the case of fiduciaries, and of the fiduciary, including 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.

§ 39.143-9 Return of income from which tax was withheld. (a) A return of the income from which the tax was withheld shall be made by the recipient of the income to the extent that the tax was credited against the total income tax as computed in the taxpayer's return. See, however, § 39.145-5. If the tax is paid by the recipient of the income or by 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 assessed against either person for failure to re- turn or pay the tax where no fraud or purpose to evade payment is involved.

(b) Tax withheld at the source upon fixed or determinable annual or period- ical income paid to nonresident alien fiduciaries is deemed to have been paid by the persons ultimately liable for the tax upon such income. Accordingly, if a person subject to the taxes imposed by section 144 (relating to tax-free covenant bonds) the tax withheld on the income is to be credited against the amount of the income tax computed upon his return, and any excess shall be credited against any income, war-profit, or excess-profit tax, or any amount thereof, then due from such person, and any balance shall be refunded.
§ 39.144-2 Aids to withholding agents in determining liability for withholding of tax. (a) Since no withholding of tax on bond interest, dividends, or other income is required in the case of a resident foreign corporation (see § 39.143-3) the person paying such income should be notified by a letter from such corporation that it is 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; if the corporation is a foreign corporation, the name of the corporation giving its official title. Such letter of notification, or copy thereof, should be immediately forwarded by the recipient to the Commissioner of Internal Revenue. Exempts, Section, Washington 25, D. C., except that, on and after July 19, 1953, such letter, or a copy thereof, shall be forwarded to the Director of Internal Revenue, Baltimore 2, Maryland. The same procedure should be followed in the case of resident partnerships, composed in whole or in part of nonresident aliens, not subject to the withholding provisions of the Code except in the case of interest on tax-free covenant bonds. The letter should be signed by a member of the firm.

(b) When a payor corporation, or any other person (including a nominee), having the control, receipt, custody disposal, or payment of dividends has no definite knowledge 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 must be assumed that the 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 nonresident alien. If a shareholder changes his address within the United States to another point in 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 written return statement that he is a citizen, or resident of the United States, may be relied upon by the payor of income as proof that such person is a citizen or resident of the United States.

§ 39.145 Statutory provisions; penalties.

Sec. 145. Penalties.—(a) Failure to file returns, submit information, or pay estimated tax or tax. Any person required under this chapter to pay any estimated tax or tax, or required under the provisions of the Code to make a return or declaration, keep any records, or supply any information, for the purposes of the computation, assessment, or collection of any estimated tax or tax imposed by this chapter, who willfully fails to pay such estimated tax or tax, make such return or declaration, keep such records, or supply such information, at the time or times required by law or regulation, shall, for each such failure to pay, for each such return or declaration, or to keep such records, or to supply such information, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(b) Failure to collect and pay over tax, or attempt to defeat or evade tax. Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully and without cause, fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(c) * * * [Repealed—see sec. 3800 (a) for corresponding provision of law.]

§ 39.145—1 Penalties. The penalties provided in this section cannot be assessed but are enforceable only by suit for money damages. For limitations on prosecutions, see section 3738. The willful failure of a taxpayer to give information required in his return as to advice or assistance rendered in the preparation of the return, and the willful failure of the person preparing a return for another to execute the statement required with respect to foreign personal holding companies and foreign corporations, see section 340.

(d) * * * [Relates to taxable years beginning before October 1, 1950, and ending after September 30, 1950.]

(e) * * * [Relates to taxable years beginning before November 1, 1951, and ending after October 31, 1951.]

§ 39.146 Statutory provisions; closing by Commissioner of taxable year. Sec. 146. Closing by Commissioner of taxable year.—(a) Tax in jeopardy.—(1) Departure of taxpayer or removal of property. If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therefrom, he may do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then
last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(2) Corporation in liquidation. If the Commissioner finds that the collection of the tax of a corporation for the current or last past taxable year will be jeopardized by the distribution of the assets of such corporation in liquidation of the whole or any part of its capital stock, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing returns and paying other taxes has expired; and such taxes shall thereupon become immediately 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 Commissioner, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may accept in lieu of security for return and payment of taxes made due and payable by virtue of the provisions of this section and such further security as may be approved by the Secretary, a bond, or notes of the United States or of possessions of the United States, or of any national banking association or any bank or bank or trust company authorized to do business in or under the laws of the United States, or of any corporation existing and doing business in any state, the obligations of which are secured by the United States or one or more states, or of any corporation existing and doing business in any state, the obligations of which are secured by the United States or one or more states, and in which the United States has an interest, or of any national bank or any foreign bank or trust company authorized to do business in or under the laws of the United States or of any state, the obligations of which are secured by the United States or any state.

(c) Same—Exemption from section. If security is approved and accepted pursuant to the provisions of this section and such further or other security as the Commissioner may accept in lieu thereof, 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 Commissioner, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may accept in lieu of security for return and payment of taxes made due and payable by virtue of the provisions of this section and such further security as may be approved by the Secretary, a bond, or notes of the United States or of possessions of the United States, or of any national banking association or any bank or bank or trust company authorized to do business in or under the laws of the United States, or of any corporation existing and doing business in any state, the obligations of which are secured by the United States or one or more states, or of any corporation existing and doing business in any state, the obligations of which are secured by the United States or one or more states, and in which the United States has an interest, or of any national bank or any foreign bank or trust company authorized to do business in or under the laws of the United States or of any state, the obligations of which are secured by the United States or any state.

(d) Citizens. In the case of a citizen of the United States or of a possession of the United States or of a citizen of a country which the United States is holding in a public trust, the Commissioner may, at his discretion, waive any or all of the requirements placed on a taxpayer by this section if it appears to the Commissioner that no tax is due and payable by such taxpayer and such exempting the taxpayer from the provisions of this section.

(e) Departure of alien. No alien shall depart from the United States unless he first procures from the district director or other officer 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.

(f) Addition to tax. If a taxpayer violates or attempts to violate this section here shall, in addition to penalties, be added to the tax, as part of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 6 per centum per annum from the time the tax became due.

§ 39.145-1 Termination of the taxable period by Commissioner. (a) Section 145 authorizes the Commissioner to terminate the taxable period of a taxpayer who designs by immediate departure from the United States or otherwise to avoid the payment of the tax for the preceding taxable year. Where such evidence satisfactory to him, declare the taxable period for such taxpayer immediately terminated and cause to be served upon him notice and demand for immediate payment of the tax for the taxable period declared terminated, and of the tax for the preceding taxable year, or so much of such tax as is unpaid. In such case the taxpayer is entitled to the exemptions for return and payment of taxes made due and payable by virtue of the provisions of this section and such further evidence of the taxpayer's design.

Sec. 146 (a) provides for a similar termination of the taxable period of a corporation if the Commissioner finds that the collection of the tax of the corporation for the current or preceding taxable year will be jeopardized by the distribution of all or a portion of its capital stock. Such finding of the Commissioner is considered prima facie correct. A taxpayer who is not in default in making the returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes which are or may be due pursuant to this section by depositing with the Commissioner United States bonds of a principal amount not exceeding double the amount of taxes due for the taxable period, or by furnishing such other security as may be approved by the Commissioner.

(b) Except as provided in paragraph (c) of this section, an alien who intends to depart from the United States and whose tax year has not been terminated by the Commissioner for the payment of such tax as is due and payable for the taxable period declared terminated, or to whom a certificate of compliance has been issued under section 145, shall, after notice and demand for immediate payment of the tax for the taxable period declared terminated, and of the tax for the preceding taxable year, or so much of such tax as is unpaid, in any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.
COMMISSIONER OF INTERNAL REVENUE

(Rule 4040D

Bonds complying with the provisions of this section, if properly executed and approved, and may be accepted

From the Secretary of the Treasury as

Held as a surety on a bond unless the corpo-

signing the Form 1133 as follows:

In the case of payments made by the United States to persons in its service (civil or armed forces) of wages, salaries, or compensation in gross income under §§ 39.22 (b) (1)–1, 39.22 (b) (2)–1, and 39.22 (b) (2)–2 come within the meaning of the term "fixed or determinable income" and are required to be reported as 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.

For purpose 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 or restriction as to the time or manner of payment or condition upon which payment is to be made, and which is attributable to him so that it may be drawn at any time, and its receipt brought within his own control and disposition.

The above provision applies to the making of payments in any case on Form 1099-B, and of Internal Revenue, Processing Division, Kansas City, Missouri. When both main office and branch office have adequate records, the return shall be made by the branch office.

(b) Amounts distributed or made available in any calendar year under an employee's trust governed by the provisions of section 162, or under an annuity plan to which § 39.22 (b) (2)–5 relates, to a beneficiary shall be reported to the extent such amounts are includible in the gross income of such beneficiary where the amounts so includible are $500 or more.

(c) Returns of information as custodians of income for meals and lodgings, as, for example, to persons in its service (civil or armed forces) as an allowance for traveling or other expenses, including an allowance for meals and lodgings, as, for example, a per diem allowance for travel expenses, is a part of Form 1040.

(District Director of Internal Revenue)

(b) A corporation will not be accepted as a surety on a bond unless the corporation holds a certificate of authority as a surety on a bond unless the corporation

Sec. 147. Information at source—(a) Payments of $600 or more. All persons, in whatever capacity acting, including lessees or mortgagees of real or personal property, fiduciaries, and employees, making payments to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in section 148 (a) or (b) in respect of the taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments, are required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(b) Returns regardless of amount of payment. Returns shall be required, regardless of amounts, (1) in the case of payments of Interest, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

(c) Recipient to furnish name and address. 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.

[Sec. 147 as amended by sec. 7 (c), Rev. Act 1940; secs. 112 (c) and 116, Rev. Act 1941; sec. 131 (c) (8), Rev. Act 1942; sec. 202 (c) (8), Rev. Act 1943; sec. 105, Rev. Act 1946]

Section 147-1 Return of information as to payments of $600 or more. (a) All persons making payments to another person of fixed or determinable income of $600 or more in any calendar year must render a return thereof for such year on or before February 28 of the following year except as specified in §§ 39.147–3 to 39.147–5, inclusive. A return shall be made in each case on Form 1099, accompanying Form 1096 showing the number of returns filed, except that the return with respect to distributions to beneficiaries of a trust or estate shall be made on Form 1041 in lieu of Forms 1099 and 1096. Returns of information on Forms 1096 and 1099 should be filed with the Commissioner of Internal Revenue, Processing Division, Kansas City, Missouri.

In the case of payments made by the United States to persons in its service (civil or armed forces) as an allowance for travel or other expenses, including an allowance for meals and lodgings, as, for example, a per diem allowance for travel expenses.
sistence, and amounts paid as reimbursements for traveling expenses.

(10) Payments of interest on obligations of the United States or any agency or instrumentality thereof, the ownership of which is not deemed by the Commissioner to be tax-exempt under section 1031, are not taxable under section 108.

(11) Payments of interest on corporate bonds, except in the case of interest on bonds, mortgages, deeds of trust, or other similar obligations issued before January 1, 1934, and containing a tax-free covenant; and

(12) Payments made to employees for services performed in Puerto Rico. The term "employee" shall not be applicable with respect to returns of information as to patronage dividends, rebates, or refunds required under section 148 (f).

§ 39.147-4 Return of information as to certain interest. In the case of payments of interest, regardless of amount, on bonds and similar obligations of corporations, and interest on obligations of the United States, a nonresident partner, a nonresident partnership, a nonresident alien, or a nonresident foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends paid in liquidation or distribution to any corporation or foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends paid in liquidation or distribution to any foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends paid in liquidation or distribution to any shareholder who is an individual (citizen or resident of the United States) or a resident partnership any member of which is a citizen or resident, accounting for $10 or more during the calendar year, shall render an information return on Forms 1096 and 1099. A separate Form 1099 must be presented for each shareholder, upon which shall be shown the name and address of the shareholder to whom such payment was made, and the amount paid. These forms, accompanied by the original Form 1096 showing the number of Forms 1099 filed therewith, shall be filed with the Commissioner of Internal Revenue, Processing Division, C. C. Station, Kansas City 2, Missouri, not later than February 28 of the following year.

The periodical distributions of earnings on running installment shares of stock paid or credited by or a withholding return on Form 1096 shall be included in the information returns required by section 115 (d). To whom such stock is payable, and the amount paid in or account of tax credits and stock subscriptions, consisting of accumulated profits, constitutes a dividend within the meaning of section 115 (a). The sum received upon withdrawal from a building and loan association includes the following: (a) The payment to the record owner of the dividends paid to him. In accordance with the regulations of the Commissioner of Internal Revenue, the information return on Forms 1096 and 1099 shall be rendered only in the case of payments amounting to $10 or more during the calendar year.

§ 39.147-6 Foreign items. The term "foreign items," as used in the regulations in this part, means any item of interest upon the bonds of a foreign country or of a nonresident foreign corporation not having a fiscal or paying agent in the United States (including Puerto Rico as if a part of the United States) or any item of dividends upon the stock of such corporation.

§ 39.147-7 Return of information as to foreign items. In the case of foreign items, an information return on Form 1096 is required to be filed by the record owner or his 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). In the case of a partnership any member of which is a citizen or resident, and if the amount of the foreign item paid in any taxable year to an individual, a partnership, or a fiduciary is $600 or more. Such forms accompanied by transmittal Form 1096 should be forwarded to the Commissioner of Internal Revenue, Processing Division, C. C. Station, Kansas City 2, Missouri, on or before February 28 of the calendar year following the calendar year in which the item was paid. See §§ 39.147-1 and 39.147-3.

§ 39.147-8 Information as to actual owner. (a) When the person receiving an item of information as to the ownership of such item is not the actual owner of the item of information, the person presenting the form for the purpose of transmitting it abroad for deposits.

(1) Except as provided in paragraph (b) of this section, every domestic corporation or foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends paid in liquidation or distribution to any corporation or foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends paid in liquidation or distribution to any shareholder who is an individual (citizen or resident of the United States) or a resident partnership any member of which is a citizen or resident, accounting for $10 or more during the calendar year, shall render an information return on Forms 1096 and 1099. A separate Form 1099 must be presented for each shareholder, upon which shall be shown the name and address of the shareholder to whom such payment was made, and the amount paid. These forms, accompanied by the original Form 1096 showing the number of Forms 1099 filed therewith, shall be filed with the Commissioner of Internal Revenue, Processing Division, C. C. Station, Kansas City 2, Missouri, not later than February 28 of the following year. The periodical distributions of earnings on running installment shares of stock paid or credited by or a withholding return on Form 1096 shall be included in the information returns required by section 115 (d). To whom such stock is payable, and the amount paid in or account of tax credits and stock subscriptions, consisting of accumulated profits, constitutes a dividend within the meaning of section 115 (a). The sum received upon withdrawal from a building and loan association includes the following: (a) The payment to the record owner of the dividends paid to him. In accordance with the regulations of the Commissioner of Internal Revenue, the information return on Forms 1096 and 1099 shall be rendered only in the case of payments amounting to $10 or more during the calendar year.

§ 39.148 (a)−(f)
the case of a savings and loan association, a cooperative bank, a home
association, a credit union, or a building and loan association an informa-
tion return is required to be filed with respect to dividends or disbursements to a
shareholder of any class of stock, or of any other information required to have
been reported under the provisions of § 39.147-1 if the dividends or distributions
have been payments of interest, except that, for years prior to 1950, such an organization is required to
file an information return where the payments to a shareholder amount to
$100 or more during the calendar year.
(c) In any case in which it is impos-
sible to file the return within the time
prescribed in this section, the corpo-
anization may, upon a showing of such fact, obtain a reasonable extension of time for
filing the return. Authority for granting extensions of time for filing the
return of information is hereby dele-
gated to the various district directors of
internal revenue. Applications for such
extensions must be addressed to the dis-
trict director of internal revenue for the
internal revenue district in which the
organization files its income tax returns, must contain a description of
the facts as will enable him to determine
how the delay must be submitted on
or before the date prescribed for filing
the return of information. No extension may be granted for more than six
months.

§ 39.148 (b)-(d) Statutory provisions: information by corporations; profits declared as dividends; accumulated earnings and profits; contemplated dissolution or liquidation.

Sec. 148. Information by corporations. * * *
(b) Profits declared as dividends. Every
corporation shall, when required by the
Commissioner, furnish him a statement of such facts as will enable him to determine
the portion of the earnings or profits of the
corporation (including gains, profits, and income not taxed) accumulated during such
periods as the Commissioner may specify,
which have been distributed or ordered to be
distributed during any calendar year, to be
reported by such corporation during such taxable years as the
Commissioner may specify.

(1) Contents of return. In every return,
the Commissioner shall be furnished with
the following information:
(a) The name and address of the
corporation;
(i) The place and date of incorpo-
ration;
(ii) The date of the adoption of the
resolution or plan and the dates of any
amendments thereof or supplements thereto;
and
(iv) The collection district in which
the last income tax return of the cor-
poration was filed and the taxable year
covered thereby.
(2) Liquidation within one calendar
month. In the event that the cor-
poration is a domestic corporation and
the plan of liquidation provides for a
distribution in complete cancellation or
redemption of all the capital stock of the
corporation, and for the trans-
fer of its assets to a trust or corporation
under the liquidation entirely within
some one calendar month pursuant to
section 112 (b) "(i) and any shareholder
claims the benefit of such section,
such return shall contain the infor-

mation required by subparagraph (1)
of this paragraph, contain the follow-
ing:
(i) A statement showing the number of
shares of each class of stock out-
standing at the time of the adoption of
the plan of liquidation, together with a
description of the voting power of each
such class;
(ii) A list of all the shareholders owning
stock at the time of the adoption of the
plan of liquidation, together with the
number of shares of each class of stock
owned by each such shareholder, the
certificate numbers thereof, and the total
number of votes to which entitled on the
adoption of the plan of liquidation; and
(iii) A list of all corporate shareholders
and of the number of shares of each class
of stock owned by each such shareholder,
the certificate numbers thereof, the total
number of votes to which entitled on the
adoption of the plan of liquidation, and
a statement of all changes in ownership
of stock by corporate shareholders be-
tween August 15, 1950, and the date of
the adoption of the plan of liquidation,
both dates inclusive.

(3) Returns in respect of amendments or supplements. If a return in respect of such amendments or supplements is required in
respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock has already been filed pursuant to section 148 (d), a re-
turn in respect of any such amendment or supplement thereto will be deemed
sufficient if it gives the date such prior
return was filed and contains a duly certified copy of the resolution or supplement and all other information required by this section and by Form
966 which was not given in such prior return. If no return was filed relative to the resolution or plan which is being amended or supplemented, the return relative to the amendment thereof or supplement thereto will include a duly certified copy of the resolution or supplement, which is to be amended or supple-
mplemented, together with all amendments thereof and supplements thereto, and all other information required by this section and by Form
966.

§ 39.148 (e) Statutory provisions; information by corporations; distributions in liquidation.

Sec. 148. Information by corpora-
tions. * * *
(e) Distributions in liquidation. Every
corporation shall, when required by the
Commissioner, render a correct return, duly verified under oath, of its distribution in liquidation, stating the number of shares of
each shareholder, the number and class of
shares owned by him, and the amount
paid to him or, if the distribution is in
property other than money, the fair market
value (as of the date the distribution is
made) of the property distributed to him.

§ 39.148 (a)–1 Return of information respecting distributions in liquidation. The return required by § 39.148 (e), in respect of which information is required to be filed pursuant to § 39.113 (b) (6)–5 (b) § 39.112 (g)–6 (a), or § 39.371–11, every corporation making any distribution of its capital stock on or after a calendar year to any shareholder in liquidation of the whole or any part of its capital stock shall file a return of information on Form 1096 and 1096L, giving all the
information required by such forms and
by the regulations in this part. A sepa-
rate Form 1099L must be prepared for
each shareholder to whom such distribu-
tion was made, showing the name and
address of such shareholder, the number
and class and shares owned by him in
liquidation of which such distribution
was made, and the total amount distrib-
uted to him on each class of stock. If the
amount distributed to such share-
holder on any class of stock consisted in
whole or in part of property other than
money the return on such form shall in
addition show the fair market value,
computed, if any, and shall list separately
each class of property other than money
distributed, giving a description of the
property in each such class and a state-
ment of its fair market value at the time
of the distribution. Such forms, accom-
§ 39.148 (f) Statutory provisions; information by corporations; patronage dividends.

Section 148. Information by corporations.

* * *

(f) Patronage dividends. Any corporation allocating amounts as patronage dividends, rebates, or refunds (whether in cash, merchandise, capital stock, revolving fund certificates, retainer certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, rebate, or refund) shall render a correct return stating (1) the name and address of each patron to whom such dividend, rebate, or refund is allocated, (2) the date and circumstances of the allocation by the corporation of any stock or securities distributed to shareholders in the liquidation, and (3) the amount of dividends, rebates, and refunds (whether in cash, merchandise, capital stock, revolving fund certificates, retainer certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, rebate, or refund) which have been distributed during the calendar year.

§ 39.149—150 Statutory provisions; returns of brokers; collection of foreign items.

Section 149. Returns of brokers. Every person doing business as a broker shall, when required by the Secretary, render a correct return duly verified under oath, under such rules and regulations as the Commissioner may prescribe, showing the amount of dividends, rebates, and refunds (whether in cash, merchandise, capital stock, revolving fund certificates, retainer certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, rebate, or refund) which have been derived from the customer during the calendar year.

§ 39.150—1. License to collect foreign items. Banks or agents collecting foreign items, as defined in § 39.147—8, and required by § 39.147—7 to make returns of information with respect thereto, must obtain a license from the Commissioner, signed by the Secretary, and the return when required, or failing to comply with the requirements of such section shall be guilty of a misdemeanor and shall be fined not more than $5,000 or imprisoned for not more than one year, or both.
(5) The total income of the trust within such year and the expenses attributable thereto, and
(6) A balance sheet showing the assets, liabilities, and net worth of the trust as of the beginning of such year.

This subsection shall not apply in the case of a taxable year if all the net income for such year is exempt and the applicable principles of the law of trusts, is required to be distributed currently to the beneficiaries.

(c) Information available to the public. The information required to be furnished by subsections (a) and (b), together with the names of such categories of contributions and trusts, shall be made available to the public at such times and in such places as the Secretary may prescribe.

(d) Penalties. In the case of a willful failure to furnish the information required under this section, the penalties provided in section 162 (a) shall be applicable.

[Sec. 183 as added by sec. 341 (a), Rev. Act 1960; amended by Pub. Law 85-524 (82d Cong.)]

§ 39.153–1 Information required from certain tax-exempt organizations. (a) Every organization described in section 101 (f) (other than those specifically exempt from filing annual returns under section 54 (f) (see § 39.101–1 (h))) shall file a return of information on Form 990–A. The return shall be on the basis of the calendar year. Where the organization has not established annual accounting period, the return shall be made on the basis of the calendar year.

The return shall be filed on or before the fifteenth day of the fifth month following the close of the taxable year of the trust with the district director of internal revenue for the internal revenue district in which charitable or other deductions were made, the total amount paid out during the taxable year which represents amounts permanently set aside in priory years for which charitable or other deductions have been taken under section 162 (a) and separately listing for each class of activity for which disbursements were made, the total amount paid out, and the amount for which charitable or other deductions have been taken under section 162 (a) and which had not been paid out at the beginning of the taxable year,

(1) The amount paid out during the taxable year which represents amounts permanently set aside in prior years for which charitable or other deductions have been taken under section 162 (a) and which had not been paid out at the beginning of the taxable year,

(2) The amount paid out of principal in prior years for charitable, etc., purposes, and separately listing for each class of activity for which disbursements were made, the total amount paid out,

(3) The amount for which charitable or other deductions have been taken in prior years under section 162 (a) and which had not been paid out at the beginning of the taxable year,

(4) The gross income of the trust for the taxable year and the expenses attributable thereto, in sufficient detail to show the different categories of income and of expense, and

(b) Exception. The provisions of paragraph (a) of this section with respect to the filing of information returns shall not be applicable to the taxable year of a trust if the trustee is bound by any instrument in trust to distribute each year to the beneficiaries all the net income of the trust (such net income being determined under the applicable principles of the law of trusts).

§ 39.153–2 Publicity of returns. The information furnished on pages 3 and 4 of Form 990–A and the information furnished on Form 1041–A shall be a matter of public record, and shall be open to public inspection, during regular hours of business, in the office of the district director of internal revenue for the internal revenue district in which the forms are filed. The Commissioner may use such information for the purposes of making and publishing statistical or other studies.

§ 39.153–4 Penalties. In the case of a willful failure to furnish the information required under section 153 and §§ 39.153–1 and 39.153–2, the penalties provided in section 162 (a) shall be applicable.

§ 39.154 Statutory provisions; income taxes of members of armed forces upon death.

§ 39.154–1 Abatement of income taxes of certain members of the armed forces of the United States upon death. (a) If an individual dies after June 24, 1950, and prior to January 1, 1954, while in active service as a member of the armed forces of the United States, if such death occurred while serving in a combat zone (as determined under section 28 (b) (13)) or as a result of wounds, disease, or injury incurred while so serving

(1) The tax imposed by this chapter shall not apply with respect to the taxable year in which the date of his death, or with respect to any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950; and

(b) The tax under this chapter and under the corresponding title of each prior revenue law for taxable years preceding these specified in clause (a) which is unpaid as of the date of his death (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

[Sec. 165 as added by sec. 334, Rev. Act 1951]
§ 39.162
forces, see §
disease, or injury incurred while serving
as a member of the armed forces,
of property of a taxpayer where such
such spouse may agree. Should they
tax paid pursuant to such declaration
spouse filed a joint declaration of esti-
mored shall not exceed the amount un-
determined under section 22
individual served in a combat zone, as
income therefrom, is, within the mean-
person or of a trust.
false year paid or permanently set
income in satisfaction of his legal
applied may be of a type to which the provisions of sections 161, 162, and
also apply, of a type which is ex-
rents of sections 161, 162, and 163. Except to the extent that section 22 (f) or
ieces of property, the treatment of such trusts
under sections 161, 162, and 163 or under
sections 22 (a), 165, and 167 is not
ed to the exemptions of employees' trusts.
(b) Taxability of the income. The
ficiary is required to make and file
ated to pay the tax on the net
f the estate, as otherwise provided in sections 22 (a)
22 (a), 165, 166, and 167, and §§ 39.22 (a)–
ld to tax and the amount thereof, consideration is to be given to
aditions authorized in section 163.
§ 39.163
Statutory provisions; estates and trusts; net income.

Sec. 162. Net income. The net income of
the estate or trust shall be computed in the same manner and on the same basis as
the case of an individual except that:
(a) Subject to the provisions of subsection (g), there shall be allowed as a deduc-
tion (in lieu of the deduction for charitable,
etc., contributions authorized by section 23 (o)) any part of the gross income, without
limitations which pursuant to the terms of
will, or deeds creating the trust, is during
the taxable year paid or permanently set
side for the purposes and in the manner
specihed in section 22 (o), or is to be used
exclusively for religious, charitable, scientific, literary, or educational purposes, or
for the prevention of cruelty to animals, or
for the establishment, acquisition, mainte-
nance or operation of a public cemetery not
operated for profit, the deduction of the
income so paid or set aside is attributable
to pain from the estate or of capital,
eligible for the deduction provided that
adjustment of the deduction otherwise allow-
able under this subsection shall be made for
any deduction allowable to the trust under
section 23 (c).
(b) There shall be allowed as an additional
deduction in computing the net income
of the estate or trust the amount of the incomes
of the estate or trust for its taxable years
which is to be distributed currently by
the trustee or the income of the estate or
trust, but the amount so allowed as a deduc-
tion shall be included in computing the
tax income of the legatee, heir, or benefici-
ary in such year.

Sec. 163. Additional deductions authorized in
sections 23 (o) and 23 (p) for a trust as a
matter of law.
estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, 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, coming to the estate or trust during any taxable year, or accruing during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be treated as part of the net income of the legatee, heir, or beneficiary.

(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 can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed may be paid, credited, or distributed under a will, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals) during the taxable year, or to be distributed (e.g., to legatees, heirs, or beneficiaries) during the taxable year or to be distributed at intervals) during the taxable year, or to be distributed on the last day of the taxable year, or, to the extent of the income of the estate or trust, to be credited, or distributed out of corpus.

(b) Payable out of income or corpus. If within the first 60 days of any taxable year of the estate or trust, an amount which can be paid at intervals out of other than income becomes payable, there shall be allowed as a deduction the amount so paid, credited, or to be distributed on the last day of the preceding taxable year the same ratio to such amount as the part of the interval not falling within the taxable year bears to the total interval. If less than 60 days of the part of the interval not falling within the taxable year is a period of more than 12 months, the interval shall be considered to begin on the first 12 months before the end of the taxable year.

(4) Excess deductions. If for any taxable year an estate or trust the deductions allowed under subsection (b) or (c) solely by reason of paragraph (3) (A) in respect of any income which becomes payable to a legatee, heir, or beneficiary from the net income of the estate or trust for such year, computed without such deductions, the amount of such excess shall not be included in computing the net income of such legatee, heir, or beneficiary exceeding the net income of the estate or trust for the part of such period not falling within the taxable year of an estate or trust the deductions allowable under subsection (b) or (c). In cases where the income deductible solely by reason of paragraph (2) or (3) (A) becomes payable to a legatee, heir, or beneficiary from the net income of the estate or trust for the purposes of this paragraph the deduction shall be applied with the application of paragraph (3) (A).

(e) Amounts allowable under section 812 (b) as a deduction in computing the net income of the estate or trust for any taxable year beginning after December 31, 1950, no amount otherwise allowable under subsection (b) shall be allowable as a deduction with respect to income of the taxable year which is allocable to its supplement U business income for such year. As used in this paragraph the term "supplement U business income" means an amount equal to the amount which, if such trust were engaged in any trade or business, would be computed as its unrelated business net income under section 502 (relating to charitable or other purposes described in subsection (a), and such transactions involved a substantial part of such corpus or income.

(f) The standard deduction provided in section 23 (a) shall not be allowed.

(g) Rules for application of section (a). In the case of trusts—(1) Trade or business income. In computing the deduction allowable under subsection (a) as a deduction under section 23, except subsection (w), in computing the net income of the estate or trust unless there is filed, within the time and in the manner and form prescribed by the Commissioner, a statement that the items have not been claimed or allowed as deductions under section 812 (b) and a waiver of the right to have such items allowed at any time as deductions under section 812 (b).

(i) The standard deduction provided in section 23 (a) shall not be allowed.

(2) Distributions in first 60 days of taxable year. If within the first 60 days of any taxable year, any income of the estate or trust, or income of the estate or trust, for a period beginning before the beginning of the taxable year, becomes payable, such income, to the extent of the income of the estate or trust for the part of such period not falling within the taxable year or, if such part is longer than 12 months, the last 12 months thereof, shall be treated as income of the estate or trust to be distributed, paid, credited, or to be distributed on the last day of the preceding taxable year. This subparagraph shall not apply with respect to any amount with respect to which subparagraph (B) applies.

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income or corpus, and which taxable year is the same, or prior to the taxable year of the trust in which such prohibited transaction occurred, such deduction shall be disallowed.

(2) As a party to such prohibited transaction, there is a definite likelihood that such party will be held liable for

(3) Cross reference. For disallowance of certain charitable, etc., deductions otherwise allowable under subsection (a), see section 461.

§ 39.162-1 Income of estates and trusts. (a) In ascertaining the tax liability of an estate or of a trust, there are deductible:

(1) Any part of the gross income of the estate or trust for its taxable year, which, by the terms of the instrument creating the trust, is paid or permanently set aside for the benefit of unborn or unascertained persons or persons with contingent interests.

(2) Any income of the estate or trust for its taxable year which is not similarly paid or credited, to a guardian for his own use and benefit, is likewise deductible from the gross income of the estate or trust.

(b) The income of the estate or trust, unless it is included in the gross income of the grantor of the trust, or in the gross income of some other person granted the power exercisable solely by him in his own right, becomes payable to the legatee, heir, or beneficiary.

(2) Otherwise allowable under section 162(a) as a deduction shall be limited to the amount actually paid out during the taxable year.

(3) In computing the gross income of the estate or trust, there are allowable certain charitable, etc., deductions otherwise allowable under subsection (a), see section 461.
trust (assuming the income tax returns of the trust are made on the calendar year basis) for the calendar year 1952 is to be deducted by the trust under section 162 (b) in computing its net income for 1952 and is to be included in the income of A for his taxable year in which December 31, 1952, falls. In the case of a similar trust, where the twenty-first birthday of B, the beneficiary was on July 1, 1952, and the income of the trust was to be accumulated until that date and then to be distributed at such time as the trustee in his discretion decides, if the trustee on December 31, 1952, decides to distribute the accumulated income to B, the income becomes payable to B on December 31, 1952, whether distributed to him or not. In such a case, the extent to which such amount is considered to be payable out of income of the trust for its taxable year is determined under section 162 (d) (2) and § 39.162-2 (b) (e) Any amount described in paragraph (d) (2) or (3) 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 legatees, heirs, or beneficiaries, whether distributable or not. Any 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 paragraph (d) (2) or (3) of this section and the inclusion in income of the legatee, heir, or beneficiary, see section 162 (d) and § 39.162-2.

(2) Any interest in an estate or trust for its taxable year which during that year may be used, pursuant to the terms of the will or trust instrument, in the discharge or satisfaction, in whole or in part, of a legal obligation of any person is, to the extent so used, taxable to such person as though directly distributed to him as a beneficiary, except in cases to which section 162 (c) and § 39.162-1 applies. See §§ 39.167-1, 39.171-1, and 39.171-2.

(g) The income of an estate of a deceased person, as dealt with in the Internal Revenue Code, is the income described as received by the estate during the period of administration or settlement thereof. The period of administration or settlement of the estate is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settling of estates. If an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, it may have been appreciated, in value since the decedent acquired it. But see sections 42, 43, and 44. As to the taxable gain realized, or the deductible loss sustained, upon the sale or other disposition of property by an administrator, executor, or trustee, and by a legatee, heir, or other beneficiary see sections 111 and 112. As to the application of the principles of § 39.162-2 to the estate of a decedent, see section 117. A statutory allowance paid a widow is not deductible from gross income, except to the extent that under the principles of § 39.162-2 such allowance is deductible to the widow. When real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

(h) 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 a taxable year, the net income on which the tax is so paid is not deductible from gross income, except to the extent that under the principles of § 39.162-2 such income is deductible to the widow. When real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

RULES AND REGULATIONS

§ 39.162-2

Allocation of estate and trust income to legatees and beneficiaries—(a) Allocation among annuitants. (1) Section 162 (d) (1) applies to all annuities in which the executor or trustees can or must (for example, by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest, devise, or inheritance out of other than income except that any annuity 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 annuitant deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies in cases in which amounts are to be paid or credited at intervals and the executor or trustees are at discretion whether to pay or credit such amounts out of income or corpus, regardless of the source (income or corpus) to which the executor or trustees credits such amount. If an annuity is paid, credited, or to be distributed tax-free, that is, under a proviso whereby the executor or trustee will pay the income tax of the annuitant resulting from the receipt of the annuity, the payment of or for the tax by the executor or trustee will be income in the hands of the annuitant under the rule of section 162 (d) to the extent such payment is treated thereunder as out of income.

(2) The method of allocating income of the estate or trust for its taxable year in cases to which section 162 (d) (1) applies is as follows: The aggregate of all amounts which can be paid, credited, or distributed to the legatees, heirs, or beneficiaries (except under a gift, bequest, devise, or inheritance not to be paid, credited, or to be distributed at intervals) is obtained.

The aggregate of such amounts is considered to be paid, credited, or distributed in such cases out of Income of the estate or trust for its taxable year if it does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts does exceed the distributable income of the estate or trust for its taxable year, the portion of such amount paid, credited, or distributed to the legatees, heirs, or beneficiaries (except under a gift, bequest, devise, or inheritance) is considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the aggregate of all amounts which can be paid, credited, or distributed out of other than Income of the estate or trust and, in computing such proportion, the amount of any gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals is not to be included.

(3) Section 162 (d) (1) introduces a concept of distributable income. This is defined in that section as the amount of the net income of the estate or trust computed with the deductions allowed under subsections (b) and (c) of section 162 in the case of amounts paid, credited, or to be distributed to which section 162 (d) (1) does not apply, or (ii) the income of the estate or trust minus the deductions provided for in subsections (b) and (c) of section 162 in the case of amounts paid, credited, or to be distributed to which section 162 (d) (1) does not apply, whichever is greater. "Net income," as thus used, 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 concept: 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
instrument stock dividends are to be allocated in accordance with the terms of the trust instrument and State law, items of income which are not includable 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 amounts which are deductible for Federal income tax purposes are, by the terms of the trust instrument or State law, not to be used to reduce income available for distribution but to be allocated to corpus.

(4) 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, 1953, to pay $2,000 a year to B, and upon the death of B to pay the corpus and any accumulated income to his estate. The returns of the trust and of B are made on the calendar year basis. The trust instrument provides that the amount payable to B is to be paid out of interest and income credited, or to be distributed to a legatee, heir, or beneficiary, other than a legatee, heir, or beneficiary, under the local law to obtain income or compel a distribution of income at a certain date, or from the exercise of the fiduciary's discretion to distribute income, or from a recognized present right under the local law to receive income.

Example. Under the terms of a trust, established in 1953, the trustees are to accumulate income until the twenty-first birthday of A, and then pay to him as a lump-sum distribution. Under section 162, the income of the trust for the period from which such income is derived will be presumed to be accumulated income for purposes of section 162 (d) (2) and (3).

(b) Allocation among income beneficiaries and legatees. (1) 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 to income which is considered to be income of the trust for the period July 1, 1951, through June 30, 1952, which is to be distributed to the beneficiaries and legatees as provided by the trust instrument. It applies only to income which is considered to be income of the trust for the period July 1, 1951, through December 31, 1951.

(2) The amount of income which is considered to be income of the trust for the period from which such income is derived will be presumed to be accumulated income for purposes of section 162 (d) (2) and (3). In such cases the income becomes payable shall be considered the last 12 months of such period (whether or not the income is actually paid), or the income which is derived from the trust during such period shall be considered as derived from the trust during the last 12 months of such period.

(3) As used in section 162, the term "income which becomes payable" means income to which the legatee, heir, or beneficiary has a present right, whether or not such income is actually paid.

Net income is not to be considered to be payable within a taxable year when during the entire taxable year there is only a present right to such income. For example, under valid terms of a trust instrument, income received by a trust during its taxable year is to be accumulated until the twenty-first birthday of the beneficiary. It becomes payable on the fifteenth birthday of the beneficiary, and is not income which becomes payable within such prior taxable year but is income which becomes payable in the taxable year in which the date of distribution occurs.

Example. Under the terms of a trust, income becomes payable in the taxable year in which the date of distribution occurs.

Income determined under section 162 (d) (1) (B) $2,000

Section 162 (b) (1) is to be included in the income of the estate or trust so far as it is not distributed. Section 162 (d) (2) also has no application in determining the amount to be included in the income of the estate or trust under section 162 (b) but applies only in determining the amount allowed as deductions under section 162 (b) and (c).

(2) Section 162 (d) (2) applies whether amounts are paid, credited, or to be distributed out of the income of the estate or trust for its current or prior taxable year. It includes a rule for allocating income of the estate or trust to the legatees or beneficiaries in cases in which the income of the estate or trust for the period from which such income is derived is not derived from the income of the trust for the period from which such income is derived.

In the absence of proof that any particular portion of income is the source of an amount of income which becomes payable within the taxable year, the period from which such income is derived will be presumed to be a period ended with the date the income becomes payable. In such a case the year ended with the date the income becomes payable shall be considered the last 12 months of such period (whether or not the income is actually paid), or the income which is derived from the trust during such period shall be considered as derived from the trust during the last 12 months of such period.

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more than 65 days after the beginning of its final taxable year that section 162 (a) (4) will be applicable most fre-
quently to eliminate the double taxation that can arise by reason of section 162 (d) (2). For example, the income of an estate during its final taxable year was accumulated between the end of such taxable year and the time the estate was closed on May 31, 1952, on which date the accumulated income was payable to the residuary legatees, together with the residue legatees, if any, of the estate. The return of the estate for the calendar year 1952 will include income of $500 from which there will be deducted under section 162 (c) (3) the sum of $1,500 (assuming that under the local law any income taxes paid by the estate with respect to the 1952 income are not chargeable to income). Since the estate is entitled to such deduction of $500 under section 162 (c) (6) without the application of section 162 (d) (2) the deduction will be treated as a deduction of $500 for the year 1952, only $700 of the $1,200 deduction is taken by the estate solely by reason of section 162 (d) (2). Thus, the deduction allowed to the estate solely by reason of section 162 (d) (2) exceeds the net income of the estate for the year 1952 computed without such deduction by the amount of $700, which amount would have been deduced from B's income for the year 1952. B's return for the calendar year 1952 would include only the income of $500 received by the estate in 1952.

(a) If a trustee is required, or permitted, under the terms of the trust to distribute in one year the income of a prior period, excess deductions of the type covered by section 162 (c) (4) also may arise by reason of section 162 (d) (2) in such a case. For example, the income of a trust for the calendar year 1952 amounted to $10,000 and was properly accumulated between the end of such taxable year and the time the trust was closed on March 1, 1953, on which date the accumulated income was payable to A and B, who share equally, in their hands. The return of the trust for the purpose of computing its net income for the calendar year 1953, the income of the year 1951 only, the trust in its return for the year 1952 will deduct the amount of income of the year 1951 not distributed on March 1, 1952. If such deduction is allowed under section 162 (d) (2) the excess of the net income of the trust for the year 1952, computed without such deduction, B will exclude the amount of such excess from his return for the calendar year 1952.

(b) The deductions allowed to an estate or trust solely by reason of section 162 (d) (2) and (3) (A) are computed under the provisions of section 162 (d) (4) with the net income of the estate or trust computed without such deductions, except that in a case where the estate or trust in computing its net income for a taxable year is entitled to a deduction under section 162 (d) (1) (relating to amounts paid to annuities), the amount of the deduction under section 162 (d) (1) will be taken into account in computing the net income of the trust under section 162 (d) (3) (A). Such application of section 162 (d) (3) (A) in computing the net income of an estate or trust for the purpose of section 162 (d) (4) is subject to the following proportions:

(1) $5,000 paid to A on Jan. 1, 1953, out of 1952 income, deductible under section 162 (d) (2) by

(2) Amount paid to B on Jan. 5, 1953, deductible for 1952 under section 162 (d) (3) (A)

(3) Total

$8,000

(c) Less deductions allowable other than under section 162 (d) (2)

(2) Excess deductions allowable other than under section 162 (d) (2)

(3) Total of deductions

$5,000

(d) Net income for the purpose of section 162 (d) (4), computed without applying section 162 (d) (2) and (3) (A), except that in computing the deduction allowed under section 162 (d) (1) it is necessary to apply section 162 (d) (3) (A) in determining the amount of the deduction allowable to the trust under section 162 (d) (3) (A). The net income so computed is $4,000, determined as follows:

(1) Net income before any deductions

$3,000

(2) Less deductions allowable other than under section 162 (d) (2)

(3) Total net income

$2,000

sections 162 (d) (1) and (3) (A), except that in computing the deduction allowed under section 162 (d) (1) it is necessary to apply section 162 (d) (3) (A) in determining the amount of the deduction allowable to the trust under section 162 (d) (3) (A). The total of deductions allowed under section 162 (d) (4) is subject to the following proportions:

(4) $5,000 of the $5,000 is excluded from A's income during the first 65 days of 1953.

(5) $3,000 of the $5,000 is excluded from B's income during the first 65 days of 1953.

(6) Section 162 (d) (4) has no application to a case where, without applying section 162 (d) (2) or (3) (A) the deduction in computing the net income of the trust under section 162 (b) or (c) by reason of distributions is

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of income exceed the net income of the estate or trust for the taxable year computed under the Internal Revenue Code without such deductions. For example, section 6016(d) (4) would not be applicable in the case of an estate or trust for the taxable year comprising the net income from other sources. The trust pays $20,000 to the Y charity, and $50,000 to A. The deduction otherwise allowable under section 162 (a) is $50,000. Under the facts in this example, the deduction allowable under section 162 (a) as a deduction shall not exceed 15 percent of the net income of such trust (computed without the benefit of section 162 (a)) for any taxable year subsequent to the taxable year in which there is mailed to the Internal Revenue Service the notice required to be given by the Commissioner that it has engaged in such prohibited transaction. Such notices shall be mailed by registered mail to the fiduciary. However, notwithstanding the requirement of notification, the Commissioner, if satisfied that the trust is engaged in such prohibited transaction, may, at any time, assess and collect income tax attributable to such income or corpus from the proceeds described in section 162 (a) and such income or corpus shall be accumulated out of income for purposes of diverting such income or corpus to any trust, estate, or charitable organization; and (c) amounts accumulated out of income for purposes the use of which results from the use of only one trust or charitable organization, and (d) the term "income" means gains, profits, and income determined from the proceeds described in section 162 (a) and such income or corpus shall be accumulated out of income for purposes of diverting such income or corpus to any trust, estate, or charitable organization; and (c) amounts accumulated out of income for purposes the use of which results from the use of only one trust or charitable organization.

§ 39.162-3 Limitation on charitable, etc., deductions from tax exempt income (a) The term "income" means gains, profits, and income from the proceeds described in section 162 (a) and such income or corpus shall be accumulated out of income for purposes of diverting such income or corpus to any trust, estate, or charitable organization; and (d) the term "income" means gains, profits, and income determined from the proceeds described in section 162 (a) and such income or corpus shall be accumulated out of income for purposes the use of which results from the use of only one trust or charitable organization.

Example (2). The trustee pays $10,000 to the Y charity, and $50,000 to A. The deduction otherwise allowable under section 162 (a) is $50,000. Under the facts in this example, the deduction allowable under section 162 (a) as a deduction shall not exceed 15 percent of the net income of such trust (computed without the benefit of section 162 (a)) for any taxable year subsequent to the taxable year in which there is mailed to the Internal Revenue Service the notice required to be given by the Commissioner that it has engaged in such prohibited transaction. Such notices shall be mailed by registered mail to the fiduciary. However, notwithstanding the requirement of notification, the Commissioner, if satisfied that the trust is engaged in such prohibited transaction, may, at any time, assess and collect income tax attributable to such income or corpus from the proceeds described in section 162 (a) and such income or corpus shall be accumulated out of income for purposes of diverting such income or corpus to any trust, estate, or charitable organization; and (c) amounts accumulated out of income for purposes the use of which results from the use of only one trust or charitable organization, and (d) the term "income" means gains, profits, and income determined from the proceeds described in section 162 (a) and such income or corpus shall be accumulated out of income for purposes the use of which results from the use of only one trust or charitable organization.

Example (3). The X trust has net income of $50,000 computed without any deduction under section 162. There is included in this amount $50,000 which is the net income from the regular operation of a trade or business. The trustee is required to pay one-half of the net income to an individual, and the balance of the net income to the Y charity, an organization described in section 23 (a) (2). (2) The amount which bears the same ratio to $10,000 as $25,000 bears to $50,000, that is, an amount which bears the same ratio to $10,000 as $25,000 bears to $50,000, that is, an amount which bears the same ratio to $10,000 as $25,500 bears to $50,000.

Example (4). The amount which bears the same ratio to $10,000 as $25,500 bears to $50,000, that is, an amount which bears the same ratio to $10,000 as $25,500 bears to $50,000, that is, an amount which bears the same ratio to $10,000 as $25,500 bears to $50,000, that is, an amount which bears the same ratio to $10,000 as $25,500 bears to $50,000, that is, an amount which bears the same ratio to $10,000 as $25,500 bears to $50,000.
the district director of internal revenue for the internal revenue districts in which the fiduciary resides or has his principal place of business. The claim must contain or be accompanied by information or evidence showing that the circumstances that existed during the time the deduction was claimed are the same as, or are prior to, the facts and surrounding circumstances indicated that the deduction was disallowed for the purpose of the normal tax. In computing the net income of any legatee, heir, or beneficiary, the estate or trust shall attach to the income of both normal tax and surtax purposes. For proration of such credit in the case of a fractional part of a year ending after termination of the taxable period by the Commissioner under section 166, see § 39.147–1. A trust is allowed, in lieu of the exemptions under section 25 (b) (1) a credit of $100 against the income of both normal tax and surtax purposes. A credit for dependents is not allowable to an estate or trust.

(b) Credit for interest on account of amortizable bond premium. See § 39.125–1. A trust or estate shall provide for the payment of interest on account of amortizable bond premium, and no deduction shall be allowed with respect to such interest.

(c) Credit for interest on account of amortizable bond premium. See § 39.125–1. A trust or estate shall provide for the payment of interest on account of amortizable bond premium, and no deduction shall be allowed with respect to such interest.

(d) The application of this section may be illustrated by the following example.

Example. Under the terms of an irrevocable trust established by A in 1917, the trustees were to pay one-half of the income of the trust to A's wife for life, and the income to her was to endow a fund to be accumulated or distribute the remaining one-half of the income to a specified charitable beneficiary. Upon the death of A, the entire corpus was to be paid to the named charity. The trust makes its income tax returns on the basis of the calendar year. For 1942, A takes a charitable deduction for the amount of the gift in trust under section 162 (a) was for the purposes of paragraphs (a) and (b) of section 23, the credit allowed by section 23 (c) (2) shall be reduced as provided in section 23 (d) (3) (A). For the purpose of the paragraph (c) (2), the proportionate share of the legatee, heir, or beneficiary of such interest shall be its proportionate share of the net income (determined without regard to this paragraph) reduced by so much of the deduction allowed for such gift or contribution as is allowable to such share.

The remainder of such deduction for the purposes of the last sentence of subsection (b), shall be applied in reduction of such credits of the estate or trust.

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from such trust. For reduction of credits on account of amortizable bond premium see § 39, 125 (c) 2.

§ 39, 164—165 Statutory provisions; estates and trusts; different taxable years; employees' trusts.

Sec. 164. Different taxable years. If the taxable year of the employee is different from that of the estate or trust, the amount which he is required, under section 163, to include in gross income from wages and net income, shall be based upon the income of the estate or trust for any taxable year of the estate or trust (whether ending on or before, or after January 1, 1929) ending within or with his taxable year.

[Sec. 164 as amended by sec. 111 (d), Rev. Act 1942]

Sec. 165. Employees' trusts—(a) Exemption from tax. A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable under this supplement and no other provision of this supplement shall apply with respect to such trust or to its beneficiaries:

(1) If contributions are made to the trust by such employer, or by employees, or both, for the purpose of providing for the welfare or advancement of the trust or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with the provisions of the plan;

(2) If under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries, to divest the trust corpus and income of the fund accumulated by the trust in accordance with the provisions of the plan;

(3) If the trust is a trust for two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under this subsection which benefit either:

(A) 70 per centum or more of all the employees, 80 per centum or more of all the employees who are eligible to benefit under the plan if 70 per centum or more of all the employees who are eligible to benefit under the plan, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding five years; or

(B) Such employees as qualify under a classification set up by the employer and found by the Commissioner not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees;

(4) If the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees; and

(5) If under the contributions or benefits provided under the plan the contributions or benefits of, or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the compensation of such employees, or merely because the contributions or benefits based on employment, retirement, or death not so excluded, or difference because of any retirement benefits created under State or Federal law.

(6) A plan shall be considered as meeting the requirements of this subsection during the whole of any taxable year of the plan if on one day in each quarter it satisfied all the conditions prescribed by the Secretary. For purposes of this subsection, the term "securities of the employer corporation" includes any security issued,-by a corporation with interest coupons issued, in registered form, and the term "security" shall include annuity contracts so purchased by the employer and transferred to the trustee; and the term "employee" shall include only a person who was in the employment of the employer, and was covered by the agreement referred to in paragraph (2), prior to October 21, 1942.

[Sec. 165 as amended by sec. 318, Rev. Act 1936; sec. 162 (a), Rev. Act 1942; sec. 5 (a), Pub. Law 378 (81st Cong.); sec. 335, Rev. Act 1941; sec. 1, Pub. Law 660 (63d Cong.)

Sec. 166. Pension trusts—[Revenue Act of 1943]. (a) (3), (4), (6) put into effect after December 31, 1944, shall be considered as satisfying the requirements of section 165 (a) (3), (4), (5) and (6) for the period beginning with the date on which the trust is formed and ending with the 15th day of the third month following the close of the taxable year of the employer on which the trust is formed. If all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period.

[Sec. 166 (d) (2) as amended by sec. 2 (b), Pub. Law 811 (76th Cong.)

§ 39, 165—1 Employees' trusts—(a) In general. (3) In order for a trust to be exempt under section 165 (a) it must be part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries. The plan must be formed and availed of solely to aid in the proper execution of a plan which is a definite written program and arrangement communicated to the employees, including the plan, the terms under which such employees or their beneficiaries shall have the right to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees.
Section 39.165-3. A trust forming part of a plan of affiliated corporations for their employees or their beneficiaries, which trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees, may be used to provide any amount of stock in the employer corporation or any other corporation as an alternate form of compensation for the participation of such employees or their beneficiaries in the plan. The contributions may be made by the employer or by any other corporation as a capital contribution to the trust. The requirements of sections 39.165-1, 39.165-2, 39.165-3, and 39.165-4 are applicable to this type of trust without regard to the manner in which they are satisfied.

Section 39.23 (p).-2. A plan containing such provisions for the exclusive benefit of employees or their beneficiaries as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-4. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-5. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-6. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-7. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-8. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-9. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-10. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.

Section 39.165-11. A plan containing such provisions for the exclusive benefit of employees as is described in section 39.165-1, (a) 20, for a particular taxable year, is exempt from the requirements of sections 39.165-2, 39.165-3, and 39.165-4. The information required by section 39.23 (p).-2 with respect to the filing of the notification and the determination of the trust’s exempt status under section 39.23 (p).-2 shall be filed with the district director of internal revenue for the district in which the trust is located.
§ 39.165-2 Impossibility of diversion under the trust instrument—(a) In general. Under section 165 (a) (2) a trust is not exempt unless under the trust instrument it is impossible to divert, to purposes other than for the exclusive benefit of such employees or their beneficiaries, or to the trust, any amounts contributed or accumulated as a result of the trust instrument. A trust upon which the employer has a reversionary interest is a trust instrument. It is not essential that the employer relinquish all power to modify or terminate, or revoke or amend, the trust instrument or arrangement forming a part of such plan, and whether the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and whether such obligations are, technically speaking, liabilities of the employer, of the trust, or of some other person forming a part of the plan or connected with it.

(b) Meaning of “liabilities”. The attempt and purpose in section 165 (a) (2) of the phrase “prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust” is to permit the employer to reserve the right to recover at the termination of the trust, and only at such termination, such balances as are due to erroneous actuarial computations during the previous life of the trust. A balance due to an “erroneous actuarial computation” is one caused by miscalculations in supervising the work of other employees, or the surplus -arising because of an erroneous actuarial calculation. If, however, the surplus of $50,000, 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 calculation. The term “liabilities” as used in section 165 (a) (2) includes both fixed and contingent obligations to employees. For example, 700 employees are covered by a trust forming part of a pension plan, 300 of whom have satisfied all the requirements for a monthly pension, while the remaining 400 employees have not yet completed the required period of service, contingent obligations to such 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 amounts other than those amounts as remain in the trust because of erroneous actuarial computations after the satisfaction of all fixed and contingent obligations, and the trust instrument must contain a definite affirmative provision to that effect; whether the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and whether such obligations are, technically speaking, liabilities of the employer, or the trust, or if of some other person forming a part of the plan or connected with it.

§ 39.165-3 Requirements as to coverage. (a) (1) In order to insure that stock bonus, pension, and profit-sharing plans are utilized for the welfare of employees in general, and to prevent the trusts or other arrangements for the principal benefit of shareholders, officers, persons whose principal duties consist in supervising the work of other employees, or of high paid employees, or as may be designated and provided by the plan's eligibility conditions, benefits, and contribution requirements, they must not discriminate in favor of shareholders, officers, employees whose principal duties consist in supervising the work of other employees, or the highly compensated employees.

(c) 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 been in the employment for a designated number of years or are employed in certain designated departments or are in other classifications. Provided, That 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 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, that fact alone will not justify the conclusion that the plan does not meet the coverage requirements of section 165 (a) (3) (B) provided the classification as established does not discriminate in favor of shareholders, officers, employees whose principal duties consist in supervising the work of other employees, and the highly paid employees. If a plan provides only for part-time employees, but the requirement of contribution by the employee participants is so burdensome as to make the plan unacceptable only to the highly paid employees, the classification as established would be considered discriminatory in favor of such highly paid employees.
(d) Section 165 (a) (5) contains a provision to the effect that a classification shall not be considered discriminatory within the meaning of section 165 (a) (3) (B) merely because there are excluded from the plan employees the whole of whose remuneration constitutes wages under section 1426 (a) (1) (for purposes of the Federal Insurance Contributions Act). This provision, on its face, is designed to permit the qualification of plans which supplement the social security program. A classification which excludes all employees the whole of whose remuneration constitutes wages under section 1426 (a) (1) or a classification including such employees in a plan under which the contributions or benefits based on that part of an employee's remuneration which is excluded from wages under section 1426 (a) (1) differs from the contributions or benefits based on the employee's remuneration not so excluded, will not be a discriminatory classification merely because of such exclusion or difference. However, in making his determination with respect to discrimination in classification under section 165 (a) (3) (B) the Commissioner will consider whether the total benefits resulting to each employee under the plan and under the Social Security Act, or under the Social Security Act and under any other State or Federal laws. See section 164 (165). If such combination of plans supplements the social security program. Thus, benefits in a stock bonus or profit-sharing plan arising from the combination of plans which supplement the social security program. Such combinations of plans which supplement the social security program may be secured to replace former participation in plans which were discriminatory within the meaning of section 165 (a) (3) (B) unless such relative or proportionate differences in benefits as between employees resulting from such classification are approved by the Commissioner.

§ 39.165-4 Discrimination as to contributions or benefits.

(a) To be exempt under section 165 (a) a trust must not only meet the coverage requirements of section 165 (a) (3), but, as provided in section 165 (a) (4), it must also be a plan that does not discriminate in contributions or benefits based on that part of the annual compensation or to the benefits of a plan of qualified retirement benefits which is not so excluded, or a plan or benefit under such law differs from contributions or benefits based on the plan which will preclude such termination. The tests of section 165 (a) (3) and under the Social Security Act and with respect to this plan which will preclude such termination. Funds in a stock bonus or profit-sharing plan arising from the combination of plans which supplement the social security program. Such combinations of plans which supplement the social security program may be secured to replace former participation in plans which were discriminatory within the meaning of section 165 (a) (3) (B) unless such relative or proportionate differences in benefits as between employees resulting from such classification are approved by the Commissioner.

§ 39.165-5 Period for which requirements of section 165 are applicable.

Although a plan may provide for termination at any time during the period of the plan, see § 39.165-1. A pension, profit-sharing, stock bonus or annuity plan shall be considered as satisfying the requirements of section 165 (a) (3) (4), (5) and (6) for the period beginning with the date on which it was put into effect and ending with the 15th day of the third month following the close of the taxable year of the employer in which the plan was put into effect, if all the provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective with respect to the whole of such period. Thus, if an employer in 1952 adopts such a plan as of January 1, 1952, and makes a return on the basis of the calendar year, he will have until March 15, 1953, to amend his plan so as to make it satisfy the requirements of section 165 (a) (3) (4), (5) and (6) for the calendar year 1952 provided that by March 15, 1953, all provisions of such plan necessary to satisfy such requirements are in effect and have been made effective for all purposes to January 1, 1952, the effective date of the plan. If an employer is on a fiscal year basis, for example, April 1 to March 31, in which such plan is not in effect and have been made retroactive for all purposes to January 1, 1952, the effective date of the plan, he will have until March 15, 1953, to amend his plan so as to make it satisfy the requirements of section 165 (a) (3) (4), (5) and (6) for the fiscal year beginning April 1, 1952, and ending March 31, 1953: Provided, That by June 15, 1953, all provisions of such plan necessary to satisfy such requirements are in effect and have been.
made retroactive for all purposes to April 1, 1952, the effective date of the plan.

§ 39.165-6 Taxability of beneficiary under a trust which meets the requirements of section 165 (a) — (a) In general (1) Section 165 (b) (c) and (d) relates to the taxation of the beneficiary of an employee's trust. If an employer makes a contribution for the benefit of an employee to a trust for the taxable year of the employee to which such employee is entitled, 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 contribution in his income except in the year or years in which such contribution is distributed or made available to him. For rules providing for exclusion from income in the year of distribution of amounts representing unrealized appreciation in the value of securities of the employer corporation, see paragraph (b) of this section. It is immaterial in the case of contributions to a trust which the employee's rights in the contribution are forfeitable or non-forfeitable at the time the contributions are made, 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 23 (2) (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 for the taxable year in which the distribution occurs, but was not so exempt for one or more prior taxable years, the amount of any such taxable distribution 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 previously accounted for as 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, it is not taxable 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 as of 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.

(2) If a trust 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 annuity is payable to the employee at any time during the year the cash value (or if no cash value, the reserve) of the insurance contract at the end of the year, the entire amount of such annuity, which is not taxable to the employee for the year or years in which the contributions or earnings are applied to the purchase of such life insurance. If the amount payable upon death at any time during the year exceeds the cash value (or if no cash value, then the reserve) of the insurance policy at the end of the year, the entire amount of such annuity, which is not taxable to the employee for the year or years in which the contributions or earnings are applied to the purchase of such life insurance, or if no cash value, the reserve at the end of the year, is included in the income of the beneficiary when the distribution is made. If the contracts or annuities issued by such trust are subject to cancellation, annuity contracts are deemed to be treated for purposes of section 23 (2) (2) as prepayment contracts, and such contracts will be treated as prepayment contracts for the year in which the trust is formed.

Example. A policy is purchased by an employer for an employee 55 years of age, providing an annuity of $100 per month upon retirement at age 65, with a minimum death benefit of $10,000. The level annual premium for the policy is $436.40. The insurance payable if death occurred in the first year would be $10,000. The cash value at the end of the first year is 0. The net insurance is therefore $10,000 minus 0, or $10,000. Assuming that the 1-year term premium for the same insurance company is $12.15 per $1,000, the premium for $10,000 of life insurance protection is therefore $121.50. This is the amount to be reported as income by the employee for the year. The balance of the amount contributed for the annuity, which is not taxable to the employee under a plan meeting the requirements of section 165 (a), except as provided in section 36 (c), is the entire net unrealized appreciation in the value of the contract which is excludible under the rules of this section for rules relating to exclusion from such excess of amounts representing net unrealized appreciation in the value of securities of the employer corporation. As to adjustments if the trust was not exempt for one or more taxable years prior to the year of distribution, see paragraph (a) (1) of this section.

(b) Distributions including securities of the employer corporation — (1) In general. If a trust exempt under section 165 (a) makes a distribution to a distributee, and such distribution includes securities of the employer corporation, there shall be excluded for purposes of section 26 of such distribution to the extent of any distribution includible in the distributee's income in a taxable year of distribution net unrealized appreciation in such securities to the following extent: (a) If the distribution constitutes a total distribution to which the rules of paragraph (a) (4) of this section are applicable, the amount to be excluded is the entire net unrealized appreciation attributable to that part of the total distribution which consists of securities of the employer corporation; and (b) If the distribution is other than a total distribution in a year, the amount to be excluded is the excess of the amount to which paragraph (a) (4) of this section is applicable, the amount to be included that portion of the net unrealized appreciation in the securities of the employer corporation which is attributable to such amount considered to be contributed by the employee to the purchase of such securities. The amount of net unrealized appreciation which is attributable to that part of the total distribution which consists of securities of the employer corporation shall be included in the basis of the securities in the hands of the distributee at the time of the distribution for purposes of determining gain or loss on subsequent dispositions. In the case of a total distribution the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of distribution shall be considered to be realized in a subsequent taxable transaction as a gain from the sale or exchange of a capital asset held for more than six months. However, if the net gain realized by the distributee exceeds the amount of the net unrealized appreciation, such excess shall constitute a long-term or short-term capital gain de-
pending upon the holding period of the securities in the hands of the distributee.

(ii) For purposes of section 165 (b) and of this section, the term "securities" means only shares of stock and bonds or debentures issued by a corporation with interest or principal payable in registered form, and the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in section 165 (c) and (d) relating to employee stock options) of the employer corporation.

(2) Determination of net unrealized appreciation. (i) The amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is to be determined by reference to the cost or other basis to the trust of such securities and by reference to the market value of such securities at the time of distribution. Thus, if a distribution consists in part of securities which have appreciated in value and in part of securities which have depreciated in value, the net unrealized appreciation shall be considered to consist of the net increase in value of all of the securities included in the distribution. For two or more distributions made by a trust to a distributee in a single taxable year of the distributee the market values of the securities at the time of distribution shall be treated as a single distribution.

(ii) The determination of the cost or other basis to the trust of a distributed security of the employer corporation, for purposes of determining net unrealized appreciation shall be made in accordance with whichever of the following rules is applicable:

(a) If a security was, at the time of purchase by, or contribution to, the trust, earmarked for the account of a particular employee so that the cost or other basis of such security to the trust is reflected in the account of such employee, such cost or other basis shall be used.

(b) If as of the close of each taxable year of the trust (or other specified period of time not in excess of 12 consecutive calendar months) the trust allocates among trust participants the securities of the employer corporation owned by the trust during the period (exclusive of securities unallocated under a plan providing for allocation in whole shares only), the cost or other basis to the trust of any securities allocated as of the close of a particular allocation period shall be the average cost or other basis to the trust of all securities of the same type which were acquired by the trust during such allocation period. For purposes of determining the average cost to the trust of securities included in a subsequent allocation, the actual cost to the trust of the securities unallocated as of the close of a prior allocation period shall be deemed to be the average cost or other basis to the trust of securities of the same type which were acquired by the trust during the close of such prior allocation period.

(c) In a case where neither (a) nor (b) is applicable, if the trust fund, or a specified portion thereof, is invested exclusively in one type of security of the employer corporation, and if during the period the distribut

(3) Unrealized appreciation attributable to employee contributions. In any case in which it is necessary to determine the amount of net unrealized appreciation in securities of the employer corporation which is attributable to contributions made by employees to the trust fund, there shall be distributed in accordance with the rules in paragraph (b) (2) of this section:

(i) The cost or other basis of the securities to the trust and the amount of net unrealized appreciation shall first be determined in accordance with the rules in paragraph (b) (2) of this section.

(ii) The amount contributed by the employee to the purchase of the securities shall be solely the portion of his actual contributions to the trust properly allocable to such securities, and shall not include any part of the increment in the trust fund expended in the purchase of the securities.

(iii) The amount of net unrealized appreciation in the securities distributed which is attributable to the contributions of the employee shall be that proportion of the net unrealized appreciation determined under the rules of paragraph (b) (2) of this section which the contributions of the employee properly allocable to such securities bear to the cost or other basis to the trust of such securities.

(iv) If a distribution consists solely of securities of the employer corporation, the contributions of the employee expended in the purchase of such securities shall be allocated to the securities distributed in a manner consistent with the principles set forth in paragraph (b) (2) (i) (a), (b), (c) or (d) of this section, whichever is applicable, that is, the amount of the employee's contribution which can be identified as having been expended in the purchase of a particular security shall be allocated to such security, and the amount of such contribution which cannot be so identified shall be allocated ratably among the securities distributed. If a distribution consists in part of securities of the employer corporation and in part of cash or other property, appropriate allocation of a portion of the employee's contribution to such cash or other property shall be made unless such allocation is inconsistent with the terms of the plan or trust.
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 the retirement date, whether voluntarily or involuntarily, is entitled to annuity payments which the trustee is obligated to make under the trust instrument based on the contributions made by the employee on his behalf, 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 such contributions are not made for his benefit prior to termination, the trustee, evidence should be presented to prove that such contract was purchased for the taxpayer by the employer pursuant to the terms of a written agreement between the prohibited employee and the employer or between the employer and the trustee, entered into before October 21, 1942.

(v) The application of this subparagraph may be illustrated by the following example:

Example. A trust distributes ten shares of stock issued by the employer corporation each of which is subject to an agreement to the trust of $100, consisting of employee contributions in the amount of $80 and employer contributions of $20, and the date of distribution has a fair market value of $180. The portion of the net unrealized appreciation attributable to the contributions of the employee with respect to each of the shares of stock is $18 computed as follows:

<table>
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<th>Item</th>
<th>Amount</th>
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<td>(3)</td>
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<td>(4)</td>
<td>$100</td>
</tr>
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<td>(5)</td>
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</tr>
</tbody>
</table>

(b) Effect of section 165 (d) (1) If the requirements of section 165 (d) are met, a contribution made by an employee to a trust which is not exempt under section 165 (a) shall not be included in the income of the employee in the year in which the contribution is made. The contribution will be taxable to the employee, when received in later years, as an annuity. (See § 39.22 (b) (2)-5.) The intent and purpose of section 165 (d) is to give those persons employed by nonexempt trusts to which section applies, essentially the same tax treatment as those covered by trusts qualifying under section 165 (a).

(2) Every person claiming the benefit of section 165 (d) must be able to demonstrate to the satisfaction of the Commissioner that all of the provisions of such section are met. The taxpayer must produce sufficient evidence to prove:

(i) That, prior to October 21, 1942, he was employed by the particular employer making the contribution in question and was at such time definitely entitled to a written agreement, entered into before October 21, 1942, between himself and the employer, or between the employer and the trustee of a trust established by the employer prior to October 21, 1942, and that the contribution by the employer was made pursuant to such agreement. Evidence that the employee’s rights in the contribution have been or may be jeopardized, or that the employee will lose his rights in the contribution, or that the employee may lose his rights in any annuity purchased, or that the annuity purchased will be taxable to the employee when received in later years, as an annuity, must be produced.

(iv) The nature and amount of such contribution and the extent to which income taxes have been paid thereon before January 1, 1949, and not credited or refunded.

For principles applicable in making appropriate adjustments if the trust was not established in 1942 or in some years prior to the year of distribution, see paragraph (a) of this section.

§ 39.165–7 Treatment of beneficiary of a trust not exempt under section 165 (a) — (A) In general. Generally, any contribution made by an employer on behalf of an employee to a trust during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt under section 165 (a) shall be included in the 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. But see section 165 (d) and paragraph (b) of this section. An employee’s beneficial interest in the contribution is nonforfeitable within the meaning of sections 165 (a) and 23 (p) (1) (D) at the time the contribution is made if there is no contingency under the plan which may cause the employee

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§ 39.166 Statutory provisions; estates and trusts; revocable trusts.

Sec. 166. Revocable trusts. Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(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 trust shall be included in computing the net income of the grantor.

§ 39.166-1 Trusts with power to revest corpus in the grantor.—(a) Scope.

(1) Where the power to revest in the grantor title to any part of the corpus of a trust is vested in the grantor or in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or both, the income of that part of the corpus of the trust the power to revest is not taxable in accordance with the provisos of sections 161, 162, and 163 but remains attributable and taxable to the trust to the extent provided in sections 22 (c) 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.

(2) For rules applicable to trusts the income of which is taxable to the grantor under section 22 (a) because the grantor has retained a control of the trust so complete that he is still in practical effect the owner of its income, see § 39.32 (a)–(21).

(3) For rules applicable to trusts the income of which is taxable under section 22 (a) to a person other than the grantor because of a power, exercisable solely by such other person, to vest the property in the trust corporation or elsewhere in himself, see § 39.32 (a)–(22).

(b) Test of taxability to grantor. (1) Section 166 provides for taxability of income to the grantor by reason of the fact that he holds a retained power to revest 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, may cause the title to the corpus to vest in the grantor. A bare legal interest in the trust corpus, of itself, is never substantial and never adverse. If the title to the corpus will vest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor (except as provided in section 22 (d) or 171) regardless of—

(1) Whether such power or ability to retake 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;

§ 39.167 Statutory provisions; estates and trusts; income for benefit of grantor.

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 such part of the income may 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, be distributed to 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." (c) Income of a trust shall not be considered taxable to the grantor under section 22 (d) or any other proviso of this chapter merely because such income, in the discretion of the grantor, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of any person whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed in cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 163 and which is not otherwise taxable to the grantor.

§ 39.167-1 Trusts in the income of which the grantor retains an interest—

(a) Scope. Section 167 prescribes that the income of a trust, or any part thereof, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the corpus of the trust (as in section 166) 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. (1) The test prescribed by the Internal Revenue Code as to the sufficiency of the grantor's retained interest in the income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, 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 a wife to whom such income is taxable under section 22 (c) or 171) in obedience to his direction or if the income is applied toward the payment of premiums upon policies of insurance on the grantor's life.

(2) For the purposes of this section, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right so to effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor. A bare legal interest, such as that of an attorney-in-fact, is never substantial and never adverse.

(3) If the grantor has retained any such interest in the income, such income is taxable to the grantor (except as provided in section 22 (d), 167 (c) or 171) regardless of—

(i) Whether it may be distributed currently or accumulated for future distribution;

(ii) Whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(iii) Whether, if such distribution is in any way affected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both;

(iv) The time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the..."
elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(v) When the trust was created.

(4) Thus, the inclusion of any trust within the scope of section 167 is based on the facts of the case and is not necessarily punitive, having regard to the expenses of the trust, whether or not the grantor is the beneficiary. The standard deduction provided in section 28 (aa) shall not be allowed.

(b) Admission and withdrawal. No gain or loss shall be realized by a participant in a trust fund by the admission or withdrawal of a participant. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by the participant.
(f) Returns by bank. Every bank (as defined in section 104) maintaining a common trust fund shall make a return under oath for each taxable year, stating specifically, with respect to such fund, the items of gross income and the deductions allowed by this chapter, and shall include in the return the names and addresses of the participants who would be entitled to share in the net income if distributed and the participants who would be entitled to share in the net income if distributed.

The return shall be in the form of a return filed by the bank under section 52.

(g) Different taxable years of common trust fund and different taxable year of the common trust fund shall make a return under regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System.

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§ 39.169-4 Admission and withdrawal of participants from the 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 they are deemed to have been held by 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 in the common trust fund, such withdrawal shall be treated as a sale or exchange of the participant's interest in the common trust fund and such basis shall not be reduced on account of the segregation of any investment in the common trust fund pursuant to the provisions of subdivision (c) (7) of section 17 of Regulation F of the Board of Governors of the Federal Reserve System, as amended, for the taxable year beginning after December 31, 1937. For the purpose of making the adjustments, additions, and reductions with respect to basis as prescribed in this paragraph, the ward, rather than the grantor, 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.

(b) Basis for gain or loss upon withdrawal. The participant's gain or loss upon withdrawal of its 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, such withdrawal shall be treated as a sale or exchange of the participant's interest in the common trust fund and such basis shall not be reduced on account of the segregation of any investment in the common trust fund and such basis shall not be reduced on account of the segregation of any investment in the common trust fund pursuant to the provisions of subdivision (c) (7) of section 17 of Regulation F of the Board of Governors of the Federal Reserve System, as amended, for the taxable year beginning after December 31, 1937. For the purpose of making the adjustments, additions, and reductions with respect to basis as prescribed in this paragraph, the ward, rather than the grantor, 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.

§ 39.170 Statutory provisions; estates and trusts; net operating losses.

§ 39.170-1 Net operating loss deduction in the case of estates, trusts, and common trust funds. (a) Estates and trusts. The net operating loss deduction allowed by section 112, as provided by section 23 (a) shall be allowed to estates and trusts under regulations prescribed by the Commissioner with the approval of the Secretary. The benefit of such deduction shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Commissioner with the approval of the Secretary.

§ 39.170-2 In computing gross income and deductions for the purposes of section 122, a trust shall exclude that portion of the income and deductions attributable to the grantor under section 106 and for which the deduction for net operating losses is allowed.

§ 39.179-1 Net operating loss deduction in the case of estates, trusts, and common trust funds.

§ 39.179-5 Returns of common trust funds. A bank maintaining a common trust fund shall make a return of income of the common trust fund, regardless of the amount of its net income. If a bank maintains more than one common trust fund, a separate return shall be made for each. The return shall be made for the taxable year of the common trust fund on the form prescribed by the Commissioner, in accordance with these regulations and the instructions on the form or blank prescribed therefor. The return of a common trust fund shall state specifically with respect to the fund the items of gross income and the deductions allowed under chapter 1, and shall include such an item stating the amount and under the appropriate heading, the ordinary net income or loss, and its proportionate share of gains and losses from sales or exchanges of capital assets.

§ 39.171 Statutory provisions; estates and trusts; income in divorce, etc., cases.
In such cases, the spouse actually entitled for taxability of income under section 22 of the wife described in section 22 for the purposes of computing the net income money or under provisions of this section, would be includable in the gross income of her husband, and such amount shall not, despite section 168, section 169, provision of this chapter, be includible in the gross income of such husband. This subsection shall not apply to the net income of the trust which the terms of the decree or trust instrument fix, in terms of an amount of money or a specified income, as is which is payable for the support of minor children of such husband. In case such income is less than the amount specified in the decree or instrument, for the purpose of applying the preceding sentence, such income, to the extent of such sum payable for such support, shall be considered a payment for such support.

(b) Wife considered a beneficiary. For the purposes of computing the net income of the estate or trust and the net income of the wife described in section 22 (k) or subsection (a) of this section, such wife shall be considered a beneficiary of the trust described in this supplement. A periodic payment under section 22 (k) to any part of which the provisions of this section applicable to any part is required to be included.

(1) Section 171 (a) provides rules in certain cases for taxability of income of trusts as between spouses who are divorced or legally separated and in which income of the beneficiary in the taxable year in which under this supplement such part is required to be included.

Sec. 171, as added by sec. 120 (c), Rev. Act 1949

§ 39.171-1 Income of trust in case of divorce, etc.—(a) In general. (1) Section 171 (a) applies to trusts which are subject to tax by the income of the beneficiaries, whether or not the trust is revocable at any time.

Example (1).—Upon the marriage of H and W, H irrevocably transfers property in trust to pay the income therefrom to W for her support and maintenance. If H later terminates the trust, W shall be entitled to receive the income from the trust, but not to include the income in her gross income. In the case of such a trust, the income of the trust is considered a beneficiary of the trust, whether or not the income of the trust is required to be included.

(2) The application of section 171 (a) may be illustrated by the following examples, in which it is assumed that both the husband and wife are income tax returns on a calendar year basis:

The benefit of the deduction for amortization of a trust described in section 22 (k) shall be applicable to property in trust, or to the extent of the sum which would become payable for support of such support that provided in the case of periodic payments under section 22 (k), (d).

§ 39.171-2 Application of trust rules to alimony payments. (a) For the purpose of the application of sections 162, 163, and 164, the wife described in section 171 (a) or section 166, as the case may be, shall be considered to be a beneficiary of the trust, whether or not the trust is revocable at any time.

(b) A periodic payment included in the wife's gross income under section 22 (k) is to be included in the wife's gross income of trust income which is payable to her for support and maintenance, and all other expenses. Some years later, W obtains a legal separation from H under an order of the court; the court, however, specifies that the husband's obligation. Further, the application of section 171 (a) applies to periodic payments payable for support of such minor children. This rule is similar to that provided in the case of periodic payments under section 22 (k). See § 39.22 (f)–(d).

§ 39.172 Statutory provisions; estates and trusts; allowance of amortization deduction.

Sec. 172. Allocations of amortization deduction. The benefit of the deduction for amortization of mortgage payments, to the extent of the sum which would become payable to W in such case, is included in the wife's gross income of trust income which is payable to her for support and maintenance, and all other expenses. Some years later, W obtains a legal separation from H under an order of the court; the court, however, specifies that the husband's obligation.

The application of section 171 (a), (d) applies to periodic payments payable for support of such minor children. This rule is similar to that provided in the case of periodic payments under section 22 (k).

§ 39.172-1 Amortization of emergency facility on estate trusts. In the case of an emergency facility, as defined in section 124A (d), amortization deductions with respect thereto in the same manner and to

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the same extent as in the case of an individual. See section 23 (b) and section 124A and the regulations 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 § 39.23 (1)–1.

SUPPLEMENT E—PARTNERSHIPS

§ 39.181 Statutory provisions; partnerships; liability for tax.

Sec. 181. Partnership not taxable. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

§ 39.181-1 Partnerships. Partnerships as such are not subject to the income tax imposed by chapter 1, but are required to make returns of income. See sections 187 and 188. For definition of what the term “partnership” includes, see section 3797 (a) (2). For rules as to allocation of partnership income in the case of family partnerships, see section 191 and the regulations thereunder.

§ 39.182 Statutory provisions; partnerships; tax of partners.

Sec. 182. Tax of partners. In computing the net income of each partner, he shall include, whether or not 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 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 the ordinary net loss of the partnership, computed as provided in section 183 (b).

Sec. 182 as amended by sec. 150 (g) (1), Rev. Act 1942.

§ 39.182-1 Distributive shares 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 a 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, community property should be reported by the husband and wife by the wife in equal proportions. In the case of a partnership closely related to other trades or businesses, see section 45.

§ 39.183 Statutory provisions; partnerships; computation of income.

Sec. 183. Computation of partnership income—(a) General rules. 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), (c), and (d).

(b) Segregation of items—(1) Capital gains and losses. There shall be segregated gains and losses from sales or exchanges of capital assets.

(2) Ordinary net income or loss. After exclusion of gains and losses from sales or exchanges of capital assets, there shall be computed—

(A) The 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 (c) 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 by the partnership within its taxable year, of the character which would have been allowed to him under section 23 (c) (4) (A) as the deduction allowed to the partnership under such section if this subsection had not been enacted.

(d) Standard deduction. In computing the net income of the partnership, the standard deduction provided in section 23 (aa) shall not be allowed.

Sec. 183 as amended by sec. 150 (g) (2), Rev. Act 1944.

§ 39.183-1 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 net income is not allowed the benefit of section 117 (e).

(b) The partnership is further required, after excluding all items described in paragraph (a) of this section, to compute its 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 the gross income. In the computation of its ordinary net income or ordinary net loss, the partnership is deemed the so-called charitable contribution deduction allowed by section 23 (c) (4) (A). 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 by the partnership within its taxable year, of a character which would be allowed to the partnership as a deduction if section 183 (c) 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 contributions being held to represent a division of partnership profits.

(c) The partnership is not allowed the standard deduction provided in section 23 (aa).

§ 39.184 Statutory provisions; partnerships; credits against net income.

Sec. 184. Credits against net income. The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. If the partnership elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (5), as amortizable, for the purposes of the provisions of this chapter and such other provisions of this title as the partnership elects to have applicable to it, the partner shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23 (v) as is attributable to such share.

Sec. 184 as amended by sec. 150 (4), Rev. Act 1942.

§ 39.184-1 Credits allowed partners. The credits against net income provided in section 25 are not applicable to partnerships as such. An individual partner, however, is entitled for the purpose of the normal tax to a credit against his net income, in addition to the credits allowed to him under section 25, of his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. There shall be included in the return of the partnership a statement of the amounts of such interest and the proportionate share thereof of each partner. For reduction of credit for such interest on account of amortizable bond premium, see § 39.125 (c)–2.

§ 39.185–187 Statutory provisions; partnerships; earned income; taxes of foreign countries and possessions of the United States; returns.

Sec. 185. Earned income. [Repealed by sec. 107 (a), Rev. Act 1943]

Sec. 186. Taxes of foreign countries and possessions of United States. The amount of taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax imposed on the member of a partnership to the extent provided in section 131.

Sec. 187. Partnership returns. Every partnership shall make a return for each taxable year, stating specifically the items of gross income and the deductions allowed to the partnership and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulation prescribe, and shall include in the return the names and addresses of the individuals who are entitled to share in the net income if distributed and the amount of the distributive share of each individual. The re-
§ 39.187-1 Partnership returns. Every partnership shall make a return of income, regardless of the amount of its net income (see section 3979 (a) (2) defining the term “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 thereon or issued with respect thereto; and shall be signed by a member of the partnership, that is, its managing partner or the person designated as such by a written declaration, signed by one or more members of the partnership, that is, for its annual accounting period (fiscal year or calendar year, as the case may be) irrespective of the taxable years of the partners. See 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).

§ 39.188-189 Statutory provisions; partnership; different taxable years of partner and partnership; net operating losses. Sec. 188. Different taxable years of partner and partnership. If the taxable year of a partner is different from that of the partnership, the inclusion with respect to the net income of the partnership, in computing the net 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 or before, or after January 1, 1959) ending within or with the taxable year of the partner.

Sec. 189. Net operating losses. The benefits of the deduction for net operating losses allowed by section 23 (e) 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.

[Sec. 189 as added by sec. 211 (d), Rev. Act 1959]

§ 39.189-1 Net operating loss deduction in the case of partners—(a) In general. The benefit of the deduction for net operating losses provided by section 23 (e) shall not be allowed to a partnership. In computing his own net operating loss or his own net income (where required to be computed in accordance with the exceptions and limitations provided in section 122 (d) (1) to (4) inclusive) for any taxable year for the purposes of the computations required by section 122, however, each partner shall take into account the income and losses of the partnership in accordance with sections 122 to 129, inclusive, with the exceptions and limitations set forth in paragraphs (b) and (c) of this section.

(b) Exceptions and limitations applicable in computation of partner’s net operating loss—(1) Long-term capital gains and losses. The partnership’s gains and losses from sales or exchanges of capital assets held for more than six months shall be taken into account in full. The business gains and losses from sales or exchanges of capital assets held for more than six months shall be taken into account in full. The business gains and losses from sales or exchanges of capital assets held for more than six months shall be taken into account in full.

§ 39.190 Statutory provisions; partnership; allocation of amortization deductions. Sec. 190. Allocation of amortization deductions. In the case of emergency facilities of a partnership, the benefit of the deduction allowed by section 1261 shall not be allowed to the members of a partnership but shall be allowed to the partnership, to the same extent as in the case of an individual.

[Sec. 190 as added by sec. 155 (b), Rev. Act 1942]

§ 39.190-1 Amortization of emergency facility of partnership. In the case of an emergency facility, as defined in section 1344, (d) (1) (acquired and completed by a partnership after December 31, 1940), the partnership is entitled to take amortization deductions with respect thereto in the same manner and to the same extent as in the case of an individual. See section 23 (t) and section 1344 and the regulations thereunder. Amortization deductions with respect to an emergency facility of a partnership are not allowed to the members of the partnership.

§ 39.191 Statutory provisions; partnership; family partnerships. Sec. 191. Family partnerships. In the case of any partnership interest enjoyed by gift, the distributive share of the donee under the partnership agreement shall be includable in the income of the donee, to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donee attributable to the donor’s capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service. For the purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The “family” of any individual shall include only his spouse, his children, his grandchildren, his parents, his siblings, and any trust for the primary benefit of such persons.

[Sec. 191 as added by sec. 340 (b), Rev. Act 1959]

§ 39.191-1 Family partnerships—(a) In general—(1) Introduction. The production of income by a partnership is attributable to the capital or services, or both, contributed by the partners.

The provisions of Section 39 (a), which govern the taxation of the income of individuals carrying on business in partnership, are to be read in the light of their relationship to section 22 (a) which requires that income be taxed to the person who earns it through his own labor and skill and the utilization of his own capital.

(2) Recognition of donees as partner with respect to partnerships in which capital is a material income-producing factor, section 3979 (a) (2) (dealing with definition of partnership and partner) provides that a person shall be recognized as a partner in income tax purposes if he owns a capital interest in such a partnership whether or not such...
interest is derived by purchase or gift from any other person. In the case of any partnership in which capital is a material income-producing factor, if any capital interest in such partnership is created by gift, section 397 provides that the allocation of such interest is determined without allowance of reasonable compensation for services rendered to the partnership by the donor or is proportionately greater than the share of the donor attributable to the donor's capital. For rules of allocation, see, see § 38.191-2.

(3) Requirement of complete transfer to donee. A donee or purchaser of a capital interest in a partnership is not recognized as a partner under the principles of section 397 (a) (2) unless the capital interest is acquired in a bona fide transaction, not a mere sham for tax avoidance purposes or otherwise, and the donee has control of the business conducted by the partnership. The reality of the operation of the partnership is not a capital interest in the partnership. The donee may be considered as a partner if, among other factors, the transfer results in fullness of control of the business conducted by the partnership. The actual conduct of the business, fictitious name, and business registration statutes are of substantial significance in this connection.

(4) Capital as a material income-producing factor. The determination as to whether capital is a material income-producing factor, for purposes of section 397 (a) (2) must be made by reference to all the pertinent facts of the particular case. Capital is a material income-producing factor if a substantial portion of the gross income of the business is attributable to the capital and the capital is used in the business conducted by the partnership. In general, capital is not a material income-producing factor where the income of the business consists principally of fees, commissions, or other compensation for personal services performed by members or employees of the partnership. On the other hand, capital is to be considered a material income-producing factor if the operation of the business requires substantial inventories or a substantial investment in plant, machinery, or equipment.

(5) Conduct of partnership business. In determining the reality of the donee's ownership of a capital interest in a partnership, consideration shall be given to whether the donee is actually treated as a partner in the operation of the business. It is of principal importance for this purpose whether the donee has been held out publicly as a partner in the conduct of the business, in relations with customers, or with creditors or other sources of financing. Other factors of significance in this connection include:

(i) Retention of control of the distribution of income or restrictions on the distribution of income other than amounts retained in the partnership annually with the consent of the partners (including the donee partner) for the reasonable needs of the business. If there is a partnership agreement providing for a managing partner, or partners, then, amounts of income may be retained in the partnership without the acquiescence of all the partners if such amounts are retained for the reasonable needs of the business.

(ii) Limitation of the right of the donee to withdraw or sell his interest in the partnership at his discretion without financial detriment.

(iii) Retention of control of assets essential to the business (for example, through retention of assets leased to the alleged partnership business which serves no purpose other than to benefit the donee).

(iv) Retention of management powers inconsistent with normal relationships among partners. Retention by the donee of control of business management or of voting control, such as is inherent in significant ownership, inconsistent with normal relationships among partners provided the donee is free to withdraw his interest without financial detriment at his discretion. The retention by the donee of the right to withdraw his interest unless, considering all the facts, it is evident that the donee is independent of the donor and has such maturity and understanding of his rights as to be capable of deciding to exercise, and of exercising, his right to withdraw his capital interest from the partnership.

The existence of some of the indicated controls, though amounting to less than substantial ownership, may in the case of such controls, may be considered along with other facts and circumstances as tending to show the lack of reality of the partnership interest.

(3) Indirect controls. Controls inconsistent with ownership by the donee may be exercised indirectly as well as directly, for example, through a separate business conducted by an individual, or other partnership. Where such indirect controls exist, the reality of the donee's interest will be determined as if such controls were exercisable directly.

(4) Participation in management. Substantial participation by the donee in the control and management of the business (including participation in the major policy decisions affecting the business) is strong evidence of a donee's interest in the capital of the partnership business. The donee may have retained such controls of the business conducted by the partnership as, for example, they are deposited, loaned, or invested in such ways that the donor may have retained such controls inconsistent with ownership.

(5) Income distributions. The actual distribution to a donee partner of all or the major portion of his distributive share of the business income for the sole benefit and use of the donee is substantial evidence of the reality of the donee's interest. In determining the reality of the donee's interest, consideration shall be given to whether the donee is actually treated as a partner in the operation of the business. If there is a partnership agreement providing for a managing partner, or partners, then, amounts of income may be retained in the partnership without the acquiescence of all the partners if such amounts are retained for the reasonable needs of the business.

(ii) Limitation of the right of the donee to withdraw or sell his interest in the partnership at his discretion without financial detriment.

(iii) Retention of control of assets essential to the business (for example, through retention of assets leased to the alleged partnership business which serves no purpose other than to benefit the donee).

(iv) Retention of management powers inconsistent with normal relationships among partners. Retention by the donee of control of business management or of voting control, such as is inherent in significant ownership, inconsistent with normal relationships among partners provided the donee is free to withdraw his interest without financial detriment at his discretion. The retention by the donee of the right to withdraw his interest unless, considering all the facts, it is evident that the donee is independent of the donor and has such maturity and understanding of his rights as to be capable of deciding to exercise, and of exercising, his right to withdraw his capital interest from the partnership.

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(4) Participation in management. Substantial participation by the donee in the control and management of the business (including participation in the major policy decisions affecting the business) is strong evidence of a donee's interest in the capital of the partnership business. The donee may have retained such controls of the business conducted by the partnership as, for example, they are deposited, loaned, or invested in such ways that the donor may have retained such controls inconsistent with ownership.

(5) Income distributions. The actual distribution to a donee partner of all or the major portion of his distributive share of the business income for the sole benefit and use of the donee is substantial evidence of the reality of the donee's interest. In determining the reality of the donee's interest, consideration shall be given to whether the donee is actually treated as a partner in the operation of the business. If there is a partnership agreement providing for a managing partner, or partners, then, amounts of income may be retained in the partnership without the acquiescence of all the partners if such amounts are retained for the reasonable needs of the business.

(ii) Limitation of the right of the donee to withdraw or sell his interest in the partnership at his discretion without financial detriment.

(iii) Retention of control of assets essential to the business (for example, through retention of assets leased to the alleged partnership business which serves no purpose other than to benefit the donee).

(iv) Retention of management powers inconsistent with normal relationships among partners. Retention by the donee of control of business management or of voting control, such as is inherent in significant ownership, inconsistent with normal relationships among partners provided the donee is free to withdraw his interest without financial detriment at his discretion. The retention by the donee of the right to withdraw his interest unless, considering all the facts, it is evident that the donee is independent of the donor and has such maturity and understanding of his rights as to be capable of deciding to exercise, and of exercising, his right to withdraw his capital interest from the partnership.

The existence of some of the indicated controls, though amounting to less than substantial ownership, may in the case of such controls, may be considered along with other facts and circumstances as tending to show the lack of reality of the partnership interest.

(3) Indirect controls. Controls inconsistent with ownership by the donee may be exercised indirectly as well as directly, for example, through a separate business conducted by an individual, or other partnership. Where such indirect controls exist, the reality of the donee's interest will be determined as if such controls were exercisable directly.

(4) Participation in management. Substantial participation by the donee in the control and management of the business (including participation in the major policy decisions affecting the business) is strong evidence of a donee's interest in the capital of the partnership business. The donee may have retained such controls of the business conducted by the partnership as, for example, they are deposited, loaned, or invested in such ways that the donor may have retained such controls inconsistent with ownership. Amounts distributed are not considered to be for the donee's sole benefit if, for example, they are deposited, loaned, or invested in such ways that the donor controls or can control the use or enjoyment of such funds.

(5) Conduct of partnership business. In determining the reality of the donee's ownership of a capital interest in a partnership, consideration shall be given to whether the donee is actually treated as a partner in the operation of the business. It is of principal importance for this purpose whether the donee has been held out publicly as a partner in the conduct of the business, in relations with customers, or with creditors or other sources of financing. Other factors of significance in this connection include:

(i) Compliance with local partnership laws, fictitious name, and business registration statutes.

(ii) Conduct of business bank accounts.

(iii) Recognition of the donee's interest in appropriate capital and drawing accounts.

(iv) Recognition of the donee's interest in insurance policies, leases, and other business contracts and in litigation affecting business.

(v) The existence of written agreements, policy declarations, stock certificates, and other evidence of title to the donee's interest in the business.
The text is legible and readable. It contains legal and financial information related to partnerships and trusts, discussing topics such as the recognition of ownership, rights, and obligations of partners and beneficiaries, as well as the concept of a bona fide purchase. The text also references cases and conditions under which legal obligations may be recognized, including the role of the grantor, trustee, and partner in the formation and management of partnerships and trusts. The text is dense and requires a thorough understanding of legal and financial principles.
(2) In determining a reasonable allowance for services rendered by the partners, consideration shall be given to all the circumstances of the business, including the fact that some of the partners may be held to a greater measure of responsibility than others. Among other factors, there shall be considered the amount that would ordinarily be paid in order to obtain comparable services from a person not having a capital interest in the partnership.

SUPPLEMENT C—INSURANCE COMPANIES

§ 39.201 Statutory provisions; tax on life insurance companies.

Esc. 201. Life insurance companies—(a) Imposition of tax. (1) General. There shall be levied, collected, and paid for taxable years beginning in 1951 and subsequent years thereupon, a tax on the increases of net income (as defined in section 203) of every life insurance company taxes computed as provided in section 13 (b) and in section 13 (d) (2) (B).

(b) Special rules. (1) The provisions of paragraph (a) of this section, relating to allocation, are applicable where the gift interest in the partnership is created indirectly as well as directly. When the transfer of partnership interest is created indirectly, the term "donor" may include persons other than the nominal transferor.

Example (1). A father gives property to his son who subsequently conveys the property to a partnership consisting of the father and the son. The partnership interest of the son may be considered created by gift, and the father may be considered the donor of the son's partnership interest.

Example (2). A father, the owner of a business conducted as a sole proprietorship, transfers the business to himself. In such case, the son's partnership interest may be considered created by gift and the father may be considered the donor of his son's partnership interest. (2) The allocation rules set forth in section 191 and paragraph (a) of this section apply in any case in which the transfer or creation of the partnership interest has any of the substantial characteristics of a gift. Thus, allocation may be resorted to when transfer of partnership interest is made between members of a family (including collaterals) under a purported purchase agreement, in which the substance of a gift is ascertained from the terms of the purchase agreement, the terms of any loan or credit arrangements made to finance the purchase, or from other relevant data.

(3) In the case of limited partnership, for the purpose of the allocation provisions of paragraph (a) of this section, proper weight shall be given to the fact that a general partner, unlike the limited partner, risks his credit in the partnership business.

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amount by which net income computed without any deduction for investment expenses allowed by this subparagraph, or for tax-free income, by subsection (A), exceeds 10% per cent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

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

(c) Depreciation. Reasonable allowance, as provided in section 23 (1), for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(d) Rental value of real estate. The deduction under subsection (e) (7) (C) or (C) (7) (D) of the amount of the rental value of real estate owned and occupied in whole or in part by the life insurance company, shall be limited to the maximum allowed under section 23 (a) and shall not exceed the ratio of such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

(e) Amortization of premium and accrual of discount or income, the credit allowed in section 201 (o) (7) (A) and the credit allowed against net income in section 201 (a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined (1) in accordance with the method regularly employed by such company, if such method is reasonable, and (2) in all other instances with reasonable approximations prescribed by the Commissioner with the approval of the Secretary.

(f) Doubt arising in this section or in section 202, 203, or 203A shall be construed to permit the same items to be twice deducted.

§ 39.201-2 Credit under section 26. For the purposes of this section, in computing normal tax net income and corporation surtax net income, the credits provided in section 25 shall be allowed in the manner and to the extent provided in sections 13 (a) and 15 (a).

§ 39.201-3 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) (3)) plus any unearned premiums and unpaid losses on 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)). 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 on such reserves comprise 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 engaged directly in the manufacture of funeral supplies or the performance of funeral services will be taxable under section 204 or section 205 on a life insurance company other than life. For the definition of an insurance company see § 39.3707-7.

§ 39.201-4 Life insurance reserves. (a) The term "life insurance reserves" as defined in section 201 (c) (3) includes all reserves in a taxable year from interest, dividends, and rents, from sources within and without the United States, pertaining to its United States business. Such reserves, as such, as reserves of such as reserves of shall be exempt from tax as reserves if a reserve in addition to the unearned premium must be maintained to cover that obligation. Reserve life insurance reserves are held to supplement the future premium receipts when the former, are insufficient to cover the increases in later years. In the case of cancelable health and accident policies and similar 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 for noncancelable health and accident policies are included in life insurance reserves, whether computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest.

§ 39.201-5 Life insurance companies; rules of construction. Life insurance companies or associations, life insurance reserves other than 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-laws (as approved by the State
in section 202

§ 39.201-5 Interest paid. Interest paid is one of the elements to be used, together with the reserve earnings rate, in computing the amount of "required interest" for purposes of determining the reserve interest credit provided in section 203A. In the case of taxable years beginning in 1952. See § 39.203A-2. Interest paid consists of (a) interest paid on indebtedness (except indebtedness incurred or continued to purchase or carry tax-exempt securities as set forth in section 201 (a) (6) (A) and (b) stockholders in the nature of interest paid on certain contracts, as provided in section 201 (a) (6) (B) Interest on indebtedness includes interest on dividends held on deposit and surrendered. Where reserves do not include interest paid on deferred dividends the reserve for which is used in determining the policy and other liability credit provided in section 202 (b) Life insurance reserves as defined in § 39.201-4 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 guaranteed interest paid within the taxable year on insurance or annuity contracts (other than contracts for annuity or annuity contracts which do not involve at the time of payment, life, health, or accident contingencies. It is immaterial whether the optional mode of settlement specified in the contract or annuity contract arises from an option exercised by the insured during his or her lifetime or from an option exercised by a beneficiary after the policy has matured, frequently referred to as a supplementary contract not involving life contingencies; for example, a contract to pay the insurance benefit in 10 annual installments. No distinction is made based on the person choosing the method of payment and the full amount of the interest paid and not merely the guaranteed interest is considered as interest paid.

§ 39.201-6 Adjusted reserves. For the purpose of determining the figure to be proclaimed by the Secretary under the formula set forth in section 202 (b) and also for the purpose of determining "re- quired interest" for years beginning in 1952, certain reserves computed on a preliminary term method are to be adjusted by increasing such reserves by 10 per cent. (see § 39.201-4). No distinction is 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 modified annuity method 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 of 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 under "net income and deductions."
estate owned by the company except to the extent used for the purpose of producing investment income. See paragraph (e) of this section. As to real estate owned and occupied by the company, see § 39.201-8.

(e) Depreciation. The deduction allowed for depreciation is, except as provided in section 201 (d) identical with that allowed other corporations by section 23 (c) (1) of the Act. 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 determination of the ratio of the face value of the space to the rental value of the entire property. Where a deduction is claimed, the ratio of the face value of the space to the rental value of the entire property, 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.

§ 39.201-9 Amortization of premium and accrual of discount. (a) Section 201 (e) provides for certain adjustments on account of amortization of premium and accrual of discount on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such adjustments are limited to 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 and to the extent used, for the purpose of producing investment income specified in section 201 (c) (1).

§ 39.201-3 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 part of the property occupied bears to the rental value of the entire property. Where a deduction is claimed, the ratio of the rental value of the part of the property occupied to the rental value of the entire property, 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.

§ 39.201-8 Adjustment for certain reserves. In the case of a life insurance company writing contracts other than life insurance or annuity contracts, or where a company initiates in the first taxable year or if, in the case of a company which has never before made such adjustments, the company initiates in the first taxable year for which the adjustments are made a reasonable method of amortization for certain reserves shall consistently follow such method thereafter. Ordinarily, a company regularly employs a method in accordance with the statute of some State, Territory, or the District of Columbia, in which it operates.

The appropriate adjustment for the purpose of this section, a fractional part of a month shall be disregarded if it is less than half a month, in which case it shall be considered as a month.

§ 39.202 Statutory provisions; life insurance companies; adjusted normal-tax net income.

Sec. 202. Adjusted normal-tax net income. In computation of income taxes for purposes of section 201, the term "adjusted normal-tax net income" means the normal-tax net income 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, "reserve and other policy liability credit" means an amount computed by multiplying the normal-tax net income by a factor 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 as follows:

(1) In general. As provided in paragraph (b), the figure shall be computed in accordance with the following formulae:

\[ \text{Reserve and other policy liability credit} = \frac{\text{Net income} \times \text{Factor}}{100} \]

(2) Special rules for 1949 and 1950.

(c) Adjustment for certain reserves. In the case of a life insurance company writing contracts other than life insurance or annuity contracts, or where a company initiates in the first taxable year or if, in the case of a company which has never before made such adjustments, the company initiates in the first taxable year for which the adjustments are made a reasonable method of amortization for certain reserves shall consistently follow such method thereafter. Ordinarily, a company regularly employs a method in accordance with the statute of some State, Territory, or the District of Columbia, in which it operates.

The appropriate adjustment for the purpose of this section, a fractional part of a month shall be disregarded if it is less than half a month, in which case it shall be considered as a month.

§ 39.202-1 Reserve and other policy liability credit for adjusted normal-tax net income. (a) 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 reserves, for interest credited on reserves, and for interest paid. This credit is a flat percentage of normal-tax net income. The figure is the same for all companies and is determined on the basis of the aggregate of the interest allowed on reserves, interest paid, and 2 percent of the reserves held for deferred dividends, as provided in section 203 (b) for all companies. The figure for each taxable year is to be determined and proclaimed by the Secretary, based on such data with respect to life insurance companies for the preceding taxable year as the Secretary considers representative for that year.

(b) 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 example:

Example: (1) The X Life Insurance Company for the calendar year 1942 had gross income, consisting of interest and rents, of $8,000,000, of which $7,000,000 consisted of interest income and $1,000,000 of rent. It had investment expenses of $700,000, real estate expenses of $60,000, and depreciation of $20,000. Its net income and its total reserve was accordingly $3,160,000 ($4,000,000 less investment expenses, real estate expenses, and depreciation, totaling $80,000) and the wholly-tax-exempt interest of $70,000.

§ 39.202-1
§ 39.202-1 Reserve and other policy liability credit for adjusted corporation surtax net income.

As used in this section, the term "reserve and other policy liability credit" means the credit computed by multiplying the corporation surtax net income of the company equal to $3,100,000 times the required interest, the reserve interest credit if any, provided in section 202 (b) (2) (A) less the credit for dividends received allowed under section 202 (b) (3) minus the reserve interest credit, if any, provided in section 203A (a) (1), computed at that rate at the beginning and the end of the taxable year.

§ 39.202-2 Reserve interest credit.

(a) In computing 1952 adjusted normal-tax net income, a reserve interest credit is allowed where the "adj usted normal-tax net income" of the company is less than 105 percent of its required interest. For the purpose of computing the Reserve interest credit, the term "adjusted normal-tax net income" means the net income of the company without any deduction for tax-free interest allowed under section 201 (c) (3) (A) less the credit for dividends received allowed under section 202 (b) (3) minus the reserve interest credit, if any, provided in section 203A (a) (1), computed at that rate at the beginning and the end of the taxable year.

§ 39.203-1 Reserve and other policy liability credit for adjusted corporation surtax net income.

As used in this section, the term "reserve and other policy liability credit" means the credit computed by multiplying the corporation surtax net income of the company by the applicable figure determined and proclaimed under section 202 (b).

§ 39.203-2 Reserve interest credit.

(a) In computing 1952 adjusted normal-tax net income, a reserve interest credit is allowed where the "adjusted normal-tax net income" of the company is less than 105 percent of its required interest. For the purpose of computing the Reserve interest credit, the term "adjusted normal-tax net income" means the net income of the company without any deduction for tax-free interest allowed under section 201 (c) (3) (A) less the credit for dividends received allowed under section 202 (b) (3) minus the reserve interest credit, if any, provided in section 203A (a) (1), computed at that rate at the beginning and the end of the taxable year.

§ 39.203-3 Tax on life insurance companies in the case of a taxable year beginning in 1952.

(a) In the case of a taxable year beginning in 1952, the tax imposed on a life insurance company for such year shall be computed by multiplying the normal-tax net income of the company by the applicable figure determined and proclaimed under section 202 (b).

§ 39.203-4 Tax on life insurance companies in the case of a taxable year ending in 1952.

(a) In the case of a taxable year ending in 1952, the tax imposed on a life insurance company for such year shall be computed by multiplying the normal-tax net income of the company by the applicable figure determined and proclaimed under section 202 (b).

§ 39.203-5 Tax on life insurance companies in the case of a taxable year beginning in 1953.

(a) In the case of a taxable year beginning in 1953, the tax imposed on a life insurance company for such year shall be computed by multiplying the normal-tax net income of the company by the applicable figure determined and proclaimed under section 202 (b).

§ 39.203-6 Tax on life insurance companies in the case of a taxable year ending in 1953.

(a) In the case of a taxable year ending in 1953, the tax imposed on a life insurance company for such year shall be computed by multiplying the normal-tax net income of the company by the applicable figure determined and proclaimed under section 202 (b).
In determining the percentage of the adjusted net income to required interest on reserve interest credit, the figures shall be computed to at least the nearest tenth of a percentage point.

§ 39.204 Statutory provisions; tax on insurance companies other than life or mutual

Sec. 204. Insurance companies other than life or mutual—(a) Imposition of tax—(1) In general. There shall be levied, collected, and paid for each taxable year upon the normal-tax and upon the corporation surtax net income of every insurance company (other than a life or mutual insurance company) and every mutual marine insurance company and every mutual fire insurance company exclusively issuing either personal policies, or policies for which the sole premium charged is a single deposit which (except for such deduction of underwriting costs as may be provided) is refundable upon cancellation or expiration of the policy taxes computed as provided in section 13 (b) and in section 13 (b).

(2) Normal-tax and surtax net income of foreign insurance companies other than life or mutual and foreign mutual marine. In the case of a foreign insurance company (other than a life or mutual insurance company) and a foreign mutual marine insurance company described in paragraph (1) of this subsection, the normal-tax and surtax net income from sources within the United States minus the credit provided in section 26 (a) and the credit provided in section 26 (b). Such net income shall be the net income from sources within the United States minus the credit provided in section 26 (b).

(3) No United States insurance business. Foreign insurance companies (other than a life or mutual insurance company) and foreign mutual marine insurance companies and foreign mutual fire insurance companies described in paragraph (1) of this subsection not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as corporations.

(b) Definition of income, etc. In the case of an insurance company subject to the tax imposed by this section, the following definitions shall apply:

(1) Gross income. "Gross income" means the sum of:

(a) The combined gross amount earned during the taxable year on investment income and from underwriting income as provided in this subsection, computed on the basis of gross premiums and fees and fees for investment regularly employed in keeping the books of the insurance company.

(b) Deductions (other than those specified in this subsection) provided in section 23;

(c) Dividends and similar distributions paid or declared to policyholders in their capacity as insured by the insurance company of the policyholders.

(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 gross amount of income earned during the taxable year from interest, dividends, rents, or gains from the sale or exchange of capital assets.

To all interest, dividends and rents received during the taxable year, add interest, dividends, rents, and gains from the sale or exchange of capital assets received at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) Underwriting income. "Underwriting income" means the amount computed 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 premiums paid for reinsurance.

For the purposes of computing the net income of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 204 (b);

(1) Losses incurred. "Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

(a) To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the taxable year, and deduct unpaid losses outstanding at the end of the preceding taxable year.

(b) Expenses incurred. "Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

(a) To all amounts shown on the annual statement approved by the National Convention of Insurance Commissioners, add expenses incurred as defined in this paragraph, and subtract the credits provided in section 26 (a) and (b), and in section 26 (b).

(3) All interest as provided in section 23 (a);

(4) All expenses incurred, as provided in section 23 (a);
§ 39.204-2 Gross income. (a) Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property, whether the income is or is not taxable under section 204 as foreign corporations. See section 231. (c) Insurance companies are subject to both normal tax and surtax. The normal tax shall be computed as provided in section 20 (b) for what constitutes corporation surtax net income, see § 39.15-1. The surtax shall be computed as provided in section 15 (b) for what constitutes normal-tax net income, see § 39.13-1. The circumstances under which the $25,000 exemption from surtax for certain taxable years may be disallowed in whole or in part, see § 39.15-3. (b) Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 204, unless the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a). (b) Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 204 unless the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a). (b) Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 204 unless the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a). (b) Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 204 unless the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a).
§ 39.205-207  Policyholders, minus the interest which rents, and net premiums, minus dividends to policyholders, minus the interest which rents, and net premiums, minus dividends to policyholders, and net income is over $50,000, a tax computed as follows:

(A) Taxable years beginning after December 31, 1950, and before April 1, 1951. ** **

(B) Taxable years beginning after March 31, 1951, and before April 1, 1954.

(i) Normal tax: A normal tax of 25 per cent of the normal-net tax income, or 50 per cent of the amount by which the normal-net tax income exceeds $75,000, whichever is the lesser; plus

(ii) Surtax. A surtax of 25 per cent of the corporation net income in excess of $25,000, or 33 per cent of the amount by which the corporation net income exceeds $50,000, whichever is the lesser.

(C) Taxable years beginning after March 31, 1954. In the case of a taxable year beginning after March 31, 1954:

(1) Normal tax. A normal tax of 25 per cent of the normal-net tax income, or 50 per cent of the amount by which the normal-net tax income exceeds $50,000, whichever is the lesser; plus

(2) Surtax. A surtax of 25 per cent of the corporation net income in excess of $25,000, or 33 per cent of the amount by which the corporation net income exceeds $50,000, whichever is the lesser.

(3) Foreign mutual insurance companies other than life or marine. In the case of a foreign mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 204 and other than an interinsurer or reciprocal underwriter) a tax computed under paragraph (1) or paragraph (5) whichever is the greater and upon the income of every mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 204) which is an interinsurer or reciprocal underwriter, a tax computed under paragraph (2) which is the lesser; plus

(4) Interest. A surtax of 25 per cent of the corporation net income in excess of $25,000, or 33 per cent of the amount by which the corporation net income exceeds $50,000, whichever is the lesser.

(5) Foreign mutual insurance companies other than life or marine. In the case of a foreign mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 204), the net income shall be the net income from sources within the United States and the gross amount of income, war-profits, and excess-profits taxes assessed, and to the extent provided in section 117, the interest which under section 22 (b) (4) is excluded for the taxable year from gross income, less interest, rents, and net premiums, minus dividends to policyholders, minus the interest which rents, and net premiums, minus dividends to policyholders, and net income is over $50,000, a tax computed as follows:

(A) Taxable years beginning after December 31, 1950, and before April 1, 1951. ** **

(B) Taxable years beginning after March 31, 1951, and before April 1, 1954—

(i) Normal tax: A normal tax of 25 per cent of the normal-net tax income, or 50 per cent of the amount by which the normal-net tax income exceeds $50,000, whichever is the lesser; plus

(ii) Surtax. A surtax of 25 per cent of the corporation net income in excess of $25,000, a tax equal to the excess of—

(A) 1 per cent of the amounts so computed, or 2 per cent of the excess of the amount so computed over $75,000, whichever is the lesser, over—

(B) The amount of the tax imposed under Subchapter E of Chapter 2.

§ 39.205-207  Policyholders, minus the interest which rents, and net premiums, minus dividends to policyholders, and net income is over $50,000, a tax computed as follows:

(A) Taxable years beginning after December 31, 1950, and before April 1, 1951. ** **

(B) Taxable years beginning after March 31, 1951, and before April 1, 1954—

(i) Normal tax: A normal tax of 25 per cent of the normal-net tax income, or 50 per cent of the amount by which the normal-net tax income exceeds $50,000, whichever is the lesser; plus

(ii) Surtax. A surtax of 25 per cent of the corporation net income in excess of $25,000, a tax equal to the excess of—

(A) 1 per cent of the amounts so computed, or 2 per cent of the excess of the amount so computed over $75,000, whichever is the lesser, over—

(B) The amount of the tax imposed under Subchapter E of Chapter 2.
(ii) Losses from the sale or exchange of capital assets sold or exchanged for capital assets to cover losses and to provide for the payment of dividends and similar distributions to policyholders.

(c) Real estate. The deduction under subsection (b) (4) or (5) of this section on account of any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by this section, shall have the same amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not occupied bears to the rental value of the entire property.

(d) Amortization of premium and accrual of discount. The gross amount of income during the taxable year from interest, the deduction provided in subsection (b) (4) and the credits allowed against net income in section 207 (a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company, if such method is reasonable, and in all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

(e) Deductions of foreign corporations. In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

(f) Double deductions. Nothing in this section is intended to permit the same item to be twice deducted.

(g) Credits under section 26. For the purposes of this section, in computing normal tax net income and corporation surtax net income, the credits provided in section 26 shall be allowed in the manner and to the extent provided in sections 19 (a) and 15 (a).


§ 39.207-1 Tax on mutual insurance companies other than life or fire or fire insurance companies subject to the tax imposed by section 204—(a) In general. (1) All mutual insurance companies, including foreign insurance companies carrying on an insurance business within the United States, not taxable under section 201 or 204 and not specifically exempt under the provisions of section 101 (11) are subject to the tax imposed by section 207 (a) on their investment income or on their gross income, whichever tax is the greater, and interest on debentures and reciprocal underwriters, whether an amount that exceeds only their investment income. For the alternative tax, in lieu of the tax imposed by section 207 (a) (1) or (2), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 117 (c) (1) and the regulations thereunder.

(2) The taxable income of mutual insurance companies subject to the tax imposed by section 207 differs from the taxable income of other corporations. See section 207 (a) (3) and section 207 (B) which is subject to the tax imposed by section 207 (a) in computing normal tax net income and corporation surtax net income, to the extent provided in section 26 (a) (4) for wholly tax-exempt interest, and the credit under section 26 (a) (2) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(3) All provisions of the Internal Revenue Code and of the regulations in this section not inconsistent with the provisions of section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 are subject to the tax imposed by section 201 or 204 and the provisions of section 201 or 204 and the regulations thereunder.

(4) The rule in section 207 (a) (d) for mutual insurance companies subject to the tax imposed by section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 are subject to the tax imposed by section 201 or 204 and the provisions of section 201 or 204 and the regulations thereunder.

(5) Mutual insurance companies subject to the tax imposed by section 207, except interinsurers or reciprocal underwriters, with corporation surtax net incomes of over $50,000, are subject to a tax computed under section 207 (a) (2). Mutual insurance companies subject to the tax imposed by section 207 are subject to a tax computed under section 207 (a) (2) for wholly tax-exempt interest, and the credit under section 207 (a) (2) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(6) The gross amount of income during the taxable year from interest, the deductions under section 207 (b) (4) (A) for wholly tax-exempt interest, and the credit under section 207 (b) (4) (C) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(7) All provisions of the Internal Revenue Code and of the regulations in this section not inconsistent with the provisions of section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 are subject to the tax imposed by section 201 or 204 and the provisions of section 201 or 204 and the regulations thereunder.

(8) Mutual insurance companies subject to the tax imposed by section 207, except interinsurers or reciprocal underwriters, with corporation surtax net incomes of over $50,000, are subject to a tax computed under section 207 (a) (2). Mutual insurance companies subject to the tax imposed by section 207 are subject to a tax computed under section 207 (a) (2) for wholly tax-exempt interest, and the credit under section 207 (a) (2) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(9) The gross amount of income during the taxable year from interest, the deductions under section 207 (b) (4) (A) for wholly tax-exempt interest, and the credit under section 207 (b) (4) (C) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(10) All provisions of the Internal Revenue Code and of the regulations in this section not inconsistent with the provisions of section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 are subject to the tax imposed by section 201 or 204 and the provisions of section 201 or 204 and the regulations thereunder.

(11) Mutual insurance companies subject to the tax imposed by section 207, except interinsurers or reciprocal underwriters, with corporation surtax net incomes of over $50,000, are subject to a tax computed under section 207 (a) (2). Mutual insurance companies subject to the tax imposed by section 207 are subject to a tax computed under section 207 (a) (2) for wholly tax-exempt interest, and the credit under section 207 (a) (2) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(12) All provisions of the Internal Revenue Code and of the regulations in this section not inconsistent with the provisions of section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 are subject to the tax imposed by section 201 or 204 and the provisions of section 201 or 204 and the regulations thereunder.

(13) Mutual insurance companies subject to the tax imposed by section 207, except interinsurers or reciprocal underwriters, with corporation surtax net incomes of over $50,000, are subject to a tax computed under section 207 (a) (2). Mutual insurance companies subject to the tax imposed by section 207 are subject to a tax computed under section 207 (a) (2) for wholly tax-exempt interest, and the credit under section 207 (a) (2) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(14) The gross amount of income during the taxable year from interest, the deductions under section 207 (b) (4) (A) for wholly tax-exempt interest, and the credit under section 207 (b) (4) (C) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. See section 207 (a) (d) and section 123 (b).

(15) All provisions of the Internal Revenue Code and of the regulations in this section not inconsistent with the provisions of section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 (a) and mutual insurance companies subject to the tax imposed by section 207 are subject to the tax imposed by section 201 or 204 and the provisions of section 201 or 204 and the regulations thereunder.

§ 39.207-1
§ 39.207-2 Net premiums. Net premiums are one of the items used, together with interest, dividends, and rents, less dividends to policyholders and wholly tax-exempt interest, in determining tax liability under section 207. They are also used in determining the limitation on certain capital losses and in the application of section 117. The term "net premiums" is 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) (3)."
and similar distributions to policyholders.

Loses in the latter case may be deducted from ordinary income while the deduction for losses under section 117 is limited to the gains. See section 117 (d).

(2) Capital assets are considered as sold or exchanged to provide for the funds or payments specified in section 207 (b) (1) if (a) excess gross receipts from the sale or exchange of such assets are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, and losses and expenses paid over the sum of interest, dividends, rents, and net premiums received. If, by reason of a particular sale or exchange of a capital asset, gross receipts are greater than such excess, the gross receipts and the resulting loss should be apportioned and the excess included in capital losses subject to the provisions of section 117.

Capital losses actually used to reduce net income in any taxable year may not again be used in a succeeding taxable year as an offset against capital gains in that year or later. A special rule is set forth for the application of section 117 (d).

(3) 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 subject to the tax imposed by section 207, in the taxable year 1953 sold capital assets in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. The gross receipts from the sale are $80,000, resulting in losses of $20,000. It pays dividends to policyholders of $150,000. It incurs losses of $25,000, and pays expenses of $25,000. It receives interest of $50,000, dividends of $60,000, rents of $4,000, and net premiums of $60,000. The excess of the sum of dividends, losses and expenses paid ($250,000) over the sum of interest, dividends, rents, and premiums received ($125,000) is $75,000. As the gross receipts from the sale of capital assets ($80,000) do not exceed $75,000, the excess of $20,000 is allowable as a deduction from gross investment income.

Example (2). If in the above example the gross receipts were $2,000,000 and the last capital asset sold, for the purpose therein specified, resulted in gross receipts of $2,000 and a loss of $500, the losses allowable as a deduction from gross investment income would be $18,700. The last sale made the gross receipts of $78,000 exceed by $1,000 the excess ($75,000) of the sum of dividends, losses, and expenses paid ($250,000) over the sum of interest, dividends, rents, and premiums received ($125,000). The gross receipts and the resulting loss from the last sale are apportioned on the basis of the ratio of $78,000 to the $78,000 in excess of $2,000, or 50 percent. Fifty percent of the loss ($500) is deducted from the total loss of $20,000. The remaining gross receipts of $76,000 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 $2,500 and, under the provisions of section 113, the excess of $10,000 over the sum of capital gains of $10,000, and losses from the sale or exchange of capital assets sold or exchanged was $10,000, excess of abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders of $20,000. Such losses of $20,000 are added to capital gains of $10,000, since they are less than corporation surtax net income, computed without regard to gains or losses from the sale or exchange of capital assets, of $29,750 ($9,750 corporation surtax net income plus $20,000 other capital losses under section 207), and losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses of $10,000 plus capital gains under section 117 of $10,000 minus capital gains under section 117 of $200.

§ 39.207–5 Real estate owned and occupied. The limitation in section 207 (b) (1) on the amount allowable as a deduction for taxes, expenses, and depreciation on or with respect to any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 207 is the same as that provided in the case of life insurance companies by section 201 (d). See § 39.201–8.

§ 39.207–6 Amortization of premium and discount. Section 207 (d) makes provision for the appropriate amortization of premium and the appropriate accrual of discount, attributable to the taxable year, on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 207. Such amortization and accrual is the same as that provided for life insurance companies by section 201 (e) and shall be determined in accordance with § 39.201–9, except that in determining the premium and discount of a mutual insurance company subject to the tax imposed by section 207 the basis provided in section 113 shall be used in lieu of the acquisition value.

§ 39.208 Statutory provisions; insurance companies; net operating losses, Sec. 208. Net operating losses.

(Repealed by sec. 161 (b) (2), Rev. Act 1942)

SUPPLEMENT H—NONRESIDENT ALIEN INDIVIDUALS

§ 39.211 Statutory provisions; tax on nonresident alien individuals.

§ 39.211. Tax on nonresident alien individuals.

(a) Nonresident alien business or office—(1) General rule—(A) Imposition of tax. There shall be levied, collected, and paid by each taxable year, in the tax imposed by sections 11 and 12, upon the amount received, by every nonresident alien individual not engaged in trade or business within the United States, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, commissions, remunerations, emoluments, or other fixed or determinable annual or periodical payments or receipts of principal, gains, profits, and income, a tax of 30 per centum of such amount, except that such rate shall be reduced to 15 per centum by the Secretary of the Treasury in the case of any country whose treaty with the United States is in force in North, Central, or South America, or in the West Indies, or of Newfoundland, to such extent as the Secretary of the Treasury determines may be provided by treaty with such country.

(b) Capital gains of aliens temporarily present in the United States. In the case of a nonresident alien individual not engaged in trade or business within the United States, there shall be levied, collected, and paid for each taxable year, in addition to the tax imposed by subparagraph (A), a tax of 30 per centum of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets sold or exchanged during such year, exceeds his losses, allowable to sources within the United States, from sales or exchanges effected during such year.

For the purposes of this subparagraph, gains and losses shall be treated as if, and to the extent that, they would be recognized and taken into account if such Individual were engaged in trade or business in the United States. The amount of gains and losses shall be computed without regard to the provisions of section 117 (b) (6) and such losses shall be determined by subtracting from the sum of capital gains of $10,000, and losses from the sale or exchange of capital assets sold or exchanged at a profit, $20,000 other capital losses under section 207 (b) (1) plus the portion of capital losses allowable under section 117 of $10,000 minus capital gains under section 117 of $200.

(c) Capital gains of United States residents. The tax imposed by paragraph (a) shall not apply to any individual if during the taxable year the sum of—

(A) The aggregate amount received from the sources specified in paragraph (1) (A), plus

(B) The amount, determined in accordance with the provisions of paragraph (1) (B), by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges, is more than $15,400.

(d) Residents of certain countries. The provisions of paragraph (2) shall not apply to a resident of any country within Central, or South America, or in the West Indies, or of Newfoundland, so long as there is in effect with such country a treaty which provides otherwise.

(e) United States business or office. A nonresident alien individual engaged in trade or business in the United States shall be taxable without regard to the provisions of subsection (a). As used in this section, section 119, section 145, section 144, and section 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, through an establishment in the United States, of daily duration for a period or periods aggregating ninety days during the taxable year and for which such individual is considered as being present in the United States.

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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 any time during the year through which or by the direction of which such transactions in commodities are effected, or in stocks or securities.

(c) No United States business or office and gross income of more than $31,400. A nonresident alien individual not engaged in trade or business within the United States shall be taxable without regard to the provisions of subsection (d) if during the taxable year the sum of the aggregate amount received from the sources specified in subsection (a) (1) (A), plus the amount (determined in accordance with the provisions of subsection (a) (1) (B)) by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges, is more than $15,400, except that—

(1) The gross income shall include only income from the sources specified in subsection (a) (1) (A) plus any gain (to the extent provided in section 117) from a sale or exchange of capital assets other than gains if such gain would be taken into account were the tax being determined under subsection (a) (1) (B).

(2) The deductions (other than the so-called "charitable deduction" provided in section 213 (c)) shall be allowed only if and to the extent that they are properly allocable to the gross income from the sources specified in subsection (a) (1), except that any loss from sales or exchanges of capital assets shall be allowed (to the extent provided in section 117) without the benefit of the capital loss carry-over provided in section 117 (e) if such loss would be taken into account were the tax being determined under subsection (a) (1) (B).

(3) The tax liability of an alien as provided by this chapter (under sections 11 and 12, or under section 117) (c) shall, in no case, be less than 30 per centum of the sum of—

(A) The aggregate amount received from the sources specified in subsection (a) (1) (A). plus

(B) The amount, determined in accordance with the provisions of subsection (a) (1) (B), by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges; and

(4) This subsection shall not apply to a resident of any South American country, or of South America, or in the West Indies, or of Newfoundland, so long as there is in effect with such country a treaty which provides otherwise.

§ 39.211-1 Taxation of aliens in general. For the purposes of chapters 1, 2, and 3, alien individuals are divided generally into two classes, namely, resident aliens and nonresident aliens.

Resident aliens are, in general, taxable the same as citizens of the United States, that is, a resident alien is taxable on income derived from all sources including sources without the United States. Nonresident aliens are taxable only on income from sources within the United States. For classification of nonresident aliens, see § 39.211-7.

§ 39.211-2 Definition. (a) A "nonresident alien individual" means an individual—

(1) Whose residence is not within the United States; and

(2) Who is not a citizen of the United States.

The term includes a nonresident alien fiduciary.

(b) An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the United States tax laws. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere transient is one who has no fixed place of abode in the United States, no floating intention, indefinite as to time, who does not intend to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention to leave the United States at some time to return to another country which purpose for which he came has been consummated or abandoned.

An alien whose stay in the United States is taxable for a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.

§ 39.211-3 Alien seamen as residents. In order to determine whether an alien seaman is a resident within the meaning of chapter 1, it is necessary to decide whether the presumption of nonresidence is overcome by facts showing that he has established residence in the United States. Residence may be established in a vessel regularly engaged in coastwise trade, but the mere fact that a seaman makes his home on a vessel flying the United States flag and engaged in foreign trade is not sufficient to establish residence in the United States, even though the vessel, while carrying on foreign trade, touches at American ports. An alien seaman may acquire an actual residence in the United States within the rules laid down in § 39.211-4, although the nature of his calling requires that he has actually departs from the United States.

An alien seaman may acquire such a residence as a seaman's boarding house or hotel, but such a claim should be carefully scrutinized in order to make sure that such residence is bona fide.

The filling of Form 1078 or taking out first citizenship papers is proof of residence in the United States. If the form is filled or the papers taken out, unless rebutted by other evidence showing an intention to be a transient, the fact that a head tax has been paid on behalf of an alien seaman entering the United States is no evidence that he has acquired residence, because the head tax is payable unless the alien who is entering the country is merely in transit through the country.

§ 39.211-4 Proof of residence of alien. (a) The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of chapter 1. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumption may be overcome—

(1) In the case of an alien who presents himself for determination of tax liability before departure for his native country by (i) proof that the alien, at least six months before the date he presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (ii) proof that the alien, at least six months before the date he presents himself, has filed Form 1078 or its equivalent, or (iii) proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident;

(2) In other cases by (i) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (ii) proof that the alien has filed Form 1078 or its equivalent, or (iii) proof of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that he has been of such an extended nature as to constitute him a resident.

(2) In any case in which an alien seeks to overcome the presumption of nonresidence under paragraph (a) (1) (i) or (ii) or (ii) (iii) of this section, if the internal revenue officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have known the alien at least six months before the date of execution of the affidavit or affidavits.

§ 39.211-5 Loss of residence by alien. An alien who has acquired residence in the United States has no residence until he abandans the same and actually departs from the United States.

An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus, an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States.

§ 39.211-6 Duty of employer to determine status of alien employee. If wages are paid to aliens without withholding the tax, except as permitted in § 39.143-3, in the case of a resident of Canada or Mexico, the employer should have prepared to prove the status of the alien as provided in §§ 39.211-1 to 39.211-5, inclusive. An employer may rely upon the evidence of residence afforded by the fact that the 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 was negligent in failing to file Form 1078 or its equivalent for failure to withhold in the past, if he had not at the time secured Form 1078 or its

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equivalent, is permitted to prove the former fact by the latter by 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.

§ 39.211-7 Taxation of nonresident alien individuals.—(a) In general. For the purposes of this section and §§ 39.212-1, 39.213-1, 39.214-1, 39.215-1, and 39.217-2, 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 such taxable year an amount of not more than $15,400 in the aggregate which is the gross amount of fixed or determinable annual or periodical income from sources within the United States plus the excess of capital gains over capital losses, determined in accordance with paragraph (b) (2) of this section, from sources within the United States; (2) nonresident alien individuals not engaged in trade or business within the United States at any time during the taxable year and deriving in such taxable year an amount of more than $15,400 in the aggregate which is the excess of capital gains over capital losses, determined in accordance with subparagraph (2) of this paragraph, is also subject to tax and is to be aggregated with such fixed or determinable annual or periodical income in determining such $15,400.

(b) No United States business; general rule.—(1) Fixed or determinable annual or periodical income. (i) A nonresident alien individual within class (1) referred to in paragraph (a) of this section, is liable to a tax of 30 percent upon the excess of capital gains derived from sources within the United States over such capital losses, determined under the provisions of section 119 and in accordance with the provisions of this subparagraph. This tax is in addition to the tax imposed and required by subparagraph (1) of this paragraph, upon the gross amount of fixed or determinable annual or periodical income derived from sources within the United States, from such sales or exchanges of a capital asset during such taxable year. (ii) No United States business; aggregated income. (1) If he has been present in the United States for a period or periods aggregating less than 90 days during the taxable year, a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year and deriving in such taxable year an amount of more than $15,400 in the aggregate which is the gross amount of fixed or determinable annual or periodical income from sources within the United States plus the excess of capital gains over capital losses, determined in accordance with paragraph (a) of this section, 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 within the United States. But see §§ 39.220-1 with respect to alien individuals who are bona fide residents of Puerto Rico during the entire taxable year.

§ 39.211-7 RULES AND REGULATIONS
§ 39.212—1 Gross income of nonresident alien individuals—(a) In general.

(1) In general, the case of nonresident alien individuals "growing" mercantile business, means only the gross income from sources within the United States. See section 119 and the regulations thereunder. The items of gross income from sources without the United States and therefore not taxable to nonresident aliens are described in section 119 (c). As to who are nonresident alien individuals, see §§ 211 (a). (b) Income received by a resident alien from sources without the United States is taxable although such person may become a nonresident alien subsequent to its receipt and before the close of the taxable year. Conversely, income received by a nonresident alien from sources without the United States is not taxable to nonresident aliens unless subsection (d) of section 119 applies.

(2) Income received by a nonresident alien engaged in trade or business within the United States at any time during the taxable year, whether such alien comes within section 211 (a) or section 211 (c) is gross income from sources within the United States consisting of fixed or determinable annual or periodical income and any gain from the sale or exchange of a capital asset to the extent required to be included in gross income under the provisions of section 211 (a) (1) or section 211 (c).

(b) No United States business. The gross income of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year, whether such alien comes within section 211 (a) or section 211 (c) is gross income from sources within the United States consisting of fixed or determinable annual or periodical income and any gain from the sale or exchange of a capital asset to the extent required to be included in gross income under the provisions of section 211 (a) (1) or section 211 (c). The gross income of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year, whether such alien comes within section 211 (a) or section 211 (c) is gross income from sources within the United States consisting of fixed or determinable annual or periodical income and any gain from the sale or exchange of a capital asset to the extent required to be included in gross income under the provisions of section 211 (a) (1) or section 211 (c).

§ 39.212-2 Exclusion of earnings of foreign ships or aircraft from gross income—(a) Ships under foreign flag. So much of the income from sources within the United States as is attributable to personal services within the United States nonresident in such foreign country and to corporations organized in the United States, shall not be included in gross income. Foreign countries which either impose no income tax, or, in imposing such tax, only include in gross income such income from sources within the United States as is derived from the operation of a ship or aircraft: (b) Commercial enterprises. A nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year, is subject to the normal tax and the surtax. However, the disallowance under section 211 (b) of the income of a nonresident alien individual, foreign partnership, or foreign corporation engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed $5,000, Such compensation is not income from sources within the United States. See section 119 (a) (3). As to the exclusion from gross income of the official compensation received by employees of foreign governments or of international organizations, see section 119 (b).
sections, whether or not the foreign country under the laws of which such sections are document the equivalent exemption of the Internal Revenue Code with the United States of a nonresident alien individual at any time within the taxable year was engaged in trade or business within the United States as consists of earnings derived from the operation of aircraft registered under the laws of the United States and grants an equivalent exemption to citizens of the United States nonresident in such foreign country and to corporations organized in the United States, shall not be included in gross income. Foreign countries which either impose no income tax, or, in imposing such tax, exempt from taxation so much of the income of a citizen of the United States nonresident in such foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of aircraft registered under the laws of the United States are considered as granting an equivalent exemption within the meaning of this paragraph. A nonresident alien individual not engaged in trade or business within the United States at any time within 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 aircraft, whether or not the foreign country under the laws of which such aircraft are registered meets the equivalent exemption requirement of the Internal Revenue Code.

§ 39.213 Statutory provisions; nonresident alien individuals; deductions.

Sec. 215. Deductions.—(a) General rule. In the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(b) Losses. (1) The deduction, for losses not connected with trade or business, 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 have been taxable under the provisions of the Internal Revenue Code.

(2) The deduction for losses of property not connected with the trade or business of aircraft of foreign registry, incurred in transactions entered into for profit, allowed by section 23 (e) (3) shall be allowed whether or not connected with income from sources within the United States, but only if the loss is of property within the United States.

(c) Charitable, etc. contributions. The so-called "charitable contribution" deduction allowed by section 23 (o) shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds or foundations created in the United States or to community chests, funds or foundations or any charitable organization within the United States, or to the vocational rehabilitation fund.

§ 39.213 Standard deduction. The standard deduction provided in section 23 (aa) shall not be allowed.

§ 39.215-1 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, except that losses allocable to sources within the United States from sales or exchanges of capital assets shall be allowed in accordance with the provisions of paragraph (b) of § 39.211-1 to the extent of gains, derived from sources therein, from such sales or exchanges.

(2) Aggregate more than $15,400. A nonresident alien individual 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 in the aggregate which is the gross amount of fixed or determinable annual or periodical income from sources within the United States plus the excess of capital gains over capital losses (determined in accordance with the provisions of paragraph (b) of § 39.211-1) from such sales or exchanges of capital assets, allocable to sources within the United States, to the extent and in the manner provided in paragraph (c) of § 39.211-7. He is also allowed the contributions or gifts made within the taxable year whether or not connected with 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 of the type specified in section 23 (o) subject to the limitations provided in section 215 (b).

(b) United States business. (1) 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 (other than the optional standard deduction for individuals allowed by section 23 (aa)) are allowed only if and to the extent that they are allocated to 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 not incurred in any transaction entered into for profit, although not connected with the trade or business, are (if otherwise allowable) deductible only if made to domestic corporations, or to community chests, funds or foundations created in the United States, or to the vocational rehabilitation fund.

(d) Charitable, etc. contributions. The so-called "charitable contribution" deduction allowed by section 23 (o) shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds or foundations created in the United States, or to the vocational rehabilitation fund.

§ 39.214 Statutory provisions; nonresident alien individuals; credits against net income.

Sec. 214. Credits against net income. In the case of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year and deriving for such year net income except for any interest paid or accrued within the taxable year, only one exemption under section 25 (b) shall be allowed.

§ 39.214-1 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 in the United States at any time during the taxable year is not allowed any credits under section 25, the tax being imposed upon the amount of gross income received.

(b) United States business. In the case of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year and deriving for such year gross income described in section 211 (a) (1) from sources within the United States of more than $15,400, the credits allowed are those applicable in the case of nonresident alien individuals engaged in trade or business within the United States.

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Statutory provisions; nonresident alien individuals; allowance of deductions and credits.

Sec. 215. Allowance of deductions and credits—(a) Return to contain information. A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this chapter only by filing or causing to be filed a return of his true and accurate return of his total income received from all sources in the United States, in the manner prescribed by this chapter; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(b) Tax withheld at source. The benefit of the exemptions under section 23 (b) may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

[Sec. 215 as amended by sec. 10 (g), Individual Income Tax Act 1944; sec. 102 (b), Rev. Act 1945]

§ 39.215-1

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 (except as provided in paragraph (b) (2) of § 39.211-7) or credits even though he may file a return of income.

(2) Aggregate more than $15,400. Unless a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year and having, for such year from sources within the United States, income described in section 211 (a) (1) in a gross amount of more than $15,400 shall be filed by him or on his behalf, the district director of internal revenue for the internal revenue district in which the credit is allowable and a return of income (not the net income) from sources within the United States. Where such a nonresident alien has various sources of income within the United States, so much of the information calls for the assessment of a surtax, and a return of income was not filed by him or on his behalf, the Commissioner will cause a return of income from sources within the United States to be made and include therein the income of such nonresident alien from all sources concerning which he has information, without allowance for deductions or credits, and will assess the tax and credits against the income from sources within the United States. Such return shall contain all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

Sec. 216. Credits against tax. A nonresident alien individual shall receive the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131. A nonresident alien individual who files an income tax return on Form 1040 for the taxable year shall make or have made a return on Form 1040NB with respect to the withholding tax at the source, a return of income is not required to be filed by him or on his behalf in respect of any interest on securities held in a bank, trust, or other financial organization outside of the United States.

Sec. 217. Returns—(a) Requirement. In the case of a nonresident alien individual with respect to foreign income, a return shall be filed by him or on his behalf, within 60 days after the return has no application. Such a return shall contain all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(b) Exemption from requirement. Subject to such conditions, limitations, and exceptions under such regulations as the Commissioner may prescribe, the Commissioner, with the approval of the Secretary, nonresident alien individuals subject to the tax imposed by section 211 (a) (1) (A) may be exempted from the requirement of filing returns of such income by any of such of the following methods:

(1) If the taxable income of the alien described in section 211 (a) (1) (A) may be exempted from the requirement of filing returns of such income by any of such of the following methods:

§ 39.217-2

Time and place for filing returns of nonresident alien individuals.

(a) In the case of a nonresident alien individual who for the taxable year does not have wages subject to withholding at the source under section 162, the return must be made on or before the fifteenth day of the sixth full calendar month following the close of the taxable year. In the case of the fractional part of a year, the Commissioner may, upon a showing by the taxpayer of unusual circumstances, prescribe a later time for the filing of the return, but such time shall not be later than the fifteenth day of the eighth full calendar month ending after the beginning of the fractional part of the year. In certain cases in which the time for filing the return is postponed, see section 3504. The return must be filed with the district director of internal revenue for the internal revenue district in which the return was properly filed, and has his principal place of business in the United States, or if he has no principal place of business in the United States, then with the District Director of Internal Revenue at Baltimore, Maryland. For failure to make and file return within the time prescribed, see section 291. For cases in which no return is required, see paragraph (b) of § 39.217-3.

(b) In the case of nonresident alien individuals who have wages subject to withholding under section 162, the general rule provided in paragraph (a) of this section with respect to the filing of the return has no application. Such persons are required to file their returns and to pay the tax at the time prescribed generally for United States citizens and residents. As to the time of filing the return in the case of United States citizens and residents, see section 53 and 383-1.

§ 39.217-3

Return of income—(a) United States business—(1) General rule. If the tax be paid on the income of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year, then on or before the fifteenth day of the sixth full calendar month following the close of the taxable year, or the returns must be made on or before the fifteenth day of the sixth full calendar month following the close of the taxable year. Such nonresident alien individual who for the taxable year does not have wages subject to withholding at the source under section 162, the return must be made on or before the fifteenth day of the sixth full calendar month following the close of the taxable year. In the case of the fractional part of a year, the Commissioner may, upon a showing by the taxpayer of unusual circumstances, prescribe a later time for the filing of the return, but such time shall not be later than the fifteenth day of the eighth full calendar month ending after the beginning of the fractional part of the year. In certain cases in which the time for filing the return is postponed, see section 3504. The return must be filed with the district director of internal revenue for the internal revenue district in which the return was properly filed, and has his principal place of business in the United States, or if he has no principal place of business in the United States, then with the District Director of Internal Revenue at Baltimore, Maryland. For failure to make and file return within the time prescribed, see section 291. For cases in which no return is required, see paragraph (b) of § 39.217-3.
in the United States, shall make or have made a full and accurate return on Form 1040N-B or Form 1040-B, except as provided under provisions described in section 211 (a) (1), (2) such return need not disclose profits derived from the effecting of transactions in securities securities or commodities (including hedging transactions) through a resident broker, commission agent, or custodian, or profits derived from the sale within the United States of personal property or real property located therein. As to the duty of the representative or agent of such alien to file the return and pay the tax, see paragraph (b) (2) of this section, which is hereby made equally applicable in the case of a nonresident alien coming within the provisions of this sub-paragraph.

(b) United States business. (1) If a nonresident alien individual at any time within the taxable year is engaged in trade or business within the United States, he shall make or have made a full and accurate return on Form 1040 of the income received from all sources within the United States. A return will not be required, however, in the case of such a nonresident alien individual, whose income from sources within the United States consists of compensation for personal services and does not exceed $600 during the taxable year.

(2) The responsible representative or agent within the United States of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States shall make in behalf of his nonresident alien principal, a return of, and shall pay the tax on, all income from sources within the United States coming within his control as representative or agent. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. Any person who collects interest or dividends on deposited securities of such a nonresident alien, executes ownership certificates in connection therewith and sells such securities under special instructions shall not be deemed merely by reason of such acts to be the responsible representative or agent of the nonresident alien.

(c) Refund based on return. Where upon filing a return of income it appears that such a nonresident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, there should, in order to obtain a refund on the basis of the showing made by the return, be verified by the taxpayer showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. See § 39.143-4.

(d) Verification of returns. A return on Form 1040B, Form 1040N-B, or Form 1040-NB or the return of a nonresident alien shall be verified by a written declaration that it is made under the penalties of perjury.

(e) Supplement U tax. For returns with respect to the tax imposed by section 421 (a) upon Supplement U net income, see § 39.621-3.

§ 39.218 Statutory provisions; non-resident alien individuals; payment of tax.

Sec. 216. Payment of tax—(a) Time of payment. In the case of a nonresident alien individual with respect to whose wages, as defined in section 6011 (a), withholding under section 3401 (a) is not made applicable, the total amount of tax imposed by this chapter shall be paid, in lieu of the tax imposed by section 311 (a) (1), by the fifteenth 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 by the fifteenth 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 nonresident aliens, see section 143.

[Sec. 218 as amended by sec. 5 (e) (2), Current Tax Payment Act 1943]

§ 39.218–1 Date on which tax shall be paid by nonresident alien individual.

(a) In the case of a nonresident alien individual for a taxable year, does not have wages subject to withholding under section 622, the tax shall be paid on or before the date prescribed by section 3401 (a) and § 3301 (a) of the return, without regard to any extension of time granted for the filing of the return under authority of section 53.

As to payment of the tax in installments, see § 38.66–1. For provisions relating to certain cases in which the time for payment of income tax is postponed by reason of an individual serving in or in support of the military or naval forces of the United States in combat zone, see section 3604.

(b) In the case of a nonresident alien individual who for the taxable year has wages subject to withholding at the source under the provisions of section 622, the tax shall be paid at the time provided in the case of United States citizens and residents. See § 38.58–1.

§ 39.219 Statutory provisions; non-resident alien individuals; partnerships.

Sec. 219. Partnerships. For the purpose of this chapter, a partnership is considered as being engaged in a trade or business, within the United States if the partnership of which he is a member is so engaged.

[Sec. 219 as amended by sec. 160 (f), Rev. Act 1942]

§ 39.219–1 Partnerships. Whether a nonresident alien individual who is a member of a partnership is taxable under the provisions of section 211 (a) or (c) or under the provisions of section 211 (b) may depend on the status of the partnership. A nonresident alien individual who is a member of a partnership which is not engaged in trade or business within the United States is subject to the provisions of section 211 (a) or (c) as the case may be, depending on whether, in the taxable year, he derives income described in section 211 (a) (1) from sources within the United States of more than $15,400, if he is not otherwise engaged in business within the United States. A nonresident alien individual who is a member of a partnership which at any time within the taxable year is engaged in trade or business within the United States is considered as being engaged in trade or business within the United States and is therefore taxable under section 211 (b) for definition of what the term "partnership" includes, see section 3907 (a) (2). The test of whether a partnership is engaged in trade or business within the United States is the same as in the case of a nonresident alien individual. See § 39.211–7.

§ 39.220 Statutory provisions; non-resident alien individuals; alien residents of Puerto Rico.

Sec. 220. Alien residents of Puerto Rico—(a) No application to certain alien residents of Puerto Rico. The provisions of this supplement shall have no application to an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, and such alien shall be subject to the taxes imposed by sections 11 and 12.

(b) Cross reference. For exclusion from gross income of income derived from sources within Puerto Rico, see section 118 (1) (1).

[Sec. 220 as added by sec. 221 (d), Rev. Act 1950]

§ 39.220–1 Alien residents of Puerto Rico. The provisions of Supplement H, relating to the taxation of nonresident alien individuals, do not apply to a nonresident alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, irrespective of whether he has engaged in trade or business within the United States during the taxable year. The income of any alien individual from sources both within and without the United States is subject to the normal tax and the surtax imposed by sections 11 and 12, respectively, except that under the provisions of section 118 (1) income derived from sources within Puerto Rico (other than amounts received for services performed as an employee of the United States or any agency thereof) is excluded from gross income. For rules respecting filing of returns and payment of tax, see sections 51, 53, 56, 58, 59 and the regulations thereunder.

§ 39.221 Statutory provisions; non-resident alien individuals; certain foreign exempt organizations.

Sec. 221. Foreign educational, charitable and certain other exempt organizations. For special provisions relating to foreign educational, charitable and other exempt organizations, see section 421 (d).

[Sec. 221 as added by sec. 301 (e) (5), Rev. Act 1950]

SUPPLEMENT X—FOREIGN CORPORATIONS

§ 39.231 Statutory provisions; tax on foreign corporations.

Sec. 231. Tax on foreign corporations—(a) Nonresident corporations—(1) Imposition of tax. There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 11 and 14, upon the amount received by every foreign corporation not engaged in trade or business within the United States, from sources within the United States as interest (except interest on U.S. government obligations), dividends, rents, salaries, wages, premiums, annuities, commissions, remunerations, emoluments, or other fixed.
or determinable annual or periodical gains, profits, and income, a tax of 50 per centum of such sums received by resident foreign corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, and respect to dividends shall be reduced to such rate (not less than 5 per centum) as may be provided by treaty with such country.

(2) Cross reference. For inclusion in computation of tax of amount specified in shareholder’s Section 202.

(b) Resident corporations. A foreign corporation engaged in trade or business within the United States shall be taxable as provided in section 13 and section 15.

(c) Gross income. In the case of a foreign corporation gross income is the gross income from sources within the United States.

(d) Exclusions. The following items shall not be included in gross income of a foreign corporation and shall be exempt from taxation under this chapter:

(1) Ships under foreign flag. Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which equivalent exemption to citizens of the United States to corporations organized in the United States;

(2) Aircraft of foreign registry. Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to corporations organized in the United States.

§ 39.231-3. Taxation of foreign corporations. (a) General. For purposes of this section and §§ 39.232-1, 39.232-1, 39.232-1, 39.232-1, 39.232-1, and 39.238-1, 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 the regulations as nonresident foreign corporations (see § 39.231-1) 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 § 39.231-1).

(b) Nonresident foreign corporations. (1) A nonresident foreign corporation is liable to the tax upon the amount received by 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 2(a) and (b), "fixed or determinable annual or periodical income" means "gross income." Specific items of fixed or determinable annual or periodical income are enumerated in the Internal Revenue Code as interests (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, renumerations, emoluments, but other fixed or determinable annual or periodical gains, profits, and income are also subject to the tax, as, for instance, royalties. As to the definition of fixed or determinable annual or periodical income, see § 39.143-2.

(2) The fixed or determinable annual or periodical income from sources within the United States, including royalties, which is fixed or determinable annual or periodical income is taxable at the rate of 30 per centum. In the case of dividends received by a nonresident foreign corporation, the rate shall be reduced to such rate as may be provided by treaty with any country.

(c) Resident foreign corporations. (1) A resident foreign corporation is not taxable upon the items of fixed or determinable annual or periodical income enumerated in section 231 (a) at the rate specified in that section. A resident foreign corporation is, under section 15, liable to a tax of 30 per centum (26 per cent for taxable years beginning after March 31, 1954) of its normal-tax net income. The normal-tax net income of a resident foreign corporation 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 232) less the credits provided in section 26 (a) and (c).

(2) A resident foreign corporation is, under section 15, also liable to a tax of 30 per centum of the amount of its corporate surtax net income of $250,000. See, however, § 39.15-2, as to the circumstances under which the $250,000 exemption from surtax for certain taxable years may be disallowed in whole or in part. The corporate surtax net income of a resident foreign corporation 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 232) less the credits provided in section 26 (b) and (c) which credit is limited in amount to 85 per centum of its adjusted net income from sources within the United States computed without regard to the deduction for net operating loss provided in section 23 (e).

(3) For taxable years beginning before April 1, 1954, and ending after March 31, 1954, see § 39.108-2.

(d) Meaning of terms used. As used in sections 119, 124, 144, 211, and 231, the term "income," "income from sources within the United States" includes the performance of personal services within the United States in any income from sources within the United States of a resident foreign corporation earning income, as herein defined, in the United States. 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 a grain futures or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.

§ 39.231-2. Gross income of foreign corporations. (a) In general. In the case of a foreign corporation, including a corporation carrying on an insurance business within the United States and holding no reserve funds upon business transacted within the United States (see section 201 (a) (3)), an insurance company other than life or mutual not carrying on an insurance business within the United States (see section 204 (a) (3)) and a foreign life insurance company other than life carrying on an insurance business within the United States (see section 207 (a)), the term "gross income" means gross income from sources within the United States as described in section 119. See §§ 39.119 (a) (1) to 39.119 (e) (3), inclusive. The items of gross income from sources within the United States of foreign corporations are divided into three classes: (1) A nonresident foreign corporation is taxable upon the items of fixed or determinable annual or periodical income enumerated in section 231 (a) at the rate specified in that section. A resident foreign corporation is, under section 15, liable to a tax of 30 per centum (26 per cent for taxable years beginning after March 31, 1954) of its normal-tax net income. The normal-tax net income of a resident foreign corporation 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 232) less the credits provided in section 26 (a) and (c).

(2) A resident foreign corporation is, under section 15, also liable to a tax of 30 per centum of the amount of its corporate surtax net income of $250,000. See, however, § 39.15-2, as to the circumstances under which the $250,000 exemption from surtax for certain taxable years may be disallowed in whole or in part. The corporate surtax net income of a resident foreign corporation 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 232) less the credits provided in section 26 (b) and (c) which credit is limited in amount to 85 per centum of its adjusted net income from sources within the United States computed without regard to the deduction for net operating loss provided in section 23 (e).

(3) For taxable years beginning before April 1, 1954, and ending after March 31, 1954, see § 39.108-2.

(d) Meaning of terms used. As used in sections 119, 124, 144, 211, and 231, the term "income," "income from sources within the United States" includes the performance of personal services within the United States in any income from sources within the United States of a resident foreign corporation earning income, as herein defined, in the United States. 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 a grain futures or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.

§ 39.231-2. Gross income of foreign corporations. (a) In general. In the case of a foreign corporation, including a corporation carrying on an insurance business within the United States and holding no reserve funds upon business transacted within the United States (see section 201 (a) (3)), an insurance company other than life or mutual not carrying on an insurance business within the United States (see section 204 (a) (3)) and a foreign life insurance company other than life carrying on an insurance business within the United States (see section 207 (a)), the term "gross income" means gross income from sources within the United States as described in section 119. See §§ 39.119 (a) (1) to 39.119 (e) (3), inclusive. The items of gross income from sources within the United States of foreign corporations are divided into three classes: (1) A nonresident foreign corporation is taxable upon the items of fixed or determinable annual or periodical income enumerated in section 231 (a) at the rate specified in that section. A resident foreign corporation is, under section 15, liable to a tax of 30 per centum (26 per cent for taxable years beginning after March 31, 1954) of its normal-tax net income. The normal-tax net income of a resident foreign corporation 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 232) less the credits provided in section 26 (a) and (c).

(2) A resident foreign corporation is, under section 15, also liable to a tax of 30 per centum of the amount of its corporate surtax net income of $250,000. See, however, § 39.15-2, as to the circumstances under which the $250,000 exemption from surtax for certain taxable years may be disallowed in whole or in part. The corporate surtax net income of a resident foreign corporation 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 232) less the credits provided in section 26 (b) and (c) which credit is limited in amount to 85 per centum of its adjusted net income from sources within the United States computed without regard to the deduction for net operating loss provided in section 23 (e).

(3) For taxable years beginning before April 1, 1954, and ending after March 31, 1954, see § 39.108-2.

(d) Meaning of terms used. As used in sections 119, 124, 144, 211, and 231, the term "income," "income from sources within the United States" includes the performance of personal services within the United States in any income from sources within the United States of a resident foreign corporation earning income, as herein defined, in the United States. 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 a grain futures or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.
§ 39.231-3 Exclusion of earnings of foreign ships or aircraft from gross income—(a) Nonresident foreign corporations. A nonresident foreign corporation 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 or aircraft, whether or not the foreign country under the laws of which such ships are documented or aircraft registered meets the equivalent exemption requirements of the statute.

(b) Resident foreign corporations. A resident foreign corporation may exclude from gross income such income from sources within the United States as is derived from the operation of a ship or ships or aircraft, whether or not the foreign country under the laws of which such ships are documented or aircraft registered meets the equivalent exemption requirements of the statute.

§ 39.232 Statutory provisions; foreign corporations; deductions.

Sec. 235. Deductions—(a) In general. In the case of nonresident foreign corporations, deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119, under the rules and regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(b) Charitable, and so forth, contributions. The so-called “charitable contributions” deduction allowed by section 23(q) (q) is allowed only if and to the extent that the deduction is allowed with respect to sources within the United States.

§ 39.232-1 Deductions allowed foreign corporations—(a) Nonresident foreign corporations. As to the income of a nonresident foreign corporation is not allowed any deductions from gross income from sources within the United States, the tax being imposed upon the gross income from sources outside the United States. See § 39.231-1.

(b) Resident foreign corporations. A resident foreign corporation is allowed the same deductions from its gross income as a resident corporation is allowed. See § 39.231-2. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119.

§ 39.233 Statutory provisions; foreign corporations; allowance of deductions and credits.

Sec. 233. Allowance of deductions and credits. A foreign corporation shall receive the benefit of the deductions and credits allowed it in this chapter for 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.

§ 39.233-1 Allowance of deductions and credits—(a) Resident foreign corporations. The benefit of the deductions and credits allowed a resident foreign corporation can be had only by filing or being allowed as a credit against its tax the director of internal revenue a true and accurate return of its total income received from sources within the United States.

(b) Nonresident foreign corporations. Inasmuch as a nonresident foreign corporation is taxable under section 231(a) only upon fixed or determinable annual or periodical gross income received from sources within the United States, such foreign corporation may not receive the benefit of the deductions and credits by filing a return of income.

§ 39.234-235 Statutory provisions; foreign corporations; credits against tax; returns.

Sec. 234. Credits against tax. Foreign corporations shall not be allowed the credits against the tax on taxes of foreign countries and possessions of the United States allowed by section 131. A foreign corporation shall not be allowed as a credit against its tax the part of the tax liability under Supplement S.

Sec. 235. Returns—(a) Time of filing. In the case of a foreign corporation not having any office or place of business in the United States, the return, in lieu of the return prescribed in section 8 (a) (1), shall be made on Form 1120 of the Corporation and with respect to the tax liability under Supplement S.

(b) Exemption from requirement. Subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Commissioner, with the approval of the Secretary, corporations subject to the tax imposed by section 231(1) may be exempted from the requirement of filing returns of such tax.

§ 39.235-1 Time and place for filing returns of foreign corporations—(a) Nonresident foreign corporations. The return in the case of a nonresident foreign corporation shall be made on or before the fifteenth day of the sixth full calendar month following the close of the taxable year. In the case of any return for a fractional part of a year the Commissioner may, upon a showing by the taxpayer of unusual circumstances, prescribe a later time for the filing of the return, but such time shall not be later than the fourteenth day of the month preceding the close of the fractional part of the year. If a nonresident foreign corporation has an agent in the United States, the return shall be made by the agent. The return must be filed with the Director of Internal Revenue, Baltimore, Maryland. See section 53(b) (2) for failure to make and file a return within the time prescribed, see section 291. For cases in which no return is required, see paragraph (a) of § 39.235-2.

(b) Resident foreign corporations. The return in the case of a resident foreign corporation, if due on the first day of the second month following the close of the fiscal year, or on or before the fifteenth day of March if on the basis of the calendar year, see section 53(d). If the return is for a fractional part of a year, it shall be filed at the time prescribed in § 39.53-1. The return must be filed with the district director of internal revenue of the district of which the resident foreign corporation has its principal place of business or principal office or agency in the United States. See section 53 (b) (2). For failure to make and file a return within the time prescribed, see section 291.

§ 39.235-2 Return of income—(a) Nonresident foreign corporations. If the tax liability of a nonresident foreign corporation is satisfied at the source, a return of income is not required. A nonresident foreign corporation shall make or have made a return on Form 1120B with respect to that portion of its income received from sources within the United States consisting of interest on so-called tax-free covenant bonds on which a tax of only 2 percent was withheld at the source, and with respect to any other fixed or determinable annual or periodical income upon which the tax was not fully satisfied at the source, including dividends received from a foreign corporation which are treated as income for purposes of the tax imposed by section 291. See section 119 (a) (2) (B) and shall pay the balance of the tax shown to be due.

(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.

(c) Supplement U tax. For returns with respect to the tax imposed by section 451 upon Supplement U net income, see § 39.421-3.

§ 39.236 Statutory provisions; foreign corporations; payment of tax.

Sec. 236. 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 income tax imposed by this chapter shall be paid, in lieu of the time prescribed in section 45 (a), on the five 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 fifteenth 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.

§ 39.236-1 Dates on which tax shall be paid by foreign corporations—Nonresident foreign corporations. In the case of a nonresident foreign corporation, the total amount of tax imposed by chapter 1 shall be paid on or before the day prescribed by section 235 and § 39.236-1 for filing of the return, without regard to any extension of time granted for the filing of the return under authority of section 55. As to payment of the tax in installments, see § 39.56-1.

(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 tax prescribed in section 236 (a) on the fifteenth day of March following the close of the calendar year, or if the return is made on the basis of a fiscal year, the first day of the third month following the close of the fiscal year. If the return is made for a fractional part of a year, the tax shall be paid at the time prescribed in § 39.56-1. As to payment of the tax in installments, see § 39.56-1.

§ 39.237-238 Statutory provisions; foreign corporations; insurance companies; certain exempt organizations.

Sec. 237. Foreign insurance companies. For special provisions relating to foreign insurance companies, see Supplement G.

Sec. 238. Foreign educational, charitable and certain other exempt organizations. For special provisions, relating to foreign educational, charitable and certain other exempt organizations, see section 421 (d).

[Sec. 238 as added by sec. 301 (c) (6), Rev. Act 1950]

SUPPLEMENT J—POSSESSIONS OF THE UNITED STATES
§ 39.251 (a) Statutory provisions; income from sources within possessions of the United States; general rule.

Sec. 231. Income from sources within possessions of the United States; general rule. In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

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

(2) If 50 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and

§ 39.251 (b) Statutory provisions; income from sources within possessions of the United States; amounts received in the United States.

Sec. 251. Income from sources within possessions of the United States; amounts received in the United States. (a) Amounts received by a citizen from a corporation or an individual from the active conduct of a trade or business within a possession of the United States of income derived from the active conduct of a trade or business within a possession of the United States, although such citizen was actively engaged in the management of such corporation or individual, shall be taxed in the United States.

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

§ 39.251 (b) Income received within the United States. Notwithstanding the provisions of section 251 (a), there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States. From the amounts so included in gross income there shall be deducted only the expenses properly apportioned or allocated therefor. For in-
rules and regulations

stance, if in the example set forth in paragraph (e) of § 39.251 (a)-(1), the taxpayer during the latter part of 1952 returned to the United States for a few weeks and while there received the proceeds resulting from the sale of the real estate located within a possession of the United States, the profits derived from such transaction should be reported in gross income. Such receipt in the United States, however, would not deprive the taxpayer of the benefits of section 251 with respect to other items of gross income excluded by that section.

§ 39.251 (c) Statutory provisions; income from sources within possessions of the United States; tax of corporations.

Sec. 251. Income from sources within possessions of the United States. • • •

(c) Tax in case of corporations—(1) Corporation tax. A domestic corporation entitled to the benefits of this section shall be subject to tax under section 13 or section 14 (b), and under section 15.

(2) Gross income for inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

[Sec. 251 (c) as amended by sec. 207, Rev. Act 1939; sec. 104 (e), Rev. Act 1940]

§ 39.251 (c)-(1) Tax in case of corporations. A domestic corporation entitled to the benefits of section 251 is, under section 251 (c) (1) subject to the normal tax on corporations imposed by section 13 and the surtax on corporations imposed by section 15.

§ 39.251 (d) Statutory provisions; income from sources within possessions of the United States; definition.

Sec. 251. Income from sources within possessions of the United States.

(d) Definition. As used in this section the term "possessions of the United States" does not include the Virgin Islands of the United States, and such term, when used with respect to citizens of the United States does not include Puerto Rico.

[Sec. 251 (d) as amended by sec. 231 (a), Rev. Act 1960]

§ 39.251 (d)-(1) Definitions. (a) As used in section 251 and the regulations thereunder, United States includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(b) As used in sections 251 and 252 and §§ 39.251 (a)–1 and 39.252–1, the term "possessions of the United States" includes the Panama Canal Zone, Guam, American Samoa, Wake, and the Midway Islands. The term does not include the Virgin Islands, nor does it include Puerto Rico when used with respect to citizens of the United States.

§ 39.251 (e) Statutory provisions; income from sources within possessions of the United States; deductions.

Sec. 251. Income from sources within possessions of the United States. • • •

(e) Deductions. (1) Citizens of the United States entitled to the benefits of this section shall have the same deductions as are allowed by Supplement IV in the case of a foreign corporation engaged in trade or business within the United States. [Sec. 251 (e) as amended by sec. 160 (d), Rev. Act 1942]

§ 39.251 (e)-(1) Deductions allowed citizens and domestic corporations entitled to the benefits of section 251. In the case of a citizen entitled to the benefits of section 251, the deductions allowed by section 23 (other than the optional standard deduction allowed by section 23 (aa)) are allowed only if and to the extent that they are connected with income from sources within the United States. The provisions of § 39.213–1 relating to the allowance to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States, of the deductions provided in section 23 (a) (2) and (2) for losses not connected with the trade or business are applicable in the case of citizens entitled to the benefits of section 251. No deduction permitted by section 251–3 pertaining to the allowance to such nonresident alien individuals of deductions for contributions provided in section 23 (c) (2) and (2) for losses not connected with the trade or business are applicable in the case of citizens entitled to the benefits of section 251 are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations to the extent that such deductions are connected with such gross income, except that the so-called charitable contribution deduction allowed by section 23 (q) (2) is allowed whether or not connected with income from sources within the United States. The proper apportionment and-allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119. [Sec. 251 (f) as amended by sec. 8 (c), Rev. Act 1940; sec. 111 (c), Rev. Act 1943; sec. 131 (a) (8), Rev. Act 1944; sec. 102 (b) (9), Rev. Act 1948]

(g) Allowance of deductions and credits. Citizens of the United States entitled to the benefits of this section shall receive the benefit of the deduction and credits allowed to them in this chapter only by filing or causing to be filed with the collector a true and accurate return of their total income received from all sources of income from 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.

§ 39.251 (g)-(1) Allowance of deductions and credits to citizens and domestic corporations entitled to the benefits of the United States or a domestic corporation entitled to the benefits of section 251 shall file or cause to be filed with the district director of internal revenue a true and accurate return of total income from sources within the United States. The tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where such a citizen or corporation has various sources of income within the United States so that the total income calls for the assessment of a tax, and a return of income was not filed by or on behalf of the citizen or corporation, the Commissioner will cause it to be made and included therein the income of such citizen or corporation from all sources concerning which he has information, and will assess the tax and collect it from one or more of the sources of income of such citizen or corporation within the United States without allowance for deductions or credits.

§ 39.251 (h)-(1) Statutory provisions; income from sources within possessions of the United States; credits against tax; prisoners of war and internees; employees of the United States.

Sec. 251. Income from sources within possessions of the United States. • • •

(h) Credits against tax. Persons entitled to the benefits of this section shall not be allowed the credits against the tax for taxes paid on foreign currencies and possessions of the United States allowed by section 131.

(1) Prisoners of war and internees. In the case of a citizen or a corporation who has been a prisoner of war while serving within a possession of the United States as a member of the military or naval forces of the United States, and in the case of a citizen interned by the enemy while serving as an employee within a possession of the United States—

(I) If such citizen was confined in any place not within a possession of the United States, such place of confinement shall, for the purposes of this section, be considered as within a possession of the United States; and

(2) Any compensation received within the United States by such citizen attributable to the period of time during which such citizen was a prisoner of war shall be deemed to be income from sources within the United States entitled to the benefits of section 251, and such income shall, for the purposes of subsection (b), be considered as compensation received outside the United States. [Sec. 251 (i) as added by Pub. Law 310 (80th Cong.)]

(1) Employees of United States. For the purposes of this section, amounts paid for services performed by a citizen of the United States as an employee of the United States or any agency thereof shall be deemed to be derived from sources within the United States.

[Sec. 251 (j) as added by sec. 230, Rev. Act 1950]

§ 39.252 Statutory provisions; taxation of citizens of possessions of the United States.

Sec. 252. Citizens of possessions of United States. • • •

(a) Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this chapter only as to income derived from sources within the United States, and in such case the tax shall be collected and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources. This subsection shall have no
application in the case of a citizen of Puerto Rico.

(b) Nothing in this section shall be construed to alter or amend the provisions of the Act entitled "China Trade Act" making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes" approved July 12, 1921 (46 U.S.C. 1923, 1934) relating to the imposition of income taxes in the Virgin Islands of the United States.

[Sec. 293 as amended by sec. 221 (b), Rev. Act 1939]

§ 39.261-1 Status of citizens of United States possession. (a) (1) A citizen of a possession of the United States (except the Virgin Islands or Puerto Rico) who is not otherwise a citizen or resident of the United States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual.

For Federal income tax purposes, a citizen of a possession of the United States who is not otherwise a citizen of the United States is treated for the purpose of the tax as if he were a nonresident alien individual.

The fixed or determinable annuity of a citizen of a possession of the United States who has not become a citizen of the United States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual.

(b) Cross reference. For inclusion in computation of the tax, see Special Dividends, in sharehold-er's consents, see section 292.

[Sec. 291 as amended by sec. 202, Rev. Act 1939; sec. 104 (1) (1), Rev. Act 1911]

§ 39.261-1 Tax on China Trade Act corporations. A China Trade Act corporation is, under section 261 (a), subject to the tax on corporations imposed by section 13 and the surtax on corporations imposed by section 15.

§ 39.262 Statutory provisions; China Trade Act corporations; credit against net income.

Sec. 262. Credit against net income—(a) Allocation of credit. For purposes of this section, the tax as computed and the corporation shall be considered to be earned and subject to the tax under section 13 or section 14 (b), and under section 15.

(b) Cross reference. For inclusions in computation of the tax, see Special Dividends, in shareholder's consent, see section 292.

Example. (1) The A Company, a China Trade Act corporation, has a net income for the calendar year 1939 of $50,000,000 and receives no dividends from domestic corporations. All of its stock on December 31, 1932, is owned on that date by persons resident in China, the United States, or possessions of the United States, or individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date.

For the purposes of this section the term "China" shall have the same meaning as when used in the China Trade Act, as amended.

Sec. 262 as amended by sec. 210 (r), Rev. Act 1939; sec. 104 (1) (2), Rev. Act 1911]

§ 39.262-1 Income and deductions of China Trade Act corporations. The items of gross income to be included in the return of a China Trade Act corporation and the deductions allowable are the same as in the case of other domestic corporations.

§ 39.262-2 Credits allowed China Trade Act corporations. (a) In addition to the credits allowed under section 23 (a) and (b), a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the taxes imposed by sections 13 and 15. This credit is in an amount equal to the par value of the 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, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date.

(b) The application of this section may be illustrated by the following example.

Example. (1) The A Company, a China Trade Act corporation, has a net income for the calendar year 1939 of $50,000,000 and receives no dividends from domestic corporations. All of its stock on December 31, 1932, is owned on that date by persons resident in China, the United States, or possessions of the United States, or individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date.

For the purposes of this section the term "China" shall have the same meaning as when used in the China Trade Act, as amended.

Sec. 262 as amended by sec. 210 (r), Rev. Act 1939; sec. 104 (1) (2), Rev. Act 1911]

§ 39.262-1 Income and deductions of China Trade Act corporations. The items of gross income to be included in the return of a China Trade Act corporation and the deductions allowable are the same as in the case of other domestic corporations.

§ 39.262-2 Credits allowed China Trade Act corporations. (a) In addition to the credits allowed under section 23 (a) and (b), a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the taxes imposed by sections 13 and 15. This credit is in an amount equal to the par value of the 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, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date.

(b) The application of this section may be illustrated by the following example.

Example. (1) The A Company, a China Trade Act corporation, has a net income for the calendar year 1939 of $50,000,000 and receives no dividends from domestic corporations. All of its stock on December 31, 1932, is owned on that date by persons resident in China, the United States, or possessions of the United States, or individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date.

For the purposes of this section the term "China" shall have the same meaning as when used in the China Trade Act, as amended.

Sec. 262 as amended by sec. 210 (r), Rev. Act 1939; sec. 104 (1) (2), Rev. Act 1911]

§ 39.262-1 Income and deductions of China Trade Act corporations. The items of gross income to be included in the return of a China Trade Act corporation and the deductions allowable are the same as in the case of other domestic corporations.

§ 39.262-2 Credits allowed China Trade Act corporations. (a) In addition to the credits allowed under section 23 (a) and (b), a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the taxes imposed by sections 13 and 15. This credit is in an amount equal to the par value of the 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, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date.

For the purposes of this section the term "China" shall have the same meaning as when used in the China Trade Act, as amended.

Sec. 262 as amended by sec. 210 (r), Rev. Act 1939; sec. 104 (1) (2), Rev. Act 1911]
RULES AND REGULATIONS

$39.262-3 Meaning of terms used in connection with China Trade Act corporations. (a) A China Trade Act corporation is one organized under the provisions of the China Trade Act, 1922 (15 U. S. C. c. 4).

(b) The term "China" means (1) China, including Manchuria, Tibet, Mongolia, and any territory leased by China to any foreign government, (2) the Crown Colony of Hong Kong, and (3) the Province of Macao.

(c) The term "special dividend" means the amount which, during the year ending on the date fixed by law for the filing of the corporation's return, is distributed as a dividend to or for the benefit of such persons as are resident in China, the United States, or possessors of the United States, or are individuals citizens of the United States or China, and owned shares of stock of the corporation. The time fixed by law for the return includes the period of any extension of time granted under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Such special dividend does not include any other amounts payable or to be payable to such persons or for their benefit by reason of their interest in the corporation and must be made in proportion to the par value of the shares of stock of the corporation owned by each.

(d) For the purposes of section 262, the shares of stock of a China Trade Act corporation are considered to be owned by the person or persons equitable right to the income from such shares as is in good faith vested.

(e) "Net income derived from sources within China" is the sum of the net income from sources wholly within China and that portion of the net income from sources partly within and partly without China which may be allocated to sources within China. The method of computing the sum of the amount shown as the tax by the taxpayer upon his return and the amounts previously assessed (or collected without assessment) as a deficiency but such sum shall first be reduced by the amount of rebates made, if no return is made, or if the return (except a return on Form 1040A pursuant to section 51 (f)) does not show any tax, for the purposes of the definition, the amount of the tax imposed by chapter 1, the tax on the taxpayer upon his return shall be considered as zero. Accordingly in any such case, if no deficiencies have been assessed, or collected without assessment, and no rebates have been made, the deficiency is the amount of the tax imposed by chapter 1. Additional tax shown on an "amended return," so-called after the due date of the return for the taxable year, is a deficiency within the meaning of the Internal Revenue Code.

(4) Since the special dividend ($100,000) exceeds the diminution of the tax ($98,500) on account of the amount of the special credit against net income, the entire amount of the special credit is allowable and the corporation has no income tax liability for 1922.

§ 39.262-4 Withholding by a China Trade Act corporation. Dividends distributed by a China Trade Act corporation which are treated as income from sources within China under the provisions of section 119 are subject to withholding at the rate of 30 percent when paid to persons (other than residents of China) who are (a) nonresident aliens, (b) nonresident shareholders composed in whole or in part of nonresident aliens, or (c) nonresident foreign corporations. The 30 percent rate of withholding specified in this section with respect to dividends shall be reduced to such rate as may be provided by treaty with any country.

§ 39.263-50 Statutory provisors; China Trade Act corporations; credits against tax; affiliation; income of shareholders.

Sec. 263. Credits against the tax. A corporation organized under 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 section 191.

Sec. 264. Affiliation. * * *

Sec. 265. Income of shareholders. For expenses incurred in dividends from gross income, see section 116.

SUPPLEMENT I—ASSESSMENT AND COLLECTION OF DEFICIENCIES

§ 39.271 Statutory provisors; assessment and collection of deficiencies; definition of deficiency.

Sec. 271. Definition of deficiency.—(a) In general. As used in this chapter in respect of a tax imposed by this chapter, "deficiency" means the amount by which the tax imposed by this chapter exceeds the excess of—

1. The sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, by section 35 for taxes withheld at the source, and without regard to so much of the credit provided in section 32 for taxes withheld at the source as exceeds 2 percent of the interest on bonds containing a tax-free covenant.

(b) The amount of the tax imposed by chapter 1 shall be considered as having been made by the taxpayer and the tax so computed shall be considered as the tax shown by the taxpayer upon his return.

(d) If so much of the credits claimed on the return for taxes withheld at the source as exceeds 2 percent of the interest on tax-free covenant bonds is greater than the amount shown as the tax by the taxpayer upon his return, and if so much of the credits claimed on the return for taxes withheld at the source as exceeds 2 percent of the interest on tax-free covenant bonds is greater than the amount shown as the tax by the taxpayer upon his return, then the taxpayer, in addition to the tax shown by the taxpayer upon his return, shall compute the amount of the tax imposed by chapter 1, the tax on the taxpayer, on the net income included in the amount shown as the tax by the taxpayer upon his return and the amount shown as the tax by the taxpayer upon his return and the amounts previously assessed (or collected without assessment) as a deficiency but such sum shall first be reduced by the amount of rebates made, if no return is made, or if the return does not show any tax, for the purposes of the definition, the amount of the tax imposed by chapter 1, the tax on the taxpayer, and no rebates have been made, the deficiency is the amount of the tax imposed by chapter 1. Additional tax shown on an "amended return," so-called after the due date of the return for the taxable year, is a deficiency within the meaning of the Internal Revenue Code.

(b) The computation by the district director of internal revenue, pursuant to section 51 (f) of the Revenue Act of 1922, of the amount of tax imposed by chapter 1 shall be considered as having been made by the taxpayer and the tax so computed shall be considered as the tax shown by the taxpayer upon his return.

Deficiency defined. The term "deficiency" means the excess of the tax imposed by chapter 1 over the net income of the taxpayer. Subsection (a) of section 119 does not apply to a deficiency within the meaning of this section.

Sec. 271. Deficiency defined. (a) The term "deficiency" means the excess of the tax imposed by chapter 1 over the net income of the taxpayer. Subsection (a) of section 119 does not apply to a deficiency within the meaning of this section.

Example (1). The amount of tax shown by the taxpayer upon his return for the calendar year 1922 was $1,500. The taxpayer had no amounts previously assessed or collected without assessment as a deficiency. He claimed a credit in the amount of $3,000 for tax withheld at source on wages under section 1622, and a refund of $500 (not a refund under section 271) was made to him as an overpayment of tax for the taxable year. It is later determined that the correct tax for the taxable year is $1,750. A deficiency of $250 is determined as follows:

Tax imposed by chapter 1 .............................. $1,500
Tax previously assessed (or collected without assessment) as a deficiency .............................. $1,750
Amount of rebates made None
Balance .................................................. $1,000
Deficiency ............................................... $250

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Example (2). The taxpayer made a return for the calendar year 1952 showing a tax of $1,250 before any credits for tax withheld at the source or for any receipt of interest on tax-free covenant bonds. The amount of $800 for tax withheld at source on wages under section 142b and $40 for tax withheld at source under section 143 upon interest on bonds is a tax-free covenant bond. The taxpayer had no amounts previously assessed (or collected without assessment) as a deficiency. The Commissioner determines that the 2 percent tax paid by the obligor on interest on tax-free covenant bonds is $11,250 (total tax $1,400 less $40 tax paid at source on tax-free covenant bonds). A deficiency in the amount of $1,250 is determined as follows:

Tax imposed by chapter 1 ($1,250 minus $40) $1,210
\[ \text{Tax shown on return ($7,890)} \]
\[ \text{(minus $600)} \]
\[ \text{Total $1,210} \]
Amount of rebates made: None

\[ \text{Balance} \]
\[ 1,210 \]

\[ \text{Deficiency} \]
\[ 1,210 \]

\[ \text{Sec. 372. Procedure in general} \]

(1) Petition to Board of Tax Appeals. If in the opinion of the Commissioner it determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Saturday, Sunday, or legal holidays in the District of Columbia), if the taxpayer has not become a tax free covenant bond. The taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for the collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of subsection (a) of this section, the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any additional amount or addition to the tax should be assessed—whether the deficiency be assessed or before the hearing or a rehearing.

(2) Further deficiency letters restricted. If the Commissioner has mailed a deficiency notice or a deficiency letter as provided in subsection (a) of this section, and the taxpayer has not filed a petition with the Board within the time prescribed, the Commissioner shall have no right to determine any additional deficiency in respect of the same taxable year, except in cases of fraud, and except as provided in subsection (d) of this section, relating to an assessment of greater deficiencies before the Board, or in section 273 (e), relating to the mailing of jeopardy assessments. If the taxpayer is notified that, on account of a mathematical error appearing upon the face of the return, an amount of tax in excess of that shown on the return is due, and that such notice shall be held in abeyance after the mailing of such a notice, the taxpayer shall not have the right to file a petition with the Board based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section.
provided in section 272 (relating to jeopardy assessments), that part of the deficiency so prorated for may be assessed at the date for payment of which has not arrived, shall be collected at the same time as and as part of such installment prescribed by the Commissioner so prorated to any installment the date for payment of which has arrived, shall be paid upon notice and demand from the Commissioner, with the approval of the Secretary of the Treasury, for a further period not in excess of twelve months, and, in exceptional cases, for a further period not in excess of twelve 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 payment of the deficiency in accordance with the terms thereof. 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.

(b) Address for notice of deficiency. In the absence of notice to the Commissioner under section 39.272-1, of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by chapter 1 (see sections 57 and 271) 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 notice to the last address known to him as the deficiency and of which he has notified the taxpayer as the deficiency and of which he has notified the taxpayer by registered mail. In such case the necessary bond referred to in section 272 (a) if such deficiency has not been assessed in accordance with law prior to the adjudication of bankruptcy or the appointment of a receiver, see sections 274 and 296 and §§ 39.274-1 and 39.274-2.

(2) As to cases coming within the provisions of paragraphs (o), (d), and (e) of 39.272-1, see sections 273 (1), 296, and 1145. As to interest on deficiencies, see section 252.

[§ 39.272-2 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 and the deficiency as determined by the Tax Court has been assessed, the unpaid portion of the amount so assessed shall be paid upon notice and demand from the district director of internal revenue. As to cases coming within the provisions of sections 272 (a) and (b) and (c) of 39.272-1, see sections 273 (1), 296, and 1145. As to interest on deficiencies, see section 252.

§ 39.272-3 Extension of time for payment of a deficiency. (a) If it is shown to the satisfaction of the district director (Commissioner if before September 1, 1953) 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 district director or Commissioner may grant an extension of time for the payment of the deficiency. If such waiver has been granted by the Commissioner or the district director, the deficiency shall be assessed immediately, irrespectively of the provisions of section 272 (a) if such deficiency has not been assessed in accordance with law prior to the adjudication of bankruptcy or the appointment of a receiver. See sections 274 and 296 and §§ 39.274-1 and 39.274-2.

(b) As to cases coming within the provisions of sections 272 (a) and (b) and (c) of 39.272-1, see sections 273 (1), 296, and 1145. As to interest on deficiencies, see section 252.

§ 39.272-4 Payment of deficiencies. The filing of notice of such with the Tax Court does not constitute filing with the Commissioner within the meaning of section 39.272-1. After such waiver has been granted by the Commissioner or the district director, the deficiency shall be assessed immediately, irrespectively of the provisions of section 272 (a) if such deficiency has not been assessed in accordance with law prior to the adjudication of bankruptcy or the appointment of a receiver.
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. Section 272 (g) provides that no extension will be granted where the deficiency is due to negligence or intentional disregard of rules and regulations or to fraud with intent to evade tax.

(b) An application for an extension of time for the payment of a deficiency should be made on Form 1127 and must be accompanied or supported by evidence showing that the undue hardship that would result to the taxpayer if the extension were refused. The application must be verified by a written declaration that it is made under the penalties of perjury. A statement of assets and liabilities of the taxpayer and an itemized statement showing all receipts and disbursements for each of the three months immediately preceding the month in which the deficiency is to be paid, 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 deficiency thereof.

(2) Deficiency letters. If the jeopardy assessment is made before any notice in writing is required by any rule or regulation for payment thereof, as shown by the notice and demand filed, the deficiency shall be made within sixty 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 or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 272 (f) prohibiting the determination of the amount of the deficiency, whether or not the taxpayer has theretofore filed a petition with the Board of Tax Appeals. The Commissioner may, at any time before the decision of the Board on the jeopardy assessment, or any unpaid portion thereof, to the extent that he believes the assessment is excessive, notify the taxpayer that the Commissioner shall notify the Board of the amount of such assessment, or abatement, if the petition is filed with the Board before the mailing of the assessment or is subsequently filed, and the Board shall have jurisdiction to redetermine the whole amount of the deficiency and of all amounts assessed at the same time in connection therewith.

(d) Amount assessable after decision of Board. If the jeopardy assessment is made after the decision of the Board, the amount thereof shall be credited or refunded to the taxpayer. The amount of the deficiency determined by the Board in its decision shall be payable in full at any time during the sixty days immediately following the decision of the Board which has become final, together with the interest due thereon at the rate of six percent per annum from the date on which such final decision was rendered. The Commissioner shall notify the taxpayer of the decision of the Board which has become final, together with the interest due thereon at the rate of six percent per annum from the date on which such final decision was rendered, and the notice and demand shall be mailed to the taxpayer at the taxpayer's last known address, determined in accordance with the rules and regulations of the Board, or at such other address as the taxpayer may designate, or as the Board may require.

(e) Expiration of right to appeal. A jeopardy assessment may not be made after the decision of the Board has become final or after the taxpayer has filed a petition for review of the decision of the Board. If a jeopardy assessment is not paid before the expiration of six months after the mailing of the assessment, the taxpayer may appeal from such decision by filing a petition for review of the decision of the Board within thirty days after the mailing of the petition, in accordance with the rules and regulations of the Board. The petition shall contain a further condition that if a petition is not filed within the period provided in such subsection, the amount of the deficiency determined by the Board shall be payable in full at any time during the sixty days immediately following the decision of the Board which has become final, together with the interest due thereon at the rate of six percent per annum from the date on which such final decision was rendered, and the notice and demand shall be mailed to the taxpayer at the taxpayer's last known address, determined in accordance with the rules and regulations of the Board, or at such other address as the taxpayer may designate, or as the Board may require.

(f) Bond to stay collection. When a jeopardy assessment has been made on or after the expiration of the period within which the assessment may be filed for review of the decision of the Board, the bond shall be payable on notice and demand for payment thereof. If the amount determined by the Board of Tax Appeals has been increased by the Board of Tax Appeals or the Court, the amount of the deficiency determined by the Board shall be payable in full at any time during the sixty days immediately following the decision of the Board which has become final, together with the interest due thereon at the rate of six percent per annum from the date on which such final decision was rendered, and the notice and demand shall be mailed to the taxpayer at the taxpayer's last known address, determined in accordance with the rules and regulations of the Board, or at such other address as the taxpayer may designate, or as the Board may require.

(g) Samo; further conditions. If the bond is given before the taxpayer has filed his petition for review of the decision of the Board, the bond shall contain a further condition that if a petition is not filed within the period provided in such subsection, the amount of the deficiency determined by the Board shall be payable in full at any time during the sixty days immediately following the decision of the Board, together with interest thereon at the rate of six percent per annum from the date on which such final decision was rendered, and the notice and demand shall be mailed to the taxpayer at the taxpayer's last known address, determined in accordance with the rules and regulations of the Board, or at such other address as the taxpayer may designate, or as the Board may require.

§ 39.273-1 Jeopardy assessments.

(a) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he is required to assess such deficiency immediately, together with any additional amounts provided by law. A 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 such deficiency determination by The Tax Court. The Commissioner is prohibited from mailng a jeopardy assessment after a period of ninety days has elapsed after the petition has been filed or after the decision of The Tax Court has become final, together with the interest due thereon. If a jeopardy assessment has been mailed to the taxpayer before the expiration of sixty days after the mailing of the petition required by section 272 (a) of the Code of Federal Regulations, the assessment shall be made only in an amount greater or less than that included in the deficiency notice. If the assessment is not mailed within ninety days after the mailing of the notice required by section 272 (a) of the Code of Federal Regulations, the assessment shall be made in an amount not exceeding double the amount of the deficiency determined by The Tax Court.

(b) Water of stay. Upon the filing of the bond the collection of $ or much of the amount covered as by deficienly shall be stayed. The taxpayer shall have the right to waive such stay at any time in respect of the amount so covered as by deficiency. If the Court has handed upon the bond and if, as a result of such waiver, any part of the amount covered by the bond is paid, the Commissioner shall not assess or collect any part of the amount of the taxpayer, proportionately reduced. If the Board determines that the amount assessed or collected on or before the date provided for payment thereof is proportionately reduced, then when the decision of the Board is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.

(1) Collection of unpaid amounts. When the petition has been filed with the Board and when the amount which has become an assessment has been determined by a decision of the Board which has become final, other than that included in the jeopardy assessment and which has been stayed by the bond, shall be collected as part of the tax upon notice and demand from the collector, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount to which the bond is related, such excess shall be credited or refunded to the taxpayer as provided in section 272 (a) of the Code of Federal Regulations. If the amount determined by the Board which has become final is greater than the amount actually assessed, the deficiency, beyond the amount which has become final, and shall be collected as part of the tax upon notice and demand from the collector.

A deficiency determination in abatement shall be filed in respect of any assessment in respect of any tax imposed by this chapter.

§ 39.273-1 Jeopardy assessments.

(a) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he is required to assess such deficiency immediately, together with any additional amounts provided by law. A 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 such determination by The Tax Court. The Commissioner is prohibited from mailing a jeopardy assessment after a period of ninety days has elapsed after the petition has been filed or after the decision of The Tax Court has become final, together with the interest due thereon. If a jeopardy assessment has been mailed to the taxpayer before the expiration of sixty days after the mailing of the petition required by section 272 (a) of the Code of Federal Regulations, the assessment shall be made only in an amount greater or less than that included in the deficiency notice. If the assessment is not mailed within ninety days after the mailing of the notice required by section 272 (a) of the Code of Federal Regulations, the assessment shall be made in an amount not exceeding double the amount of the deficiency determined by The Tax Court.

(b) Water of stay. Upon the filing of the bond the collection of $ or much of the amount covered as by deficienly shall be stayed. The taxpayer shall have the right to waive such stay at any time in respect of the amount so covered as by deficiency. If the Court has handed upon the bond and if, as a result of such waiver, any part of the amount covered by the bond is paid, the Commissioner shall not assess or collect any part of the amount of the taxpayer, proportionately reduced. If the Board determines that the amount assessed or collected on or before the date provided for payment thereof is proportionately reduced, then when the decision of the Board is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.

(1) Collection of unpaid amounts. When the petition has been filed with the Board and when the amount which has become an assessment has been determined by a decision of the Board which has become final, other than that included in the jeopardy assessment and which has been stayed by the bond, shall be collected as part of the tax upon notice and demand from the collector, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount to which the bond is related, such excess shall be credited or refunded to the taxpayer as provided in section 272 (a) of the Code of Federal Regulations. If the amount determined by the Board which has become final is greater than the amount actually assessed, the deficiency, beyond the amount which has become final, and shall be collected as part of the tax upon notice and demand from the collector.

A deficiency determination in abatement shall be filed in respect of any assessment in respect of any tax imposed by this chapter.
Saturday Sunday, or a legal holiday in the District of Columbia as the 90th Saturday Sunday, or a legal holiday in the District of Columbia. If a petition is filed within the 90-day period, the amount will be stayed by the bond filed. If a petition is filed after the expiration of the 90-day period, the amount of the jeopardy assessment will be made, the list showing such assessment or abatement, and the Tax Court will determine whether the assessment or abatement is proper. It must be conditioned upon the payment of the amount of the deficiency together with interest as provided in this chapter. If such deficiency has not theretofore been assessed in accordance with law, in such cases, claims for the deficiency and interest may be made in accordance with law, to the court before the expiration of the 90-day period. If a petition is filed by the taxpayer within the 90-day period, the collection of the amount covered by the bond will be stayed. The taxpayer may at any time waive the stay of collection of the whole or any part of the amount covered by the bond. If as a result such waiver any part of the amount covered by the bond is paid, or if any portion of the bond is paid after the expiration of the 90-day period, the amount assessed will be proportionately reduced at the request of the taxpayer after The Tax Court renders judgment.

(c) After a jeopardy assessment has been made, the list showing such assessment will be immediately transmitted to the district director of internal revenue. Upon receipt of the list containing the assessment, the district director of internal revenue is required to send notice and demand to the taxpayer for the amount of the deficiency as assessed. Regardless of whether the taxpayer has filed a petition with The Tax Court, he is required to make payment of the amount assessed within a period of 10 days after the notice and demand. If the taxpayer does not make such payment within the 10 days, the district director of internal revenue will send notice and demand for the unpaid portion of the amount assessed to The Tax Court, collection of which has been stayed by the bond. The district director of internal revenue is required to include in the notice and demand for the unpaid portion the amount determined by The Tax Court, the collection of which has been stayed by the bond. The district director of internal revenue is required to notify the taxpayer that the amount assessed is greater than the correct amount of the tax, the bond will also be proportionately reduced at the request of the taxpayer after The Tax Court renders judgment.

(d) After The Tax Court has rendered its decision and such decision has become final, the district director of internal revenue will be notified of the action taken. The district director of internal revenue will then send notice and demand for the unpaid portion of the amount determined by The Tax Court, the collection of which has been stayed by the bond. The district director of internal revenue is required to include in the notice and demand for the unpaid portion, interest at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of notice and demand referred to in this paragraph. If the amount of the jeopardy assessment is less than the amount determined by The Tax Court, the difference, together with interest as provided in section 294, will be assessed and collected as part of the tax, upon notice and demand from the district director of internal revenue. If the amount included in the notice and demand made after the decision of The Tax Court is not paid within 10 days after such notice and demand, there shall be collected as part of the tax, interest as provided in section 294.

§ 39.274-1 Bankruptcy and receivership proceedings. (a) During a bankruptcy proceeding, or an equity receivership proceeding, or at any time thereafter, the assets of the taxpayer in any bankruptcy proceeding 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, or any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the Commissioner before the date of the jeopardy notice and demand to the date of payment.

(b) The Tax Court, it must contain a further condition that if a petition is not filed by the taxpayer before the expiration of the 90-day or 150-day period, the amount assessed will be proportionately reduced at the request of the taxpayer after The Tax Court renders judgment.

(c) The Tax Court, either before or after the making of the jeopardy assessment, the district director of internal revenue will stay collection of the deficiency, or any unpaid portion thereof, to the extent that he believes the amount is not such a bond as is contemplated by section 273 (f) and, while the district director of internal revenue may in his discretion accept the bond and stay collection of the deficiency, the taxpayer will not be relieved from payment of interest on the amount of the deficiency at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of payment.

(d) Upon the filing of a bond of the character described within 10 days after the date of a jeopardy assessment, the district director of internal revenue will give bond of the character described within 10 days after the date of a jeopardy assessment, the amount of the deficiency together with interest as provided in this chapter.

§ 39.274-2 Bankruptcy and receivership proceedings. (a) If to bankruptcy proceedings for the relief of debtors and receivership proceedings, see sections 274 and 298 and §§ 39.274-1 and 39.274-2.

§ 39.274 Statutory provisions; assessment and demand of deficiency; jeopardy assessment; bankruptcy and receivership proceedings. (a) Immediate assessment. Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding 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, or any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the Commissioner before the date of the jeopardy notice and demand to the date of payment, the amount of the deficiency together with interest as provided in this chapter upon such taxpayer shall, despite the restrictions imposed by section 278 (a) of the Code, be included in the assessment. If such deficiency has not theretofore been assessed in accordance with law, in such cases, claims for the deficiency and interest may be made in accordance with law, to the court before the expiration of the 90-day period. If a petition is filed by the taxpayer within the 90-day period, the collection of the amount covered by the bond will be stayed. The taxpayer may at any time waive the stay of collection of the whole or any part of the amount covered by the bond. If as a result such waiver any part of the amount covered by the bond is paid, or if any portion of the bond is paid after the expiration of the 90-day period, the amount assessed will be proportionately reduced at the request of the taxpayer after The Tax Court renders judgment.

(b) Unpaid claims. Any portion of the claim allowed in such bankruptcy or receivership proceeding which is unpaid shall be paid by the taxpayer upon notice and demand from the collector after the termination of such proceeding, and may be collected by distraint or proceeding in court within 6 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 272 (f) and section 290 in the case of a deficiency in a tax imposed by this chapter.

§ 39.274 Statutory provisions; assessment and demand of deficiency; jeopardy assessment; bankruptcy and receivership proceedings. (a) Immediate assessment. Upon the adjudication of bankruptcy of any taxpayer

§ 39.274
bankruptcy proceeding by order of the court in which such proceeding is pending, or to a receiver or any receivership proceeding is required to give notice in writing to the Commissioner of Internal Revenue, Washington 25, D. C., of the adjudication of bankruptcy or the appointment of a receiver, and if such notice is not given in writing promptly, such notice should be filed, and in any event within the time limited by the appropriate provisions of the Bankruptcy Act, and the orders of 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 departmental instructions direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. At the same time, the order of the court appointing the receiver in a bankruptcy or receivership court, the district director of internal revenue will send notice and demand for payment to the taxpayer together with a copy of such claim.

(c) Under section 3466 of the Revised Statutes and section 3467 of the Revised Statutes, as amended, and section 64 of the Bankruptcy Act, taxes are entitled to the priority over other claims theretofore stated and the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the bankruptcy or receivership proceeding is pending, may be held personally liable for failure on his part to protect the orders of 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 departmental instructions direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. At the same time, the order of the court appointing the receiver in a bankruptcy or receivership court, the district director of internal revenue will send notice and demand for payment to the taxpayer together with a copy of such claim.

(d) If any portion of a claim of the United States for taxes except in the case of a proceeding under Chapter X of the Bankruptcy Act, and except to the extent which may be provided in a plan or arrangement duly executed in a bankruptcy proceeding, any portion of a claim of the United States for taxes which has been allowed by the court in which the bankruptcy or receivership proceeding shall be collected with interest as provided in section 298.

§ 39.274-2 Immediate assessments in bankruptcy and receivership cases
(a) If the Commissioner has determined that a deficiency is due in respect of income tax and the taxpayer has filed a petition with The Tax Court of the United States prior to the adjudication of bankruptcy or the appointment of a receiver, the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the bankruptcy or receivership proceeding is pending, may proceed against the taxpayer before the Tax Court as to that particular determination. No petition shall be filed with The Tax Court for a determination of the deficiency at the adjudication of bankruptcy or the appointment of a receiver.

(b) Claim for the amount of a deficiency, even though pending before the Tax Court, may be filed with the court in which the bankruptcy or receivership proceeding is pending without awaiting final decision of the Tax Court. In case of final decision of the Tax Court the court shall enter a judgment for the judgment of The Tax Court. In case of final decision of the Tax Court the court shall enter a judgment for the judgment of The Tax Court. In case of final decision of the Tax Court the court shall enter a judgment for the judgment of The Tax Court.

(c) The deficiency is incorrect, and that upon request he will be granted a hearing within six years after the termination of such proceeding. Such request may be filed at any time within six 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 337 (b) (relating to the inclusion in the gross income of United States shareholders of their distributive shares of the net income of a foreign personal-holding company); or

(2) A corporation. If the income received during the taxable year from the trust or estate during the taxable year from the tax administration, 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 a corporation unless:

(1) Such request notifies the corporation that the corporation contemplates distribution at or before the expiration of such 10 months' period, and

(d) The dissolution is completed.

(2) The dissolution is completed.

(e) Omission from gross income. If the taxpayer omits from gross income an amount properly includible therein:

(1) No petition shall be filed with the Tax Court of the United States prior to the adjudication of bankruptcy or the appointment of a receiver, the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the bankruptcy or receivership proceeding is pending, may be held personally liable for failure on his part to protect the orders of 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 departmental instructions direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. At the same time, the order of the court appointing the receiver in a bankruptcy or receivership court, the district director of internal revenue will send notice and demand for payment to the taxpayer together with a copy of such claim.

(c) Under section 3466 of the Revised Statutes and section 3467 of the Revised Statutes, as amended, and section 64 of the Bankruptcy Act, taxes are entitled to the priority over other claims theretofore stated and the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the bankruptcy or receivership proceeding is pending, may be held personally liable for failure on his part to protect the orders of 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 departmental instructions direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. At the same time, the order of the court appointing the receiver in a bankruptcy or receivership court, the district director of internal revenue will send notice and demand for payment to the taxpayer together with a copy of such claim.

(d) 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 district director of internal revenue 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 restrictions as provided in sections 272 (1) and 297. See § 39.272-2. (c) This section deals only with immediate assessments provided for in section 274 and the procedure in connection with such assessments.
§ 39.275-1 Period of limitation upon assessment of tax. The amount of income tax imposed by the Internal Revenue Code must be assessed within three years after the return was filed. For the purposes of subsections (a) (b) (c) and (d) of section 275, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. Excep-
tions to the period of limitation stated in this section (other than those provided for elsewhere in the Code) are as follows:

(a) 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 contemplating dissolution, the tax shall be assessed within 18 months after written request therefor by the fiduciary or legal representative of the estate of the decedent or by the corporation, but not after the expiration of three years after the return was filed. If the person is to limit the period in which the Commissioner may assess the tax in such cases to a period of 18-month period in which the assessment may under ordinary circumstances be made. The request, in order to be effective, must be made after the return is filed and in such language as to make it clear to the Commissioner that it is desired to take advantage of the provisions of section 275 (b) (1) (a) 275 (b) (2) or (b) (3).

(b) 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 becomes final, and for 60 days thereafter.

(c) If the Commissioner has mailed to the taxpayer under the provisions of section 275 (a) (2) or (b) (2) the notice of deficiency contained in the report of the Board of Review of the Commissioner, the tax may be assessed at any time prior to the expiration of the 18-month period of limitation stated in that notice unless:

(1) The written request notifies the Commissioner that the corporation contemplates dissolution at or prior to the expiration of such 18-month period.

(2) The written request is a request for a final determination of the deficiency pursuant to 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 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 becomes final) and for 60 days thereafter.

(3) If the Commissioner mails to a taxpayer a notice of deficiency within the statutory period of limitation and the taxpayer does not appeal to the Tax Court, the notice of deficiency so given does not suspend the running of the period of limitation on assessment for the purpose of any additional deficiency shown to be due in a subsequent deficiency notice.

(d) In a bankruptcy or receivership proceeding the running of the statute of limitations 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 on which the notice provided for in 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 sections 274 (a) and §§ 30.274–1 and 30.274–2.

(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. But see paragraph (b) of this section.

(f) If the taxpayer omits from gross income an amount properly includible therein under section 331 (b) as his income, the determination of the undistributed Supplement P net income of a foreign personal holding company (see sections 331 to 340, inclusive), or an amount properly includible therein under section 331 (c) as his distributive share of the Supplement S net income of a personal service corporation (see sections 391 to 396, inclusive) 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 (d) 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 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 becomes final, and for 60 days thereafter.

(i) If the Commissioner has mailed to the taxpayer under the provisions of section 275 (a) (2) or (b) (2) the notice of deficiency, the tax may be assessed at any time prior to the expiration of the 18-month period of limitation stated in that notice unless:

(1) The written request notifies the Commissioner that the corporation contemplates dissolution at or prior to the expiration of such 18-month period.

(2) The written request is a request for a final determination of the deficiency pursuant to 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 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 becomes final) and for 60 days thereafter.

(3) If the Commissioner mails to a taxpayer a notice of deficiency within the statutory period of limitation and the taxpayer does not appeal to the Tax Court, the notice of deficiency so given does not suspend the running of the period of limitation on assessment for the purpose of any additional deficiency shown to be due in a subsequent deficiency notice.

(j) In a bankruptcy or receivership proceeding the running of the statute of limitations 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 on which the notice provided for in 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 sections 274 (a) and §§ 30.274–1 and 30.274–2.

(k) A special period of limitation is provided in section 276 (d) within which a deficiency in any tax (including a deficiency which may be assessed pursuant to the provisions of section 278 (b) (2) or (3) relating to tentative carry-back ad-

(1) In the case of a deficiency described in section 112 (f) (3) (C) or (D), such deficiency may be assessed at any time prior to the expiration of the period therein provided.

(2) In the case of a deficiency described in section 112 (f) (3) (C) or (D), such deficiency may be assessed at any time prior to the expiration of the period therein provided.

(3) In the case of a deficiency described in section 112 (f) (3) (C) or (D), such deficiency may be assessed at any time prior to the expiration of the period therein provided.
for the taxable year of the loss or unused
profit credit carry-back, or an unused excess
profit credit carry-back may be assessed.

The period within which such a deficiency
can be assessed depends, in general, on the period
within which a deficiency may be assessed with
respect to the taxable year of the net operating
loss or the unused excess profits credit which
resulted in the carry-back, or the period within
which a deficiency attributable to the application
to the taxpayer of the carry-back of a net operat-
ing loss carry-back or an unused excess profits
credit which resulted in the carry-back may be
assessed:

(1) The period within which a deficiency
may be assessed with respect to the tax
imposed by chapter 1 or subchapter A of
chapter 2 for the taxable year of the loss
or unused credit which resulted in the
carry-back; or

(2) The period within which a deficien-
cy may be assessed with respect to the
tax imposed by a corporation which is not
a personal holding company, other than a
foreign personal holding company, for the tax-
able year of the loss or unused credit which
resulted in the carry-back.

If a corporation is not a personal hold-
ing company, as defined in section 501, for
the taxable year of the loss or unused credit
which resulted in the carry-back, the period
within which a deficiency may be assessed with
respect to the surtax on personal holding
companies, imposed by section 275 (d) of
chapter 2, for the taxable year of the loss
or unused credit which resulted in the
carry-back.

For the period of limitations for
assessing a deficiency attributable to the
application to the taxpayer of the carry-
back of a net operating loss carry-back or
an unused excess profits credit, or to the
resulting carry-back, or to the net operat-
ing loss deduction, the exception shall be
considered to be attributable to the appli-
cation to the taxpayer of such
carry-back which entered into the
computation of such net operating loss
deduction. If the period within which a
deficiency may be assessed under any
other law is longer than the period provided in
section 276 (d), a deficiency attributable to
the application to the taxpayer of such
carry-back may be assessed at any time
prior to the expiration of such longer
period.

(1) In the case of a joint return made
under section 51 (g), the period of limi-
tations shall not expire until one year
immediately after the date of the actual
filing of such return, computed without
regard to the provisions of section 51 (g).

(2) By the exception stated in
paragraph (d), a deficiency attributable to
the application to the taxpayer of the
resulting carry-back resulting from
an adjustment to a net operating loss
carry-back which entered into the
computation of such net operating loss
deduction. If the period within which a
deficiency may be assessed under any
other law is longer than the period provided in
section 276 (d), a deficiency attributable to
the application to the taxpayer of such
carry-back may be assessed at any time
prior to the expiration of such longer
period.

(3) If there is omitted from the gross
income stated in the return an amount
properly includible therein which is in
excess of 25 percent of the gross income
so stated, a proceeding in court for the
collection of the tax without assessment
may be begun at any time within five
years after the return was filed.

(4) If the taxpayer omits from gross
income an amount properly includible
therein under section 337 (b) as his dis-
tributive share of the undistributed
Supplement P net income of a foreign
personal holding company (see sections
311 to 316, inclusive), or an amount prop-
erly includible therein which is
excess of 25 percent of the gross income
so stated, a proceeding in court for the
collection of the tax without assessment
may be begun at any time within
four years after the return was filed.

§ 39.275-2

Period of limitation on
collection of tax. (a) In the case of
the taxes imposed by the Internal
Revenue Code, a proceeding in
court without assessment for the collection
of such tax must be begun within
three years after the return was filed.

(b) The exceptions to the period of
limitation upon collection of the tax
without assessment stated in paragraph
(a) of this section are as follows:

(1) In the case of Income received
during the lifetime of a decedent or by
his estate during the period of admin-
istration, or by a corporation, a proceed-
ing in court for the collection of the tax
without assessment must be begun within
18 months after a written request there-
for by the executor, administrator, or
other fiduciary responsible for the estate
of the decedent, or by the corporation,
but not after the expiration of three
years after the return was filed. Such
a request does not have the effect of
extending the regular period of limitation
within which a proceeding in court with-
out assessment may be begun, even
though the request is made less than 18
months before the expiration of the reg-
ular period of limitation, nor is it so of
any effect if made after the return is filed.

In the case of a corporation the condi-
tions stated in (1), (2) and (3) of par-
agraph (a) of § 39.275-1 also must be met.

(2) A proceeding in court for the
collection of the tax without assessment
may be begun at any time—

(i) In case the taxpayer files a false
or fraudulent return with intent to
 evade tax; or

(ii) In case the taxpayer fails to file
a return.

(3) In the case of Income received
by the transferee of property, or the
executor, administrator, or other
fiduciary responsible for the estate
of the decedent, or by a corporation,
but not after the expiration of three
years after the return was filed.

(4) If the taxpayer omits from gross
income an amount properly includible
therein under section 337 (b) as his dis-
tributive share of the undistributed
Supplement P net income of a foreign
personal holding company (see sections
311 to 316, inclusive), or an amount prop-
erly includible therein which is
excess of 25 percent of the gross income
so stated, a proceeding in court for the
collection of the tax without assess-
ment may be begun at any time within
five years after the return was filed.

(5) If the taxpayer omits from gross
income an amount properly includible
therein under section 315 (c) as his dis-
tributive share of the undistributed
Supplement P net income of a personal
service corporation (see sections
311 to 336, inclusive), or an amount prop-
erly includible therein which is
excess of 25 percent of the gross income
so stated, a proceeding in court for the
collection of the tax without assess-
ment may be begun at any time within
seven years after the return was filed.

§ 39.275-2
time within four years after the return was filed.

In the case of a joint return made under section 51 (g) the period of limitations shall not be less than one year immediately after the date of the actual filing of such return, computed without regard to the provisions of section 51 (g) (7).

(c) In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding to dispose of such tax with the collection of such tax may be begun within six years after the assessment thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner for the taxpayer before the expiration of such 6-year period. The period so agreed upon may be extended by subsequent agreements written 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 commence on the date 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.

(d) If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see § 39.272-1) then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court after assessment or 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 becomes final and is final) and 60 days thereafter.

(e) With respect to the period of limitation upon the collection of the tax on unpaid claims in bankruptcy or receivership proceedings, see section 274 (b) and § 39.274-2.

SUPPLEMENT M—INTEREST AND ADDITIONS TO THE TAX

§ 39.291 Statutory provisions; interest and additions to the tax; failure to file return.

Sec. 291. Failure to file return. (a) In any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is 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 additional 5 per cent for each additional thirty days or fraction thereof during which failure continues, not to exceed 25 per cent in the aggregate.

(b) A taxpayer who wishes to avoid the addition to the tax for deficiency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

(c) If the addition to the tax for deficiency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

(d) For addition to the tax in case of a deficiency due to fraud with intent to evade tax, see section 293. As to the prorating of a deficiency, and of section 293, relating to interest on deficiencies, shall not be applicable.

(e) If any part of the tax is due to fraud with intent to evade tax, then 60 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 (a), relating to the prorating of a deficiency, and of section 293, relating to interest on deficiencies, shall not be applicable.

(f) If any part of the tax is due to fraud with intent to evade tax, then 60 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 (a), relating to the prorating of a deficiency, and of section 293, relating to interest on deficiencies, shall not be applicable.

§ 39.292-294 Statutory provisions; interest and additions to the tax; interest on deficiencies; additions to tax in case of deficiency; additions to tax in case of nonpayment.

Sec. 292. Interest on deficiencies—(a) General rule. Where the amount determined as the tax imposed by this chapter, or any installment thereof, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 6 per cent per annum from the date prescribed for its payment until it is paid.

(b) If extension granted. Where an extension of time for payment of the amount so determined as the tax by the taxpayer, or any installment thereof, has been granted, the amount so determined is paid on or before the date prescribed for its payment under the terms of the extension, then, in lieu of interest provided for in paragraph (1) of this subsection, interest at the rate of 6 per cent per annum from the date of such extension to the date of the expiration of the period of the extension, plus 5 per cent per annum from the date of such extension to the date of the expiration of the period of the extension until it is paid.

§ 39.291-1 Addition to the tax in case of failure to file return. (a) In case of failure to file return required by chapter 1 within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, the amount so added to any tax shall be due, with respect to any period prior to the expiration of any period for collection agreed upon in writing by the Commissioner for the taxpayer before the expiration of such 6-year period. The period so agreed upon may be extended by subsequent agreements written 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 commence on the date 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.

(b) Deficiency resulting from relief under section 752. (c) Deficiency resulting from carry-back of overpayment of credit against deficiency determined under section 3771 (e), or a decrease determined under section 3780 (b), in any other tax is attributable to the carry-back of an overpayment of tax determined under section 3771 (e), or in a decrease determined under section 3780 (b), no interest shall be assessed or collected, and no part of the deficiency determined during which interest was not allowed with respect to such overpayment or for a period prior to the application of such decrease.

(d) With respect to any corporation entitled to receive payment for the transportation of United States mail, if such award is retroactively received for the transportation of United States mail, and if such award is required to be treated as income in the year or years in which the mail or property covered by the award is delivered, then, notwithstanding the provisions of subsection (a) of this section, no interest shall be assessed or collected, and no part of the deficiency determined during which interest was not allowed with respect to such overpayment or for a period prior to the application of such decrease.

[Sec. 39.21 as amended by sec. 172 (f) (4), Rev. Act 1942; sec. 6 (b) (7), Individual Income Tax Act 1944]
tax in case of delinquency provided for in section 291. The amount of the unpaid amount at any time within a period of 30 days from the date of notice and demand from the collector, shall be collected as part of the tax interest, upon the unpaid amount, at the rate of 6% per annum from the date of such notice and demand until it is paid. If any part of a deficiency provided under section 291 (A), (B), or (C) is not paid in full on or before the date prescribed for the payment of such deficiency, such deficiency shall be considered as part of the tax interest upon the unpaid amount at the rate of 6% per annum from the date of such notice and demand until it is paid.

(b) Failure to pay instalments of estimated tax declared. Where a declaration of estimated tax has been made and filed within the time prescribed, or where a declaration of estimated tax within the time prescribed, or where a declaration of estimated tax within the time prescribed, and the Commissioner has found that failure to make and file such declaration within the time prescribed was due to reasonable cause and not to willful neglect, or of a deficiency provided under section 291 (A), (B), or (C) is not paid in full on or before the date prescribed for the payment of such deficiency, such deficiency shall be considered as part of the tax interest upon the unpaid amount at the rate of 6% per annum from the date of such notice and demand until it is paid. If any part of a deficiency provided under section 291 (A), (B), or (C) is not paid in full on or before the date prescribed for the payment of such deficiency, such deficiency shall be considered as part of the tax interest upon the unpaid amount at the rate of 6% per annum from the date of such notice and demand until it is paid.

(c) Filing of jeopardy bond. If a bond is filed, as provided in section 273, the provisions of subsection (b) of this section shall not apply to the amount covered by the bond.

(d) Estimated tax—(1) Failure to file declaration or payment of estimated tax—(A) Failure to file declaration. In the case of a failure to make and file a declaration of estimated tax within the time prescribed, unless such failure is shown to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5% of each installment due and unpaid, and in addition, with respect to each installment due but unpaid, exceed 10% of the unpaid amount thereof for each month (except the first) or fraction thereof during which such unpaid amount remains unpaid. In no event shall the aggregate addition to the tax under this subparagraph with respect to any installment due but unpaid, exceed 10% of the unpaid amount thereof. This subsection shall apply without regard to the tax imposed by subsection (b), relating to farmers.

(B) Substantial overstatement of expected carry-backs. If the time for payment of any tax or taxes for any taxable year is extended under section 7701, there shall be added to such tax an amount equal to 5% of the penalty portion. If at the end of the period of extension such extension is made, there was reasonable cause to expect there would be no penalty portion. The penalty portion shall be the excess of the amount to which such extension relates which is not paid by the end of the taxable year in which such extension was made, there was reasonable cause to expect there would be no penalty portion.

(C) Failure to account for tax withheld at source. If a return is filed by the taxpayer or title to an account the facts established for the purpose of an application under section 7701 (a) the amount of tax due, there shall be added to the tax 5% of the unpaid amount for each month (except the first) or fraction thereof during which such amount remains unpaid. In no event shall the aggregate addition to the tax under this subparagraph with respect to any installment due but unpaid, exceed 10% of the unpaid amount thereof. These additions to the tax are in addition to any applicable criminal penalties.

(2) Failure to pay timely a declaration of estimated tax; and (3) Substantial underestimate of the estimated tax. These additions to the tax are in addition to any applicable criminal penalties.

§ 39.294-1 Additions to the tax—(a) In general. Section 294 (d) provides for certain additions to the tax in the case of—

(1) Failure to file timely a declaration of estimated tax; (2) Failure to pay within the time prescribed any instalment of declared estimated tax; and (3) Substantial underestimate of the estimated tax. These additions to the tax are in addition to any applicable criminal penalties.

(b) Additions for specific failures on the part of the taxpayer with respect to the estimated tax—(1) Failure to file declaration. (i) Section 294 (d) (1) (A) provides for an addition to the tax in the case of a failure to make and file a declaration of estimated tax. Within the time prescribed unless such failure is shown to be due to reasonable cause and not to willful neglect. Such addition to the tax shall be an amount equal to 5% of the unpaid amount of each installment and in addition 1 percent of the unpaid amount of the installment for each month (except the first) or fraction thereof during which such amount remains unpaid. Such addition to the tax with respect to any installment due but unpaid shall not exceed 10 percent of the unpaid amount of such installment. For the purposes of section 294 (d) (1) (A) the amount and due date of each installment shall be the same as if a declaration had been filed within the time prescribed showing an estimated tax equal to the correct tax reduced by the credits for tax withheld at source.

(ii) The application of section 294 (d) (1) (A) in the case of taxpayers not entitled to elect under section 60 (a) relating to farmers, may be illustrated by the following example:

Example. An individual filed a declaration on May 15, 1952, for the calendar year 1952, disclosing an estimated tax of $1,405, and paid installments of $550 each on May 16, June 15, and September 15, 1952, and January 15, 1953, in computing his estimated tax he correctly estimated the amount of tax to be withheld at source on his wages for 1952 to be $1,030. On March 15, 1953, he filed a return on Form 1040 showing a correct tax of $4,025 and paid the balance of the tax due, $1,000 ($4,025 less the sum of $1,405 and $1,030). Examination of his return disclosed that his entire income consisted of a regular salary, dividends, and interest. The failure to file a timely declaration was not due to reasonable cause. Hence the individual is subject to the penalty imposed by section 294 (d) (1) (A). Under the facts assumed, installments of tax in the amount of $550 each were due and payable on March 16, June 15, and September 15, 1952, and January 15, 1953, that is, one-fourth of the entire tax due. Interest remaining after taking into account the amount withheld at source on his wages. The entire amount of the March installment of $550 remained unpaid for four months; $400 of the September installment remained unpaid for six months; $550 of the January installment remained unpaid for two months. The addition to the tax under section 294 (d) (1) (A), subject to the limitation of 10 percent of the unpaid amount of each installment is $179, computed as follows:

<table>
<thead>
<tr>
<th>Unpaid amount</th>
<th>Percentage</th>
<th>Penalty before limitation</th>
<th>10 percent limitation</th>
<th>Additions to tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>March</td>
<td>$270</td>
<td>5 percent plus 1 percent</td>
<td>$18.10</td>
<td>$20.00</td>
</tr>
<tr>
<td>June</td>
<td>$450</td>
<td>5 percent plus 1 percent</td>
<td>$30.25</td>
<td>$35.25</td>
</tr>
<tr>
<td>January</td>
<td>$500</td>
<td>5 percent plus 1 percent</td>
<td>$32.50</td>
<td>$38.50</td>
</tr>
</tbody>
</table>

Total additions to tax under sec. 294 (d) (1) (A) $179

§ 39.294-1
(2) Failure to pay installment of declared estimated tax. (i) Section 294 (d) (1) (B) provides for an addition to the tax in the case of failure to pay an installment of the declared estimated tax within the time prescribed unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not due to willful neglect. Such addition to the tax is applicable to delinquency in payment only (a) where a timely declared estimated tax has been made and filed or (b) where the Commissioner has found that the failure to make and file a timely declaration was due to reasonable cause and not to willful neglect. Such addition to the tax shall be in an amount equal to 5 percent of the unpaid amount of each installment of declared estimated tax and in addition 1 percent of such unpaid amount for each month (except the first) or fraction thereof during which such amount remains unpaid. The addition to the tax is limited with respect to any single installment to 5 percent of the unpaid portion of such installment. Such addition to the tax is not applicable in cases to which the addition to the tax under section 294 (d) (1) (A) applies.

(ii) The application of section 294 (d) (1) (B) in the case of taxpayers not entitled to elect under section 60 (a) relating to farmers, may be illustrated by the following examples:

Example (1). For the calendar year 1953 E and F, husband and wife, file timely declarations. E's separate declaration discloses a balance of estimated tax of $500. In the amount of $600. Instead of making timely payment of one installment of $100, he pays such amount 10 days after the due date. The delay in payment was not due to reasonable cause. F is similarly delinquent with respect to one installment of $50 of her balance of estimated tax of $500. On the joint return of E and F for 1953 the addition to the tax with respect to the delinquent installments of estimated tax will be $7.50, which is the sum of 5 percent of $100 and 5 percent of $50.

Example (2). The timely joint declaration of G and H calendar year 1953 discloses a balance of estimated tax in the amount of $600. G and H are delinquent without interest for a period of more than one month in the payment of one installment of $125. They file separate income tax returns for 1953. They are jointly and severally liable for the payment of the addition to the tax for delay in paying an installment of estimated tax. Such addition amounts to $6.25, that is, 5 percent of $125.

(3) Substantial understatements of estimated tax. (i) Section 294 (d) (2) provides for an addition to the tax in the case of a taxpayer who makes a substantial understate the estimated tax on his declaration. The addition shall not apply to the taxable year in which falls the death of the taxpayer. Except as hereinafter provided—

(a) Individual other than those exercising the election under section 60 (a) relating to farmers, an addition to the tax under section 294 (d) (2) is applicable in the event that the amount of the declared estimated tax (increased by the amount of the credit for taxes withheld at source on wages under section 35 and the credit under section 32) is less than 80 percent of the tax imposed by chapter 1 for the taxable year (determined without regard to such credit). In the event of a failure to file the required declaration, the amount of the estimated tax for the purposes of this provision is zero.

(b) In the case of farmers exercising the election under section 60 (a) relating to farmers, the addition to the tax is applicable if the amount of the estimated tax increased by the amount of the credit for taxes withheld at source on wages under section 35 and the credit under section 32 is less than 66 2/3 percent of the amount of the tax (determined without regard to such credit).

(c) The addition to the tax in any case in which there has been such under-estimate as comes within the scope of section 294 (d) (2) is an amount equal to—

(f) The excess of 80 percent of the tax (or 66 2/3 percent in the case of farmers exercising an option under section 60 (a)) determined without regard to the credit for taxes withheld at source on wages under section 35 and the credit under section 32 over the amount of the estimated tax increased by such credits;

or

(2) 6 percent of the excess of the tax determined without regard to the credit for taxes withheld at source on wages under section 35 and the credit under section 32 over the amount of the estimated tax increased by such credits;

whichever is the lesser.

(ii) The addition to the tax for substantial understate the estimated tax shall not apply to the taxable year in which the taxpayer makes a timely payment of estimated tax within or before each quarter of such year in an amount at least as great as though such estimated tax were computed under the law applicable to the taxable year on the basis of the taxpayer's status with respect to the personal exemption and credit for dependents on the date of filing the declaration of estimated tax within or before each quarter of such year, but otherwise as though such estimated tax were computed on the basis of the net income and the surtax net income shown on the taxpayer's return for the preceding taxable year, adjusted to conform to the law applicable to the taxable year.

The net income and the surtax net income shown on the taxpayer's return for the preceding taxable year shall be considered to be zero for the purposes of this section if for such year the taxpayer did not file a return and was not required to file a return. In the case of fishermen exercising an election under section 60 (a) such addition to the tax shall not apply to the taxable year in which the taxpayer makes a timely payment of estimated tax for the last quarter of such year in an amount at least as great as though computed under the law applicable to the taxable year on the basis of the taxpayer's status with respect to the personal exemption and credit for dependents on the date of filing the declaration, but otherwise as though computed on the basis of the net income and the surtax net income shown on the taxpayer's return for the preceding taxable year, adjusted to conform to the law applicable to the taxable year.

(iii) As used in subdivision (b) of this paragraph, the expression "personal exemption and credit for dependents" shall be taken to refer to the exemptions for both normal tax and surtax under sections 35 and 662A (ii) the expression "last quarter" shall be taken to include the period (ending with the fifteenth day of the first month of the succeeding taxable year) within which the last installment of the estimated tax is required to be paid; and the expression "last quarter" shall mean the period (similarly ending with the fifteenth day of the first month of the succeeding taxable year) within which farmers exercising an election under section 60 (a) are required to pay the estimated tax.

(iv) The application of section 294 (d) (2) (ii) in the case of taxpayers not entitled to elect under section 60 (a) relating to farmers, may be illustrated by the following examples:

Example (1). A, a professional man made a return on January 10, 1953, for the calendar year 1952. A was entitled to only one exemption and he used a gross income of $6,200 declaration of estimated tax for the calendar year 1953. A made payment of the estimated tax in four installments of $1,750 each on March 15, June 15, and September 15, and January 10. As a result of a transaction occurring in December 1952, A received taxable income in an amount which made him subject to a tax for the calendar year 1953 in the amount of $18,600. A's tax at 1953 rates on $10,000 amounts to $10,400 computed as follows:

Gross income shown on return for 1952

Less: Deductions

Net income

Less: Exemption

Income subject to tax

Normal tax

Surtax

Total tax on basis of 1952 Income

Example (2). O, a single individual (and not the head of a household) with no dependents, received a salary of $6,200 for the calendar year 1951. O made a return of estimated tax for the calendar year 1952. On March 15, 1952, at which time O's status for exemptions purposes had not changed, he filed a declaration of estimated tax for the calendar year 1953. In computing his estimated tax, he used a gross income of $6,200 (his income) for 1951 and declared the tax shown on his estimated tax for the calendar year 1951 in the amount of $1,000, of which O used one exemption and the rates for 1952. Since his salary had increased to $6,500 a month on January 1, 1953, he computed his estimated tax withheld and to be withheld during the entire year (on the excess of $6,500 over the excess for withholding at
The penalty portion in effect, therefore, is the excess of the amount of tax the time for payment of which was extended over 125 percent of the amount the time for payment of which might properly have been extended. Interest on such amount was paid before the end of the taxable year in which the extension was made shall not be deemed to be an amount the time for payment of which was extended in determining under section 3706 (c) whether the amount the time for payment of which was extended was substantially in excess of the amount of tax, and the surtax net income shown on his return for the taxable year in which the extension was made was paid before the end of the taxable year in which the extension was made. The excess of the amount of tax the time for payment of which might properly have been extended is the penalty portion of the amount to which the extension relates.

Example. Corporation X, which came into existence on January 1, 1952, and which kept its books and made its tax returns on the calendar year basis, made an extension under section 3779 on March 15, 1953, extending the time for payment of $855 of its income tax for 1952. The extension was based on an expected net operating loss carry-back from 1953, and no part of the amount to which the extension related was paid before the end of 1953. Corporation X had a net operating loss for 1953, and on March 31, 1954, it filed an application under section 3779 (c) for tentative carry-back adjustment with respect to the recutting carry-back from 1953. The application for the tentative carry-back adjustment for 1952 was decreased by $455 as a result of such carry-back from 1953. The Commissioner allowed the application in full on June 29, 1954, on the grounds that the corporation's income tax for 1952 was applied against the $855 of its income tax for 1952, the time for payment of which had been extended, and the corporation did not protest at the time of the statement filed under section 3779 on March 15, 1953. Since the decrease in the corporation's income tax for 1952 was only $455, the corporation paid the remainder of $400 for 1952 in cash. The penalty portion is $286.25, and the addition to the tax is $143.10. These amounts are computed as follows:

| Amount to which extension under section 3779 related which was paid before the end of 1953 | $855.00 |
| Amount of $455 (amount of tax time for payment of which might properly be extended) | $455.00 |
| Addition to the tax (5 percent of $455) | $22.75 |
| Penalty portion | $286.25 |
| Total amount | $143.10 |

Since the reduction, attributable to the net operating loss carry-back from 1953, in the corporation's income tax for 1952 was previously determined for taxable years before 1953 was only $455, the corporation would not be subject under section 3779 the time for payment of an amount greater than $455. The penalty portion accordingly is the excess of the amount the time for payment of which was extended over 125 percent of the amount the time for payment of which might properly have been extended. The above addition to the tax is not paid in full within ten days from the date of notice and demand from the collector under section 273 (1) (i) is not paid in full within ten days from the date of such notice and demand until payment.

§ 39.295--299 Statutory provisions; interest and additions to tax; time extended for payment of tax shown on return; time extended for payment of deficiency; interest in case of jeopardy assessments; bankruptcy and receiverships; removal of property or departure from United States.

Sec. 295. Time extended for payment of tax shown on return. If the time for payment of the amount determined as the tax for which the application for a tentative installment was made will be payable at the rate of 6 per centum per annum from the date of such notice and demand until payment.

Sec. 296. Time extended for payment of deficiency. If the time for payment of the amount determined as the tax by the Commissioner for any part of a deficiency is extended, there shall be collected, as a part of the tax, interest on such unpaid amount at the rate of 6 per centum per annum from the date of such notice and demand until payment.

Sec. 297. Interest in case of jeopardy assessments. In the case of the amount collected under section 273 (1) thereof shall be collected at the same time as such amount, and in as a part of the tax in the same manner. In the case of such amount, there shall be collected, as a part of the tax, the amount from the date of such notice and demand until payment.

Sec. 298. Bankruptcy and receiverships. If the unpaid portion of the claim allowed in a bankruptcy or receivership proceeding, as provided in section 274, is not paid in full within ten days from the date of notice and demand from the collector, then there shall be collected, as a part of the tax, the amount from the date of such notice and demand until payment.

Sec. 299. Removal of property or departure from United States. If the unpaid portion of the claim allowed in a bankruptcy or receivership proceeding, as provided in section 274, is not paid in full within ten days from the date of notice and demand from the collector, then there shall be collected, as a part of the tax, the amount from the date of such notice and demand until payment.

§ 39.295-299
§ 39.311 Statutory provisions; claims against transferees and fiduciaries; transferred assets.

§ 39.311 Claims in cases of transferred assets. (a) The amount for which a transferee of property of a taxpayer is liable, at law or in equity, is the amount of tax shown on the return or as a deficiency in the tax imposed by chapter 1, except as hereinafter in this section provided, be assessed, collected, and demanded, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds:

(1) Transferees. The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax paid by law) imposed upon the transferor of such property, shall expire one year after the return of executor, or last preceding transferee, respectively, has been begun against the transferee, or fiduciary, not later than one year after the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later;

(2) Fiduciaries. The liability of a fiduciary under section 3467 of the Revised Statutes, as amended (U. S. C. Title 31, sec. 184), in respect of payment of any such tax from the estate of the taxpayer.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency tax.

(b) Period of limitation. The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer, within one year after the expiration of the period of limitation for assessment against the taxpayer;

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer, within one year after the expiration of the period of limitation for assessment against the preceding transferee, but only if within three years after the expiration of the period of limitation for assessment against the taxpayer:

except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax by distraint or otherwise, respect thereof has been begun against the taxpayer or last preceding transferee, respectively, the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

(3) 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 for collection of the tax in respect of which such liability arises, whichever is the later.

(4) 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 within one year prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(d) Suspension of running of statute of limitations. The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in section 272 (a), be suspended for the period during which the Commissioner is making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for sixty days thereafter.

(1) Address for notice of liability. In the absence of notice to the Commissioner under section 311 (b) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this chapter, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this chapter even if such person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(2) Definition of "transferee." As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

§ 39.311-1 Notice of deficiency in a tax imposed by chapter 1, except as hereinafter in this section provided, be assessed, collected, and demanded, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds:

(1) Definitions. As used in this section, the term "taxpayer" includes the person or corporation, and the provisions prohibiting claims and suits for refunds, the filing of a petition with The Tax Court of the United States, and the filing of a petition in the Court of Claims or the District Court of the United States, respectively, are included in the sections of the Internal Revenue Code (and regulations pertaining thereto) relating to deficiencies in tax imposed by chapter 1.

(2) As used in this section, the term "transferee" includes an heir, legatee, devisee, distributee, 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.

(a) Period of limitation for assessment of the liability of a transferee or of a fiduciary, referred to in paragraph (a) of this section, is as follows:

(1) In the case of the liability of an initial transferee of property of the taxpayer, one year after the expiration of the period of limitation for assessment against the taxpayer (see sections 275 to 277, inclusive).

(2) In the case of the liability of a transferee of the property of the taxpayer, one year after the expiration of the period of limitation for assessment against the preceding transferee, or three years after the expiration of the period of limitation for assessment against the taxpayer, whichever of the two periods (the 1-year period or the 3-year period) first expires.

(3) If a court proceeding against the taxpayer or last preceding transferee for the collection of the tax or liability in respect thereof, respect to which such liability arises or is not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later.

(4) 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 for collection of the tax in respect of which such liability arises, whichever is the later.

(5) 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 within one year prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(d) For the purpose of determining the period of limitation for assessment of the liability of a transferee or a fiduciary, if the taxpayer is deceased and the corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

(e) If a notice of the liability of a transferee or the liability of a fiduciary has been mailed to a transferee or a fiduciary under the provisions of section 272 (a) then the running of the statute of limitations shall be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

§ 39.312 Statutory provisions; claims against transferees and fiduciaries; notice of fiduciary relationship.

§ 39.312 Notice of fiduciary relationship.

(a) Fiduciary of taxpayer. Upon notice to the Commissioner that any person is acting in a fiduciary capacity such fiduciary shall serve a copy of the return, demands, summons or other process, and notice of the commencement of any action in respect of any deficiency in a tax imposed by chapter 1, except as otherwise specifically provided and except that the tax shall be collected from the estate of the taxpayer, until notice is given that the fiduciary relationship has terminated.

(b) Fiduciary of transferee. Upon notice to the Commissioner that any person is acting in a fiduciary capacity such fiduciary shall serve a copy of the return, demands, summons or other process, and notice of the commencement of any action in respect of any deficiency in a tax imposed by chapter 1, except as otherwise specifically provided and except that the tax shall be collected from the estate of the taxpayer, until notice is given to the fiduciary relationship has terminated.
leges of such person under such section (except that the deficiency is not to be assessed from the estate of such person), until notice is given that the fiduciary capacity has terminated.

(c) Manner of notice. Notice under subsection (a) or (b) shall be given in accordance with regulations prescribed by the Secretary with the approval of the Commissioner.

§ 39.312-1 Fiduciaries. (a) As soon as the Commissioner receives notice that a person is acting in a fiduciary capacity, such notice shall be served on the person and an agreement entered into by the Commissioner with the person for the purpose of determining the amount of the taxes which the person is required to pay under section 311, such notice is required to be served on the fiduciary capacity specified in section 311, such fiduciary is required to assume the powers, rights, duties, and privileges of the taxpayer with respect to income tax imposed by chapter 1. If the person is acting as a fiduciary for a person subject to the liability specified in section 311, such fiduciary must, except as the Commissioner within the meaning of section 3467 of the Revised Statutes, as amended, shall be considered an overpayment. If no claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer, during the three years immediately preceding the filing of the claim.

(b) Limitation on allowance.—(1) Period of limitation. Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the filing of the claim.

Supplement C—Overpayments

§ 39.321-322 Statutory provisions; overpayment of installment of tax; refunds and credits.

Sec. 321. Overpayment of installment. If the taxpayer has made an overpayment of an amount determined to be the correct amount of such installment, the overpayment shall be credited against the correct amount of the tax installment, and 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 refunded as provided in section 322.

Sec. 322. Refunds and credits.—(a) Authorization of Commissioner. If there has been an overpayment of any tax imposed by this chapter, the amount of such overpayment shall be credited against any installation of such tax or installment thereof due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

(b) Excessive withholding. Where the amount of the tax withheld at the source under Subchapter D of chapter 1 or section 276 (b) exceeds the taxes imposed by this chapter against the tax so withheld may be credited under section 35, the amount of such excess shall be an overpayment.

(c) Credits against estimated tax. The Commissioner is authorized to prescribe with the approval of the Secretary, regulations providing for the crediting against the estimated tax for any taxable year of the amount determined by the taxpayer or the Commissioner to be on overpayment of the tax on that taxable year.

(d) Credit for "special refunds" of employee social security tax. The Commissioner is authorized to prescribe regulations providing for the crediting against the tax imposed by section 39.313, the amount of the amount determined by the taxpayer or the Commissioner to be allowable under section 104 (d) as a special refund of tax imposed specifically provided, that is, whether it is a liability specified in section 311.

§ 39.313 Statutory provisions; claims against transferees and fiduciaries; cross references.

Ex. 313. Cross reference. For prohibition of suits to restrain enforcement of liability of transferee or fiduciary, see section 3633 (b).

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agreement, (B) after the execution of the agreement and before the expiration of the period within which the Commissioner may make an assessment pursuant to such agreement or any extension thereof, and (C) during six months after the expiration of such period, except that the provisions of paragraph (2) shall apply to any claim filed, or credit or refund allowed, before the execution of the agreement and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, and (D) during six months after the expiration of such period. If no claim is filed, or credit or refund allowed, before the execution of the agreement and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, the amount of the credit or refund shall be determined without regard to any extension of time granted by the taxpayer.

(5) Special period of limitation with respect to federal, state and local taxes. If the claim for credit or refund relates to an overpayment on account of a debt or loss described in subparagraph (2) or (3), the time within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, the amount of the credit or refund shall be determined without regard to any extension of time granted by the taxpayer.

(6) Special period of limitation with respect to net operating loss carry-backs and unused excess profits credit carry-backs. If the claim for credit or refund relates to an overpayment on account of a net operating loss carry-back or to an unused excess profits credit carry-back, the time within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, the amount of the credit or refund shall be determined without regard to any extension of time granted by the taxpayer.

(7) Determination of amount of tax. For refund or credit in case of withholding agent, see sec. 143 (1). For refund or credit in case of employer required to deduct and withhold tax, see sec. 143 (2). For refund or credit in case of employer required to deduct and withhold tax, see sec. 143 (2).

(8) Overpayments attributable to not operating loss carry-backs and unused excess profits credit carry-backs. If an overpayment of tax attributable to a carry-back or to an unused excess profits credit carry-back is otherwise prevented by the operation of any law or rule of law other than section 3761, relating to compromises, or refund may be allowed or made if application for the refund is made within the period provided in subsection (b). If an overpayment attributable to a carry-back or to an unused excess profits credit carry-back is otherwise prevented by the operation of any law or rule of law other than section 3761, such application, credit or refund may be allowed or made if application therefor is made within the period provided in subsection (b). If an overpayment attributable to a carry-back or to an unused excess profits credit carry-back is otherwise prevented by the operation of any law or rule of law other than section 3761, such application, credit or refund may be allowed or made if application therefor is made within the period provided in subsection (b).
Section 322, such claim shall be considered as filed. In any proceeding against him for refusing to file the return or for the recovery of any money exacted by or paid to him and subsequently paid into the treasury, in performing his official duties, the court shall: (1) Probable cause existed for the return of the taxes, etc., for which the judgment was entered, or which caused the judgment to be entered, or which the clerk of the court, or any party to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

§ 39.322-5 Claim for payment of judgment obtained in United States district court against the United States. A claim for the payment of a judgment rendered by a United States district court against the United States representing taxes, penalties, or other sums should be made on a properly executed Form 843 and filed directly with the Commissioner of Internal Revenue, Washington, 25, D. C. The claim must be accompanied by two certified copies of the final judgment and the itemized bill of the court costs paid. A certificate of the clerk of the court in which the judgment was recovered for 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 § 39.322-3.

§ 39.322-6 Claim for payment of judgment obtained in the Court of Claims against the United States. A claim for the payment of a judgment rendered by the United States Court of Claims against the United States representing taxes, penalties, or other sums should be made on a properly executed Form 843 and filed directly with the Commissioner.
§ 39.322-7

Limitations upon crediting and refunding of taxes paid, general rule.

(a) 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 law. The period referred to shall be three years unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

(b) For the purposes of this section and §§ 39.322–8 to 39.322–11, inclusive, a return filed before the last date prescribed for the filing thereof, or an advance payment of any portion of the tax made before such date, shall be considered as filed or made on the last date prescribed for the payment of such return or the payment of such tax, whichever is later.

(c) The period within which a claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, shall not expire before two years after the time the tax was paid, but if claim for credit or refund is filed, the period shall expire more than six months after the expiration of the period within which the Commissioner may make an assessment pursuant to an agreement or any extension thereof, the amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim or, if no claim is filed, immediately preceding the allowance of the credit or refund.

(d) In making a credit or refund of income tax, the Commissioner may make an assessment pursuant to an agreement or any extension thereof, the amount of the credit or refund shall not exceed the sum of the portion of the tax paid during the two years immediately preceding the filing of the claim or, if no claim is filed, immediately preceding the allowance of the credit or refund.

§ 39.322–8

Limitations upon crediting and refunding of taxes paid, overpayment on account of bad debts, worthless securities, etc.

(a) (1) If the claim for credit or refund relates to an overpayment on account of—

(i) The deductibility of a debt or loss described in subparagraph (3) of section 122, or subparagraph (2) of section 23 (g) or (k) of a loss from the worthlessness of a security, or

(ii) The effect that the deductibility of a debt or loss described in subparagraph (1) of this paragraph has on the application to the taxpayer of a capital loss carry-over provided in section 117 (a), a net operating loss carry-over provided in section 15 (d), or an unused excess profits credit carry-over provided in section 432 (c) then in lieu of the 3-year period from the date the return was filed in which claim may be filed or credit or refund allowed or made, as prescribed in § 39.322–7, the period shall be seven years from the date prescribed by law for filing the return (determined without regard to any extension of time for filing such return) for the taxable year for which the claim is made or the credit or refund allowed or made.

(b) (1) If the claim for credit or refund relates to an overpayment on account of the effect that the deductibility of a debt or loss described in subparagraph (1) of this paragraph has on the application to the taxpayer of a net operating loss carry-back provided in section 122 (b) or an unused excess profits credit carry-back provided in section 432 (c) such period shall be whatever of the following two periods expires later:

(i) Seven years from the date prescribed by law for filing the return (determined without regard to any extension of time for filing such return) for
the taxable year of the net operating loss or the unused excess profits credit; or

(ii) The period prescribed in § 39.322-7 or § 39.322-8, whichever is applicable, and

(iii) The amount of overpayment due to the deductibility of items described in this section.

(d) The amount of overpayment due to the deductibility of Items described in this section.

(e) The portion of an overpayment due to items described in this section shall be determined by treating the proper deduction of such items as the first adjustment to be made in computing such overpayment.

(f) Where an amount collected in a case where collection has not been stayed by the filing of a bond is disallowed in whole or in part by the reviewing court, then the amount of credit or refund otherwise due to an adjustment caused by the reviewing court shall be credited or refunded within the period of limitation provided in section 322(b).

§ 39.322-11 Limitations upon credit- and refunding of taxes paid—overpayment on account of net operating loss carry-backs and unused excess profits credit carry-backs—(a) Special period of limitation. (1) If the claim for credit or refund relates to an overpayment attributable to a net operating loss carry-back, provided in section 322(b), or to an unused excess profits credit carry-back, provided in section 322(e) then in lieu of the 3-year period from the date the return was filed in which the claim may be filed or credit or refund allowed or made, as prescribed in § 322-4, the period shall be whichever of the following two periods expires later:

(i) The period which ends with the expiration of the fifteenth day of the thirty-ninth month following the end of the taxable year of the net operating loss which resulted in the carry-back; or

(ii) The period prescribed in § 39.322-7, or in § 39.322-11, whichever is applicable.

(b) In the case of a jeopardy assessment made under section 743, if the amount which should have been assessed as determined by a decision of the Tax Court which has become final is less than the amount already collected, the excess payment shall be credited or refunded without the making of claim therefor subject to a determination being made by the Tax Court with respect to the time of payment as stated in paragraph (a) of this section.

(c) In any such case, the decision of the Tax Court shall be conclusive.

(d) For special provisions in the case of an overpayment resulting from the application of section 322(c) (3) (relating to war loss recoveries) see section 742(a) (f) and the regulations thereunder.

§ 39.322-10 Limitations upon credit- and refunding of taxes paid—overpayment determined by the Tax Court. (a) In any case where a person having a right to file a petition with the Tax Court of the United States with respect to a deficiency tax imposed by chapter 1 filed such petition within the prescribed time, no credit or refund of the tax for the year to which the deficiency relates shall be allowed or made, and no suit for the recovery of any part of such tax shall be instituted by the taxpayer, subject to the following exceptions:

(1) If the Tax Court finds that the person has overpaid his tax for the year to which the claim relates, and the decision of the Tax Court as to the amount overpaid has become final (see section 1140, Internal Revenue Code) the overpayment shall be credited or refunded without the making of a claim therefor, subject to a determination being made by the Tax Court with respect to the time of payment as stated in paragraph (a) of this section.

(2) If the portion of the deficiency determined by the Tax Court (in a case where collection has not been stayed by the filing of a bond) is disallowed in whole or in part by the reviewing court, then in lieu of the 3-year period from the date the return was filed in which the claim may be filed or credit or refund allowed or made, as prescribed in § 322-4, the period shall be whichever of the following two periods expires later:

(i) The period which ends with the expiration of the fifteenth day of the thirty-ninth month following the end of the taxable year of the net operating loss which resulted in the carry-back; or

(ii) The period prescribed in § 39.322-7, or in § 39.322-11, whichever is applicable.

(3) In the case of any claim described in this subsection, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in § 39.322-7 or § 39.322-8, whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this section.

(4) A claim for credit or refund is not filed within the applicable period prescribed in paragraph (a) of this section, the amount of the credit or refund in the case of a bad debt or loss has on the amount of the overpayment attributable to the deductibility of items described in this section.

(5) If the claim for credit or refund relates to an overpayment attributable to items described in this section with regard to an overpayment of the amount of the overpayment attributable to the deductibility of items described in this section which occurred in a taxable year other than the taxable year of the net operating loss, then credit or refund may be allowed or made, or if the claim for credit or refund is not filed, the excess payment shall be credited or refunded without the making of a claim therefor subject to a determination being made by the Tax Court with respect to the time of payment as stated in paragraph (a) of this section.

(6) The portion, if any, of the tax paid within the period provided in § 39.322-7 or § 39.322-8, whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this section.
(ii) The period which ends with the expiration of the period prescribed in §39.322-8 within which a claim for credit or refund may be filed with respect to the taxable year of the net operating loss which resulted in the carry-back.

(2) In the case of a claim described in subdivision (1) of this paragraph, the amount of the credit or refund may be reduced the portion of the tax paid within the period prescribed in §39.322-7 or §39.322-8, whichever is applicable, to the extent of the amount of the overpayment attributable to the carry-back. Such a credit or refund cannot exceed the sum of the following:

(i) The portion, if any, of the tax paid within the period prescribed in §39.322-7 or §39.322-8, whichever is applicable, and

(ii) The amount of the overpayment attributable to the carry-back.

(3) The portion of an overpayment attributable to a carry-back shall be determined by treating the net operating loss deduction and the unused excess profits credit adjustment, to the extent that they are not refunded by the net operating carry-back or the unused excess profits carry-back, as the first adjustments to be made in computing such overpayment. If claim for credit or refund is filed and a credit or refund is not allowed or made, within the period described in this paragraph, then credit or refund may be allowed or made only if claim therefor is filed within the period prescribed in §39.322-7 or §39.322-8, whichever is applicable, subject to the provisions hereof limiting the amount of credit or refund in the case of a claim filed, or if no claim was filed, in case of credit or refund allowed or made within such applicable period. For the limitation upon the allowance of interest for an overpayment where credit or refund is subject to the provisions of section 322 (b) (6) see section 3771 (e)

(b) Barred overpayments. If the allowance or refund of an overpayment of tax attributable to a net operating loss carry-back or to an unused excess profits carry-back is otherwise prevented by the operation of any law or rule of law (other than section 3761, relating to compromises) such credit or refund may be allowed or made under the provisions of section 322 (c) if a claim therefor is filed within the period provided by section 322 (b) (6) and paragraph (a) of this section for filing a claim for credit or refund of an overpayment attributable to a carry-back, or the allowance of an application, credit, or refund of a decrease in tax determined under section 3780 (b) (6) is otherwise prevented by the operation of any law or rule of law (other than section 3761) such application, credit, or refund may be allowed or made if an application for a tentative carry-back-adjustment is filed within the period provided in section 3780 (a). Thus, for example, even though the tax liability for a given taxable year has previously been litigated before The Tax Court of the United States, credit or refund of an overpayment may be allowed or made despite the provisions of section 322 (c) if claim therefor is filed within the period provided in section 322 (b) (6) and paragraph (a) of this section. In the case of a claim for credit or refund of an overpayment attributable to a carry-back, the determination of any court, including The Tax Court of the United States, concerning a proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction and the unused excess profits credit adjustment, and the effect of such deduction or adjustment, to the extent that such deduction or adjustment is affected by a carry-back which was not in issue in such proceeding.

§39.322-12 Crediting of accounts of district directors in cases of assessments subject to section 487 and section 3311. If assessments have been made against several persons covering the same tax liability, and payment of such assessments in full has been made, or such persons have been duly certified to the Commissioner, the Commissioner, for the purpose of temporarily relieving the district director of internal revenue of the burden of such assessments, may authorize him to take credit temporarily with respect to the assessments not specifically paid. Such action, however, shall not constitute an abatement and shall not discharge the liability of the persons concerned.

SUPPLEMENT F—FOREIGN PERSONAL HOLDING COMPANIES

§39.331-1 Definition of foreign personal holding company.

(a) A foreign personal holding company is any foreign corporation (other than section 321) which comes within the classification of a foreign personal holding company as defined in section 332;

(b) A foreign corporation which comes within the classification of a foreign personal holding company is not subject to taxation either under section 103 or section 500. The fact that a foreign corporation is a foreign personal holding company does not relieve the corporation from liability for the taxes imposed generally under section 231 upon foreign corporations, since such taxes apply regardless of the classification of the foreign corporation as a foreign personal holding company.

§39.331-2 Gross income requirement.

(a) To meet the gross income requirement, it is necessary that either of the following percentages of the gross income of the corporation for the taxable year (including the additions to gross income provided in section 334 (b) as required by section 334 (c) (2)) be foreign personal holding company income as defined in section 332:

(1) Sixty percent or more; or

(2) Fifty percent or more if the foreign corporation has been classified as a foreign personal holding company for any taxable year ending after August 26, 1937, unless—

(i) 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

(ii) Three consecutive years have intervened since the last year for which it was so classified, during each of 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 gross receipts. For a further discussion of what constitutes “gross income,” see section 22 (a) and §§39.22 (a)–1 to 39.22 (a)–23, inclusive.

§39.331-3 Stock ownership requirement.

(a) 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 not more than five individuals who are citizens or residents of the United States, otherwise referred to as “United States group.” For such purpose, the ownership of the stock must be determined as provided in section 333 and

§ 39.322-12
(b) 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, or immediately prior to and subsequent to such change, the conditions with respect to stock ownership are present at any time during the taxable year on which any 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 (by name or by description) in the contract; and

(ii) At some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by the individual who is to perform the services, or 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.

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. The term "dividends" includes dividends as defined in section 115 (a) and amounts required to be included in gross income under section 342.

(b) Interest. The term "interest" means any amounts, includible in gross income, received for the use of money loaned.

(c) Royalties. The term "royalties" includes amounts received for 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. As used in this paragraph the term "overriding royalties" means 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.

(d) Annuities. The term "annuities" includes annuities only to the extent includible in the computation of gross income. See section 22 (b) (2).

(e) Annuities received in respect of any profit-sharing agreement, or any profit-sharing plan (including any joint-stock company, insurance company, association, or other organization classified as a corporation by the Internal Revenue Code) certifies of interest or participation in any profit-sharing agreement, or in any oil, gas, or other mineral royalty, or lease, collateral trust certificates, voting trust certificates, stock rights or warrants, bonds, debentures, certificates of indebtedness, notes, equipment trust certificates, bills of exchange, and obligations issued by or on behalf of a government, 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 transfer or exchange of stock or securities made in the normal course of business. As used in section 332 (b) the term "regular dealers in stock or securities" means corporations which are regularly engaged in the purchase of stock or securities and their resale to customers, but such corporations are not dealers with respect to stocks or securities held for speculation or investment.

(1) Gains from futures transactions in commodities. Gains from futures transactions in commodities include gains from transactions which are speculative unless they are hedges against price fluctuations 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.

(2) Income from estates and trusts. 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 income and gain 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.

(h) Amounts received under personal service contracts. (1) 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—

(i) Some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services (by name or by description) in the contract; and

(ii) At some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by the individual who is to perform the services, or 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.
the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform such personal services. Stock ownership must be determined as provided in section 333 and §§ 39.333(a)–1 to 39.333(a)–7, inclusive, and § 39.333(b)–1.

(3) The application of section 332 (e) and this paragraph may be illustrated by the following examples:

Example (1). A, whose profession is that of an actor, owns all of the outstanding capital stock of the M Corporation, a corporation. The M Corporation entered into a contract with A under which A was to perform personal services for the person or persons which the M Corporation might designate, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation was to pay the M Corporation $500,000 a year. The $500,000 received by the M Corporation from the O Corporation was to be used to acquire foreign personal holding company income. The individual who performed the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $500,000 received by the N Corporation from the O Corporation does not constitute 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 was 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 sublease or other arrangement. The property may consist of a yacht, a city residence, a country house, or any other kind of property. See sections 331(a)(2) and 335 and §§ 39.333(a)–1 to 39.333(a)–7, inclusive, and § 39.333(b)–1.

(2) Rents. The 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 (1) 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.

§ 39.333 (a) Statutory provisions; foreign personal holding companies; constructive stock-ownership rules.

Sec. 333. Stock ownership. (a) Constructive ownership. For the purpose of determining whether a foreign corporation is a foreign personal holding company, in so far as such determination is based on stock ownership under section 331(a)(2), section 332(e), or section 332(f)(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 shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of this paragraph the family of any individual includes such individual's brothers, 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 owned by such person. For the purposes of this paragraph an option to acquire such stock, or any of a series of such options, shall be considered as an option to acquire such stock.

(4) Application of family-partnership and option rules. Paragraphs (2) and (3) shall be applied as follows:

(A) For the purposes of the stock ownership requirement provided in section 333 (a)(2), if, but only if, the effect is to make the corporation a foreign personal holding company;

(B) For the purposes of section 333 (e) (relating to personal service contracts), or of section 335 (f) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such subsection as foreign personal holding company income.

(5) Constructive ownership as actual ownership. Stock owned by a person by reason of the application of paragraph (1) or (3) shall, for the purpose of applying paragraph (1) or (2), be treated as held by such person; but stock constructively owned by an individual by reason of the application of paragraph (3) shall be treated as owned by such person for the purpose of again applying such paragraph in order to make another the constructive owner of such stock.

(6) Option rule in lieu of family and partnership rule. If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

§ 39.333 (a)–1 Stock ownership. (a) For the purpose of determining whether—

(1) a foreign corporation is a foreign personal holding company, so far as such determination is based on the stock ownership requirements specified in section 331(a)(2) and § 39.333–1; or

(2) Amounts received under a personal service contract or from the sale of such a contract constitute foreign personal holding company income so far as such determination is based on the stock ownership requirement specified in section 333 (f) and paragraph (1) of § 39.333–1, stock owned by an individual includes stock constructively owned by him as provided in section 333.

(3) Compensation for the use of property constitutes foreign personal holding company income so far as such determination is based on the stock ownership requirement specified in section 333 (f) and paragraph (1) of § 39.333–1, stock owned by an individual includes stock constructively owned by him as provided in section 333.

(b) For the purposes of paragraph (a) of this section, constructive ownership of stock shall be determined and applied in accordance with the rules provided in section 333 and §§ 39.333(a)–7, inclusive, and § 39.333(b)–1. All forms and classes of stock, however denominated, which represent the interests of shareholders, members, or beneficiaries in the corporation shall be taken into consideration.

§ 39.333 (a)–2 Stock not owned by individual. In determining the ownership of stock for any of the purposes set forth in § 39.333 (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 § 39.333 (a)–6.

§ 39.333 (a)–3 Family and partnership ownership. (a) In determining the ownership of stock for any of the purposes set forth in § 39.333 (a)–1, an individual shall be considered as owning 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 and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(b) The application of the family and partnership rule in determining the ownership of stock for the purpose set forth in paragraph (a) (1) of § 39.333 (a)–1 is illustrated by the following example:

Example. (1) The M Corporation at some time during the taxable year had 1,800 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 1,350 were held by 51 shareholders as follows:

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By applying the statutory rule provided in section 333 (a) (2) five individuals own more than 50 percent of the outstanding stock as follows:

<table>
<thead>
<tr>
<th>Relationships</th>
<th>Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>An individual</td>
<td>A 100</td>
</tr>
<tr>
<td>His father</td>
<td>AP 10</td>
</tr>
<tr>
<td>His wife</td>
<td>B 100</td>
</tr>
<tr>
<td>His brother</td>
<td>DP 10</td>
</tr>
<tr>
<td>His sister</td>
<td>BM 100</td>
</tr>
<tr>
<td>His daughter by former marriage (son's mother)</td>
<td>AM 100</td>
</tr>
<tr>
<td>His brother's wife</td>
<td>AW 100</td>
</tr>
<tr>
<td>His wife's husband</td>
<td>BB 100</td>
</tr>
<tr>
<td>His wife's brother</td>
<td>AD 100</td>
</tr>
<tr>
<td>Individual's partner</td>
<td>AB 100</td>
</tr>
</tbody>
</table>

Total, or more than 50 percent: 910

(3) 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. A's partner owns 10 shares of the stock. Individual D represents the case where stock is held by the group because of the ownership of stock by his immediate family. Individuals C and D represent cases where the individuals fall in groups headed in C's case by his wife and in D's case by his brother because of the predecessor 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.

(c) 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 paragraphs (a) (2) and (3) of § 39.333 (a) (1).

§ 39.333 (a) (4) Options. In determining the ownership of stock for any of the purposes set forth in § 39.333 (a) (1), if any person has an option to acquire stock, such stock may be considered as actually owned by such person for the purpose of applying either the option rule provided in section 333 (a) (2) relating to stock not owned by an individual (see § 39.333 (a) (2)) or the rule provided in section 333 (a) (1) relating to stock not owned by an individual, in order to make another person the constructive owner of such stock.

(b) The application of paragraph (a) 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 O Corporation in turn owns all the stock of the P Corporation, as illustrated in section 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 directly by the M Corporation, the sole shareholder of the O Corporation. Such constructive ownership of the stock of the P Corporation is considered to be actual ownership for the purposes of 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 333 (a) (2) in order to make a the constructive owner of the stock of the P Corporation. The application of such rule is necessary for any of the purposes set forth in § 39.333 (a) (1). But the stock, that is, the constructive ownership may not be considered as actual ownership for the purpose of again applying the family and partnership rule provided in section 333 (a) (2) and (3) of § 39.333 (a) (1) for another purpose or other purposes.

Example (2). B is a United States citizen who owns all the stock of the R Corporation, which has an option to acquire the stock of the S Corporation, a foreign corporation, owned by C, an individual, who is not related to B. Under the option rule provided in section 333 (a) (3) the R Corporation may be considered as owning constructively the stock of the S Corporation owned by C. Such constructive ownership of the stock of the R Corporation is considered as actual ownership for the purpose of applying the rule provided in section 333 (a) (1), relating to stock not owned by an individual, in order to make B, the sole shareholder of the R Corporation, the constructive owner of the stock of the S Corporation. The stock is thus constructively owned by B by reason of the option rule provided in section 333 (a) (1), illustrative of actual ownership for the purposes of applying the family and partnership rule provided in section 333 (a) (3) in order to make another member of B's family, for example, B's wife, BW, the constructive owner of such stock. However, the family and partnership rule could not again be applied as to make still another individual the constructive owner of such stock or the constructive owner of the stock of the R Corporation, that is, the stock constructively owned by BW could not be considered as actually owned by her in order to make BW's father the constructive owner of such stock by a second application of the family and partnership rule.

§ 39.333 (a) (7) Option rule in lieu of family and partnership rule. (a) If, in determining the ownership of stock for any of the purposes set forth in § 39.333 (a) (1), stock may be considered as constructively owned by an individual by an application of both the family and partnership rule provided in section 333 (a) (2) (see § 39.333 (a) (3)) and the option rule provided in section 333 (a) (3) (see § 39.333 (a) (4)) such stock shall be considered as actually owned by such individual by reason of the application of the option rule.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. (1) Two brothers, A and B, each own 10 percent of the stock of the M Corporation, a foreign corporation, and A's wife, AW, also owns 10 percent of the stock of the M Corporation. AW's husband, A, has an option to acquire the stock owned by her at any time. It becomes clear for one of the purposes stated in § 39.333 (a) (1), to determine the stock ownership of B in the M Corporation.

(2) If the family and partnership rule were the only rule that applied in the case, B would be considered, under that rule, as owning 20 percent of the stock of the M Corporation, namely, his own stock plus the stock owned by his brother. In that event, B could not be considered the constructive owner of the stock held by AW since (1) AW is not a member of B's family and (2) the constructive ownership of such stock by A through the application of the family and partnership rule
rule in his case is not considered as actual ownership so as to make B the constructive owner of stock of his wife. If A is considered as owning the stock of his wife by application of the option rule and the constructive ownership rule (§ 39.231-2) or application of both family and partnership rules to reclassify ownership of the stock, then A is constructive owner of the stock of his wife. If A is owning the family and partnership rule so as to reclassify ownership of his wife's stock under the provisions of section 331 (a) (1), then A, and A's wife, may be considered as constructive owner of his wife's stock under the provisions of section 331 (a) (1). Hence, for both purposes, the gross income includes income from all sources, whether within or without the United States, which is not excluded from gross income by section 331 (f).

§ 39.334–2 Additions to gross income for purposes of Supplement P (a) If, for any taxable year—

(1) A foreign corporation meets the stock ownership requirement specified in § 39.331–1, regardless of whatever day in its taxable year is the last day on which the required United States group exists, and
(2) Such foreign corporation is a shareholder in a foreign personal holding company on any of its taxable years, and
(3) All the shares of such foreign corporation are directly or indirectly owned by such foreign holding company on any day of its taxable year in which a United States group existed with or without the taxable year of the first company and such day is the last day in the taxable year of the second company and on which the United States group exists with respect to the second company, then for the purpose of—

(3) Determining whether the first company meets the stock ownership requirement specified in § 39.331–2, so as to be considered within the classification of a foreign personal holding company, and
(4) Determining the undistributed Supplement P net income of the first company which (in the event the first company is a foreign personal holding company) is to be included, in whole or in part, in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies.

Such convertible securities shall be considered as outstanding stock for the purpose of determining its undistributed Supplement P net income which, or a part of which, is to be included in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies; and

§ 39.334–3 Gross income in general for purposes of Supplement P For all taxable years ending on or after January 1, 1953, the provisions of Supplement P net income of the first company shall be computed as if the corporation were a domestic corporation and without regard to the provisions of Supplement P (sections 231 to 238, inclusive) and §§ 39.331–1 to 39.339–3, inclusive, of the gross income of a foreign corporation shall be computed as if the corporation were a domestic corporation and without regard to the provisions of Supplement P (sections 231 to 238, inclusive) and §§ 39.331–1 to 39.336–1, inclusive, relating to the taxation of foreign corporations generally.

§ 39.333 (b) Statutory provisons; foreign personal holding companies; constructice stock-ownership rules; convertible securities.

Sec. 333. Stock ownership. (a) Constructive securities. Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be included unless all outstanding stock having a prior conversion date are also so considered.

(b) Convertible securities. Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock if, and only if, the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company as of the last day of the taxable year.

(c) Constructive ownership. For the purpose of section 333 (a) (6) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company, such convertible securities shall be considered as outstanding stock unless all outstanding securities having a prior conversion date are also included.

§ 39.333 (b)–1 Convertible securities. Under section 333 (b) outstanding securities of a foreign corporation, such as bonds, dividends, or other convertible obligations, convertible into stock of the corporation (whether or not convertible during the taxable year) shall be considered as outstanding stock of the corporation for the purpose of the stock ownership requirement provided in section 331 (a) (2) but only if the effect of such consideration is to make the corporation a foreign personal holding company.
end. If on the last day referred to in subparagraph (2) of this paragraph there had been distributed by the second company, and received by the shareholders, which bears the same ratio to the undistributed Supplement P net income of the second company for its taxable year as the portion of such tax such last day bears to the entire taxable year. The foregoing rules apply to any chain of foreign corporations regardless of the number of corporations included in the chain.

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example 1. The X Corporation is a foreign corporation whose stock is owned by A, a United States citizen. The X Corporation owns the entire stock of the Y Corporation, another foreign corporation. The taxable year of the X Corporation is the calendar year and the taxable year of the Y Corporation is the fiscal year ending June 30. The X Corporation had earnings and profits of $100,000 for the fiscal year ending June 30, 1953. The Y Corporation had earnings and profits of $100,000 for the fiscal year ending June 30, 1953, but paid dividends of $30,000 in 1953. The income of the Y Corporation for such fiscal year amounts to $70,000, of which $30,000 is distributed as dividends after September 30, 1953. The undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1953, since at one time in such fiscal year, or from July 1 to and including September 30, 1953, it meets the stock ownership requirement, and the gross income requirement is also satisfied. In determining whether the X Corporation constitutes a foreign personal holding company, the undistributed Supplement P net income of the Y Corporation for the fiscal year ended June 30, 1954 (3% of $70,000) would be included in the gross income of the Y Corporation, and, therefore, the undistributed Supplement P net income of the Y Corporation would be included in the gross income of the X Corporation.

Example 2. The X Corporation referred to in Example 1 sold its stock in the Y Corporation to other interests on September 30, 1953, after which date the United States group existed with respect to the Y Corporation. For the fiscal year ending June 30, 1954, the percentage of the gross income of the X Corporation consists of foreign personal holding company income. The income of the Y Corporation for such fiscal year amounts to $61,000,000, of which $9,000,000 is distributed as dividends after September 30, 1953. The undistributed Supplement P net income of the Y Corporation for such fiscal year amounts to $52,000,000. On the basis of these facts the X Corporation is a foreign personal holding company for the fiscal year ending June 30, 1954. The portion of the undistributed Supplement P net income of the X Corporation, and, therefore, the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1954 (3% of $52,000,000) would be included in the gross income of the X Corporation.

Example 3. The X Corporation sold its stock in the Y Corporation to other interests on September 30, 1953, after which date the United States group existed with respect to the Y Corporation. For the year ending June 30, 1954, the portion of the undistributed Supplement P net income of the Y Corporation consisting of foreign personal holding company income was $52,000,000. The undistributed Supplement P net income of the Y Corporation for the entire taxable year of the Y Corporation is $61,000,000. Whether the X Corporation constitutes a foreign personal holding company, the undistributed Supplement P net income of the Y Corporation would be included in the gross income of the X Corporation in determining the undistributed Supplement P net income of the X Corporation which is included in the gross income of the Y Corporation in which or with which the X Corporation exists, so that the X Corporation is a foreign personal holding company, the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1954 (3% of $52,000,000) would be included in the gross income of the X Corporation. The X Corporation would then be a foreign personal holding company for the fiscal year ending June 30, 1954. The portion of the undistributed Supplement P net income of the X Corporation, and, therefore, the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1954 (3% of $52,000,000) would be included in the gross income of the X Corporation.

Example 4. If the Y Corporation in Example 1 owns all of the stock of the Z Corporation, another foreign corporation, there would be a chain of three foreign corporations. In such case, assuming that the Z Corporation is a foreign personal holding company for a taxable year ending with or within the taxable year of the Y Corporation, the undistributed Supplement P net income of the Z Corporation would be included in the gross income of the X Corporation for the purpose of determining whether the X Corporation constitutes a foreign personal holding company or in determining the undistributed Supplement P net income of the Y Corporation to which the X Corporation is a foreign personal holding company, the undistributed Supplement P net income of the Z Corporation would be included in the gross income of the X Corporation in determining whether the X Corporation constitutes a foreign personal holding company. If, after the inclusion of such presumptive dividends due to the undistributed Supplement P net income of the Z Corporation, the X Corporation would be included as a foreign personal holding company, the undistributed Supplement P net income of the Z Corporation would be included in the gross income of the Y Corporation which is included in the gross income of the X Corporation. The same process would be repeated with respect to determining whether the X Corporation is a foreign personal holding company 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, as a result, be included as a dividend in the gross income of A, the ultimate beneficial shareholder of the chain.

The foregoing rules and the example apply to the taxation of a foreign personal holding company for a taxable year ending with or within the taxable year of the Y Corporation in which or with which the X Corporation exists, so that the X Corporation is a foreign personal holding company, the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1954 (3% of $52,000,000) would be included in the gross income of the X Corporation. The X Corporation would then be a foreign personal holding company for the fiscal year ending June 30, 1954. The portion of the undistributed Supplement P net income of the X Corporation, and, therefore, the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1954 (3% of $52,000,000) would be included in the gross income of the X Corporation.

Example 5. The X Corporation referred to in Example 1 sold its stock in the Y Corporation to other interests on September 30, 1953, after which date the United States group existed with respect to the Y Corporation. Assuming that the Y Corporation is a foreign personal holding company, the income of the Y Corporation for the entire taxable year of the Y Corporation in which the X Corporation existed, and therefore, the portion of the undistributed Supplement P net income of the Y Corporation included in the gross income of its shareholders is likewise equal to 100 percent.

Example 6. The X Corporation having the sole shareholder of the Y Corporation must include such portion in its gross income for 1953, the taxable year in which or with which the taxable year of the Y Corporation ends. If, after the inclusion of the presumptive dividend in its gross income, the X Corporation is a foreign personal holding company, the undistributed Supplement P net income of the X Corporation in the year ending with or within the taxable year of the Y Corporation in which the X Corporation exists, so that the X Corporation is a foreign personal holding company, the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1954 (3% of $52,000,000) would be included in the gross income of the X Corporation in determining whether the X Corporation constitutes a foreign personal holding company. If, after the inclusion of such presumptive dividends due to the undistributed Supplement P net income of the Z Corporation, the X Corporation would be included as a foreign personal holding company, the undistributed Supplement P net income of the Z Corporation would be included in the gross income of the X Corporation in determining whether the X Corporation constitutes a foreign personal holding company.
ing the tax imposed by section 102, section 336 (b) (2) and 336 (b) (3) in the computation of its Supplement P net income. Section 336 (b) (3) provides that the net operating loss deduction provided by section 23 (g) shall be allowed under section 336 (b) (2) the aggregate of the deductions allowed under section 23 (a) relating to expenses, and section 23 (1) relating to depreciation, which are allocable to the operation of property owned or operated by the company shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner—

(1) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

The burden of proof will rest upon the taxpayer to sustain the deduction claimed. If a United States shareholder, in computing his distributive share of the undistributed Supplement P net income of a foreign personal holding company to be included in gross income in his individual return (see section 337 and § 337–1) claims deductions for expenses of, and depreciation on, the property used 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 he shall attach to his income tax return a statement of the necessity for such expenses and depreciation allocable to the maintenance and operation of property owned or operated by the company, in an amount equal to the rent or other compensation received for the use of, or the right to use, the property.

§ 39.336–1 Supplement P net income.

(a) 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 sections 336 (b) (2) and 336 (b) (3)) and section 336 (b) (3) in the computation of the shareholder’s distributive share of the undistributed Supplement P net income of another foreign personal holding company with respect to the M Corporation, a foreign personal holding company, for the calendar year 1952. The purposes for 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 is 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):

(1) The gross income of the corporation as defined in section 334 amounts to $300,000, of which $150,000 represents its distributive share of the undistributed Supplement P net income of another foreign personal holding company in which it is a shareholder.

(b) The expenses of the corporation amount to $65,000, of which $25,000 is allocable to the maintenance and operation of the property used by the principal shareholder and the remainder $40,000 consists of interest, which is allowable as a deduction.

(3) Federal income tax withheld at the source on the income of the corporation from sources within the United States amounts to $30,125.

(4) The expenses of the corporation amount to $25,000, of which $15,000 is allowed to the maintenance and operation of the property used by the principal shareholder and the remainder $10,000 consists of interest, which is allowable as a deduction.

(5) The expenses of the corporation amount to $59,000, of which $50,000 is allocable to the maintenance and operation of the property used by the principal shareholder and the remainder $9,000 consists of interest, which is allowable as a deduction.

(6) The expenses of the corporation amount to $30,000, of which $25,000 is allocable to the maintenance and operation of the property used by the principal shareholder and the remainder $5,000 consists of interest, which is allowable as a deduction.
### Table: Income and Deductions

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>$500,000</td>
</tr>
<tr>
<td>Interest</td>
<td>$10,000</td>
</tr>
<tr>
<td>Rent</td>
<td>$5,000</td>
</tr>
<tr>
<td><strong>Gross income as defined in section 22</strong></td>
<td><strong>215,000</strong></td>
</tr>
<tr>
<td>Distributable share of undistributed Supplement P net income of the other foreign personal holding company (considered as a dividend)</td>
<td><strong>85,000</strong></td>
</tr>
<tr>
<td><strong>Gross income as defined in section 334</strong></td>
<td><strong>300,000</strong></td>
</tr>
<tr>
<td><strong>Deductions (section 22)</strong></td>
<td></td>
</tr>
<tr>
<td>Expenses allocable to operation of the rented property</td>
<td>$75,000</td>
</tr>
<tr>
<td>Depreciation of the rented property</td>
<td>$30,000</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 sec. 23 (g))</td>
<td><strong>5,000</strong></td>
</tr>
<tr>
<td><strong>Net income for purposes of computing Supplement P net income</strong></td>
<td><strong>160,000</strong></td>
</tr>
<tr>
<td>(c) The Supplement P net income and the undistributed Supplement P net income of the corporation are $310,875 and $160,075, respectively, computed as follows:</td>
<td></td>
</tr>
<tr>
<td>Net income for purposes of computing Supplement P net income</td>
<td><strong>160,000</strong></td>
</tr>
<tr>
<td>Add (see sec. 336 (b)) Contributions deductible in computing net income under sec. 21</td>
<td>$5,000</td>
</tr>
<tr>
<td>Excess property expenses and depreciation over amount of rent received for use of property ($105,000)</td>
<td><strong>100,000</strong></td>
</tr>
<tr>
<td><strong>Total deductions</strong></td>
<td><strong>165,000</strong></td>
</tr>
<tr>
<td>Deduct (see section 336)</td>
<td></td>
</tr>
<tr>
<td>Federal income taxes</td>
<td>$53,125</td>
</tr>
<tr>
<td>Contributions (within the 15 percent limitation specified in sec. 336 (a) (2))</td>
<td><strong>74,125</strong></td>
</tr>
<tr>
<td><strong>Net additions under section 336</strong></td>
<td><strong>30,000</strong></td>
</tr>
<tr>
<td>Supplement P net income</td>
<td><strong>210,875</strong></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Basic surtax credit for dividends paid (see sec. 335)</td>
<td><strong>50,000</strong></td>
</tr>
<tr>
<td><strong>Undistributed Supplement P net income</strong></td>
<td><strong>160,875</strong></td>
</tr>
</tbody>
</table>

**FEDERAL REGISTER**

§ 39.337-1 Income of foreign personal holding companies taxed to United States shareholders—(a) General rule. Supplement P (sections 331 to 340, inclusive) does not impose a tax on foreign personal holding company income. The undistributed Supplement P net income of such companies, however, must be included in the manner and to the extent set forth in this section, in the gross income of their United States shareholders, that is, the shareholders who are individual citizens or residents of the United States, domestic corporations, partnerships, or estates or trusts (other than estates or trusts the gross income of which under chapter 1 includes only income from sources within the United States). (b) Amount includable in gross income. (1) Each United States shareholder, who was a shareholder on the day in the taxable year of the foreign personal holding company on which the last day on which a United States group existed with respect to the company, received and would have received as a dividend if on such last day there had been distributed by the company, an amount which bears the same ratio to the undistributed Supplement P net income of the company as of such specified time as is the ratio of the statutory income of United States shareholders as of such time to the statutory income of United States shareholders as of the close of the taxable year in which the last day on which a United States group existed with respect to the company. The amount so includable shall be determined, for each such shareholder, by applying the ratio of the statutory income of United States shareholders as of such time to the statutory income of United States shareholders as of the close of such taxable year, to the undistributed Supplement P net income of the company, as of such time.

§ 39.337-2 **Statutory provisions; foreign personal holding companies; income taxed to United States shareholders.**

Sec. 337. Corporation income taxed to United States shareholders—(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 corporations, 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 Supplement.

(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 group existed with respect to the company, shall include in his gross income, for the purposes of the provisions of section 336—(1) that portion of the undistributed Supplement P net income of the company which bears the same ratio to the statutory income of United States shareholders as of the close of the taxable year in which or with which the taxable year of the company ends, the amount which he would have received as a dividend if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed Supplement P net income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) Credit for obligations of United States and its instrumentalities. Each United States shareholder shall be allowed a credit against net income, for the purpose of the tax imposed by sections 11, 13, 221, 221, 221, or 221, of his proportionate share of the interest specified in section 23 (a) (1) or (2), which is included in gross income of the company otherwise than by the application of the provisions of section 334 (b) (relating to the inclusion of the dividend income of foreign personal holding company of its distributed share of the undistributed Supplement P net income of another foreign personal holding company which was the last day on which a United States group existed with respect to the company). If the foreign personal holding company elects to include such interest specified in section 23 (a) (1) or (2), as amortizable, for the purposes of the preceding sentence such United States shareholder's proportionate share of such interest received by the foreign personal holding company shall include in gross income of the company an amount which bears the same ratio to the statutory income of United States shareholders as of the close of such taxable year, determined by applying the ratio of the statutory income of United States shareholders as of such time to the statutory income of United States shareholders as of the close of the taxable year in which the last day on which a United States group existed with respect to the company; but only to the extent determined in this sentence.

(d) Information in return. Every United States shareholder who is required under subsection (b) to include in his gross income any amount with respect to the undistributed Supplement P net income of a foreign personal holding company, shall, on the last day on which a United States group existed with respect to the company, own 5 per centum or more in value of the outstanding stock of such company, shall have, in his gross income and credits, net income, Supplement P net income, and undistributed Supplement P net income of such company, (e) Effect on capital account of foreign personal holding company. An amount which bears the same ratio to the undistributed Supplement P net income of a foreign personal holding company as its gross income and credits, net income, Supplement P net income, and undistributed Supplement P net income of such company for the taxable year in which or with which the taxable year of the company ends, the amount which he would have received as a dividend if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed Supplement P net income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(2) The undistributed Supplement P net income of the foreign personal holding company is includable only in the gross income of the United States shareholders who were shareholders in the company on the last day of its taxable year on which the last day on which a United States group existed with respect to the company. Such United States shareholders, accordingly, are determined by the stock holdings as of such time, and the rule applies to every United States shareholder who was a shareholder in the company at the specified time regardless of whether such amount of gain has been made (if it had been made), to be treated as having been reinvested by the shareholder as a contribution to the capital of the company. Hunters set forth in this section, the amount to which such amount is includable in the gross income of the United States, domestic corporation, partnership, or estate and trust the gross income of which under chapter 1 includes only income from sources within the United States, the shareholders who are individual citizens or residents of the United States, the shareholders who are domestic corporations, partnerships, or estates or trusts (other than estates or trusts the gross income of which under chapter 1 includes only income from sources within the United States), who were shareholders in the company on the last day of its taxable year on which the last day on which a United States group existed with respect to the company, shall be included in the gross income of the United States, domestic corporation, partnership, or estate and trust the gross income of which under chapter 1 includes only income from sources within the United States, to the extent set forth in this Supplement.

§ 39.337-3 Basis of stock in hands of shareholders. The amount required to be included in the gross income of a United States shareholder under subsection (a) of this section is the product of multiplying the basis of his stock with respect to which the distribution would have been made (if it had been made), by the amount which bears the same ratio to the undistributed Supplement P net income of the company as the statutory income of United States shareholders bears to the statutory income of United States shareholders in the taxable year in which the last day on which a United States group existed with respect to the company, determined by applying the ratio of the statutory income of United States shareholders as of such time to the statutory income of United States shareholders as of the close of the taxable year in which the last day on which a United States group existed with respect to the company; but only to the extent set forth in this Supplement.

§ 39.337-4 Basis of stock in hands of shareholders. The amount required to be included in the gross income of a United States shareholder under subsection (a) of this section is the product of multiplying the basis of his stock with respect to which the distribution would have been made (if it had been made), by the amount which bears the same ratio to the undistributed Supplement P net income of the company as the statutory income of United States shareholders bears to the statutory income of United States shareholders in the taxable year in which the last day on which a United States group existed with respect to the company, determined by applying the ratio of the statutory income of United States shareholders as of such time to the statutory income of United States shareholders as of the close of the taxable year in which the last day on which a United States group existed with respect to the company; but only to the extent set forth in this Supplement.
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 in the undistributed Supplement P net income even though the domestic corporation cannot be included within the United States group since, under section 337 (a) (1) and 337 (f) of the Code, the foreign corporation is considered as being owned proportionately by its shareholders for the purpose of determining whether the foreign corporation is a foreign personal holding company.

(3) The United States shareholders must include in their gross income their distributive shares of that portion of the undistributed Supplement P net income for the taxable year of the company which is equal in ratio to that which the portion of the taxable year up to and including the last day on which the United States shareholder was a member of the United States group existed, such portion of the taxable year existing was also the taxable year of the M Corporation. Thus, if the last day in the taxable year on which the required United States group existed was September 30, 1952, the portion of the taxable year up to and including such last day would be equal to one-twelfth of such portion of the taxable year of the M Corporation.

(4) The amount which each United States shareholder must return is that amount which he would have received as a dividend if the above specified portion of the undistributed Supplement P net income had been distributed by the foreign personal holding company as a dividend on the last day of its taxable year on which the required United States group existed. Such amount is determined, therefore, by the interest of the 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 relative rights of his class of stock, 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 shareholders are entitled to a specified dividend before any distribution may be made to the common shareholders, the assumed distribution of the stated portion of the undistributed Supplement P net income must first be treated as a payment of the specified dividend on the preferred stock before any part of it may be treated as a dividend on the common stock.

(5) The assumed distribution 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 for 1952, and if A, one of its United States shareholders, makes a return of his distributive share for the taxable year 1952, and B, another United States shareholder, makes returns on the basis of a fiscal year ending November 30, 1952, A must return his assumed dividend for the taxable year 1952, and B must return his distributive share as income for the fiscal year ending November 30, 1953.

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 September 30, 1952, was the last day on which the United States group with respect to the company existed, A would still be required to return his assumed dividend as income for the fiscal year ending November 30, 1953, even though the calendar year is used as the taxable year up to and including such last day as of which the distribution is assumed to have been made, does not fall within such fiscal year.

§ 39.337-2 Credit for obligations of the United States. (a) 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, 16, 291, 204, 207, or 362, a credit against his net income for his proportionate share of whatever interest on obligations of the United States or its instrumentalities (as specified in section 337 (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 as may be so included by reason of the tax imposed by section 334 (b) and 39.333-4. For reduction of credit for such interest on account of amortizable bond premium, see § 39.125 (a)–2.

(b) The rule set forth in paragraph (a) of this section may be illustrated by the following example:

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 25 (a) (1) and 2. In applying the credit allowable under section 337 (c), the United States shareholders of the M Corporation would be entitled to a credit only for their proportionate shares of the interest received by that company and not for any portion received by the N Corporation, regardless of whether the interest received by the N Corporation is included in the gross income of the M Corporation, as an actual dividend or as a constructive dividend under section 334 (b).

§ 39.337-3 Information in return. The information required by section 337 (d) in the returns of certain United States shareholders relating 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 of whom the information is required. The information shall be submitted as a part of the income tax returns required by the Internal Revenue Code of such persons, in the form of a statement attached to the return.

§ 39.337-4 Effect on capital account of foreign personal holding company and basis of stock in hands of shareholders. Sections 337 (e) and 337 (f) 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 which owns all or part of the stock of the N Corporation, another for-
§ 39.333-1 Information returns by officers and directors of certain foreign personal holding companies; annual returns for foreign corporations.—(a) Requirements for filing returns.—(1) General. Under section 333 (a) on the fifteenth day of each month each individual who on such fifteenth day is an officer or a director of a foreign corporation which, with respect to its taxable year preceding the taxable year in which such month occurs, was a personal holding company, is required to file a monthly information return as provided in section 333 (a) and this section.

(ii) The return for the last month of the preceding taxable year shall be filed on the fifteenth day of the first month following the close of such taxable year.

(ii) Subsequent returns shall be filed for each 6-month period following the close of such taxable year and shall be filed on the fifteenth day of the first month following such period.

(iii) If any change in the stockholdings of such corporation occurs during such periods or if a resolution or plan is adopted during such periods, a monthly information return must also be filed on the fifteenth day of the month following each month in which the change occurs or the resolution or plan is adopted.

(iv) In any case under this subparagraph, where the date for filing a monthly return coincides with the date for filing the return for a 6-month period, only the return for the 6-month period need be filed.

(b) Form of return. The return under section 333 (a) shall be on Form 537, copies of which, upon request, may be procured from any district director of internal revenue. Each officer or director of the corporation should carefully prepare his return so as to set 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 these 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 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 is incorporated;
(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 conversion privilege of, each series and class of 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 adopted by any amendment thereof or supplements thereto, or for or in respect of the dissolution of the corporation or the liquidation of the whole or any part of its capital stock;

(11) Such other information as may be required by the return form.

(d) Separate return for each corporation. If a person is required to file a return under section 333 (a) and this section with respect to more than one foreign corporation, a separate return must be filed with respect to each foreign corporation.

§ 39.333-2 Annual information returns by officers and directors of certain foreign personal holding companies; information returns for foreign corporations.—(a) Requirements for filing returns.—(1) General. Under section 333 (b), on the sixtieth day after the close of the taxable year of a foreign personal holding company each individual who on such sixtieth day is an officer or a director of the corporation shall file with the Commissioner a return setting forth:

(i) The name and address of the corporation;
(ii) The form, set forth with respect to the period, the rate of dividend on such stock and whether such dividend is cumulative or noncumulative;
(iii) Any change in the stock holdings during such period;
(iv) Any change in the stock holdings of such securities during the period;
(v) Any change in the stockholdings during the period;
(vi) Any change in the securities issued by the corporation;
(vii) Any change in the securities issued by the corporation;
(viii) Any change in the securities issued by the corporation;
(ix) Any change in the securities issued by the corporation;
(x) Any change in the securities issued by the corporation;
(xi) Any change in the securities issued by the corporation;
(xii) Any change in the securities issued by the corporation;
(xiii) Any change in the securities issued by the corporation;
(xiv) Any change in the securities issued by the corporation;
(xv) Any change in the securities issued by the corporation;
(xvi) Any change in the securities issued by the corporation;
(xvii) Any change in the securities issued by the corporation;
(xviii) Any change in the securities issued by the corporation;
(xix) Any change in the securities issued by the corporation;
(xx) Any change in the securities issued by the corporation;
(2) Returns jointly made. If two or more officers or directors of a foreign personal holding company are required to file information returns for any period under section 333 (b) and this section, any two or more of such officers or directors may, in lieu of filing separate returns for such period, jointly execute and file one return.

(b) Form of return. The return under section 333 (b) and this section shall be on Form 537, copies of which, upon request, may be procured from any district director of internal revenue. Each officer or director of the corporation should carefully prepare his return so as to set 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 taxable year of the foreign personal holding company the following information:

(1) The gross income, deductions and credits, net income, Supplement P net income, and undistributed Supplement P net income of the foreign personal holding company for each taxable year, in complete detail;
(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 calendar year the name and address of each shareholder, the amount and number of shares held by each, together with any changes in stockholdings during such period, and all other information with respect to the stock and securities of the corporation as required by the Internal Revenue Code.

(d) Verification of returns. Every return required by section 339 (a) and section 339 (b) shall be verified by a written declaration that it is made under the penalties of perjury.

§ 39.339–3 Time and place of filing returns. Returns required by section 339 (a) and 339 (b) shall be filed with the Commissioner of Internal Revenue at the Internal Revenue Service Center, Audit Division, for filing the returns required by section 339 (b) 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 the returns required by section 339 (b) are to be prepared, may be procured from any district director of internal revenue, and each such shareholder shall carefully prepare his return so as to set forth fully and clearly the information called for therein and by the applicable regulations. Returns which have not been so prepared may not be considered as meeting the requirements of the Internal Revenue Code.

(e) Verification of returns. Every return required by section 339 (a) and section 339 (b) shall be verified by a written declaration that it is made under the penalties of perjury.
the purposes of this chapter, the term "regulation" and approved
the securities of such issuer, as determined
Issuers which the taxpayer controls and
per centum of the outstanding voting se-
position of stock or securities held for less
income is derived from the sale or other dis-
sed
by
less
securities of such issuer, and (A) not more
value of the total assets
calculation limited in respect of any one issuer
other regulated investment companies, and
a management company or as a unit invest-
defined
as
"invest-
"reg-
for
not be
in
of
under
any
than
the
"controlled group," as
corporations connected through
voting power of all classes of stock entitled
to vote of each of its shareholders (except
the taxpayer) is owned directly by one or
more of the other corporations, and (ii) the
the sale or other disposition
of
the
sub-
(2) Less than
30.340 Statutory provisions; foreign
personal holding companies; penalties.
Sec. 340. Penalties. Any person required under
section 340(b) or regulations thereunder, to
supply any information, who willfully
fails to file such return, or supply such infor-
mation, at the time or times required
thereunder, shall be deemed to have
met such requirements at the close of
any quarter of any taxable year, inclusive
of such quarter more than 30 days after the
close of such quarter.
Supplement Q—Regulated Investment
Companies

39.361 Statutory provisions; definition
of regulated investment company.
Sec. 301. Definition—(a) In general. For
the purposes of this chapter, the term "regu-
lated investment company" means any dom-
estic corporation, or a foreign corporation
(except as an investment trust, or otherwise),
other than a personal holding company as
defined in section 501, which is organized
to engage in one or more of the following
activities:
(a) to acquire and own, for the purposes of
investment, securities of other individual
corporations, or of any one or more of
such corporations, or of two or more
corporations, of any one issuer, or of two
or more issuers of such corporations,
by
more
of
the
value
of
the
total
assets
are
represented by securities of
Issuers with respect to each of which the
investment company has not conti-
uously held for 10 or more years preceding
such quarter un-
twice
for
10
or
more
years
preceding
such
qua-
ter.

Sec. 301 as amended by sec. 170, we. Rev.
Act 1942; sec. 337, Rev. Act 1951.
39.361-1 Definition of a regulated
investment company.—(A) Limitations upon
source of income.—(1) and (2) provides that at least
90 percent of the corporation's gross
income for the taxable year must be derived from
dividends, interest, rent, or gains from the
sale or other disposition of stock or securities,
and less than 30 percent of the
corporation's gross income must have
been derived from the sale or other dis-
position of stocks or securities held for
less than three months. As to the
definition of the term "corporation," see
section 6125.
39.361-7 Definiton of regulated
investment companies.
of the corporation be represented by cash and cash items (including receivables) of the corporation, other securities of other regulated investment companies, and other securities.

For the purpose of this calculation, investments in securities other than Government securities or cash items (including receivables) of the corporation shall be limited in respect of any one issuer to an amount not greater than 5 percent of the value of the total assets of the corporation at the close of each quarter of the taxable year, and to the extent provided in section 361 (c) in the case of certain venture capital registered management investment companies, to not more than 10 percent of the outstanding voting securities of such issuer. Assuming that at least 50 percent of the value of the total assets of the corporation satisfies these requirements, and that the limiting provisions of clause (B) are not violated, the corporation will satisfy the requirements of section 361 (b) (3) notwithstanding that the remaining assets do not satisfy the diversification requirements of clause (A).

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 the securities of Government securities, 20 percent in the securities of regulated investment companies as defined in section 361 (b) (1), 15 percent in the securities of Corporation A, 15 percent in Corporation B, 20 percent in Corporation C, and the balance, 20 percent, in the securities of various other companies, comprising 8 percent of its assets in any one company. Investment Company W owns 16 percent of the outstanding voting stock of Corporation A 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 is a member of a controlled group. Investment Company W meets the requirements of clause (A) at the end of its first quarter under section 361 (b) (3). It complies with clause (A) since it has 55 percent of its assets invested as provided in clause (A) (1), 10 percent more than is required by clause (B) since it does not have more than 25 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 Y at the close of the taxable year has its assets invested as follows: 10 percent in cash, 35 percent in Government securities, 7 percent in the securities of Corporation A, 12 percent in Corporation B, 16 percent in Corporation C, and 21 percent in Corporation D. Investment Company Y fails to meet the requirements of clause (A) of section 361 (b) (3) since its assets invested in Corporations A, B, C, and D exceed 50 percent of the value of its assets invested in the total assets of the company at the close of the particular quarter.

Example (3). Investment Company X at the close of the particular quarter of the taxable year has its assets invested as follows: 50 percent in cash and Government securities, 5 percent in Corporations A, 10 percent in Corporation B, 22 percent in Corporation C, and the other 40 percent in the securities of various other companies, not exceeding 5 percent in any one issuer. Investment Company X owns less than 10 percent of the outstanding voting stock of any one of the corporations, except it owns more than 20 percent of the outstanding voting stock of Corporations C and D.

(2) Venture capital registered management investment companies.

(i) Section 361 (c) provides that under certain conditions set forth below a registered management investment company which has been certified by the Securities and Exchange Commission for the taxable year in question, in the computation of 50 percent of the value of its assets under clause (b) of section 361 of the Code in any quarter of such taxable year, including with respect to securities other than Government securities or securities of other regulated investment companies, the value of any securities of an issuer, notwithstanding the fact that such registered management investment company holds more than 10 percent of the outstanding voting securities of such issuer, if the Corporation in question is the holder of record of the voting stock of such issuer and the corporation has not continuously held any security of such issuer or any of its subsidiaries of such issuer for 10 or more years preceding such quarter of such taxable year.

(2) Venture capital registered management investment companies.

(i) Section 361 (c) provides that under certain conditions set forth below a registered management investment company which has been certified by the Securities and Exchange Commission for the taxable year in question, in the computation of 50 percent of the value of its assets under clause (b) of section 361 of the Code in any quarter of such taxable year, including with respect to securities other than Government securities or securities of other regulated investment companies, the value of any securities of an issuer, notwithstanding the fact that such registered management investment company holds more than 10 percent of the outstanding voting securities of such issuer, if the Corporation in question is the holder of record of the voting stock of such issuer and the corporation has not continuously held any security of such issuer or any of its subsidiaries of such issuer for 10 or more years preceding such quarter of such taxable year. All other provisions and requirements of section 361 and the
be considered to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products, not previously generally available.

For the purpose of the aforementioned determination and certification, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the date of the first acquisition of any security in such corporation by any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and the investment company shall be considered at any time to be furnishing capital to any company whose securities it holds if it has acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or its predecessor.

Section 361 (c) does not apply in the quarterly computation of 50 percent of the value of the assets of an investment company under clauses (A) of section 361 (b) (3) for any taxable year if a corporation (a) was or (b) was for 30 or more years preceding such quarter, unless the value of its total assets so computed is reduced to 25 percent or less within 30 days after the close of such quarter.

As used in section 361 (c) and this subparagraph, the term "predecessor company" means any corporation the securities of whose securities in the hands of the registered owner of such stock are held by the registered owner prior to the provisions of section 113, the same in whole or in part as the basis of any of the securities of the issuer and any corporation with respect to whose securities any of the securities of the issuer were received directly or indirectly by the investment company in a transaction or series of transactions involving nonrecognition of gain or loss in whole or in part.

subsection (a) of this subparagraph have the same meaning as when used in section 361 (b) (3).

(4) In the case of taxable years beginning after December 31, 1950, there shall be levied, collected, and paid for each taxable year upon its Supplement Q net income a tax equal to 25 per centum of the amount thereof.

In the case of taxable years beginning after March 31, 1951, and before April 1, 1951, there shall be levied, collected, and paid for each taxable year upon its Supplement Q net income a tax equal to 25 per centum of the amount thereof.

(4) In the case of taxable years beginning after December 31, 1950, there shall be levied, collected, and paid for each taxable year upon its Supplement Q net income a tax equal to 22 per centum of the amount thereof.

(5) No 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.

§ 39.362 Statutory provisions; tax on regulated investment companies.

Sec. 362. Tax on regulated investment companies for the purpose of this subdivision. The earnings and profits of a regulated investment company for any taxable year beginning after December 31, 1949 (or, in the case of an accumulated earnings and profits carried over to a taxable year of the company for any taxable year beginning after December 31, 1949) shall not be reduced by any amount which is not allowable as a deduction in computing its net income for such taxable year.

(b) Method of taxation of companies and shareholders. In the case of a regulated investment company described in section 361 (b) (3), the excess of the net long-term capital gain over the net short-term capital loss of the company for any taxable year beginning after December 31, 1949 shall be allocated to its shareholders as a capital gain dividend.

(7) Capital gain dividends may be treated as dividends which are actually paid or distributable at any time prior to the expiration of 365 days after the close of its taxable year.

(8) For purposes of this subsection, any dividend or portion thereof which is designated by the company as a capital gain dividend shall be treated as paid, and the amount of such dividend as capital gain dividends, at the time the dividend is to be paid or distributed.

(9) The aggregate amount of dividends paid during the taxable year by such company to shareholders is capital gain dividends paid during the year.

(10) No 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.

§ 39.362-1 Earnings and profits of a regulated investment company.

In the determination of the earnings and profits of a regulated investment company, the earnings and profits shall not be reduced by any amount which is not allowable as a deduction in computing its net income for any taxable year.

§ 39.362-2
§ 39.362-2 Method of taxation of regulated investment companies. (a) 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 net long-term and net short-term capital gains and losses for such year (as defined in section 39.362-3 (relating to records required to be kept for the purpose of ascertaining the actual ownership of its outstanding stock) it is taxable as a regulated investment company in the taxable year in which the distribution is made and subject to the provisions of sections 39.362-3 and 39.362-7 with respect to the concept of earnings and profits for purposes of section 39.362-3 (relating to records required to be kept for the purpose of ascertaining the actual ownership of its outstanding stock). For the purpose of the earnings-and-profits concept, it is immaterial whether during the taxable year a regulated investment company is taxable under Subchapter M of chapter 1 of subchapter A of title 26 of the United States Code.

(b) If a regulated investment company does not distribute in a particular year dividends, other than capital gain dividends, to its shareholders as defined in section 39.362-3 (relating to records required to be kept for the purpose of ascertaining the actual ownership of its outstanding stock), it is taxable in the taxable year in which it otherwise satisfies the requirements of section 39.362-3 (relating to records required to be kept for the purpose of ascertaining the actual ownership of its outstanding stock) and in the taxable year in which it does distribute such dividends.

(c) Due to the provision in section 362 (a) with respect to the concept of earnings and profits for a regulated investment company, even though such a company has no accumulated 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 Subchapter M of chapter 1 of subchapter A of title 26 of the United States Code.

§ 39.362-3 Records to be kept for purpose of determining whether a corporation claiming to be a regulated investment company is a personal holding company. Every regulated investment company shall maintain in the internal revenue district in which it is required to make return of income a complete record of all transactions which affect the net income, and thus not be liable for any income tax for the taxable year provided it otherwise satisfies the requirements of Supplement Q.

(f) The terms "Supplement Q net income," "Supplement Q surtax net income," and "capital gain dividend" are defined in section 362 (b) (1), (2) and (7) respectively.

§ 39.362-3 Records to be kept for purpose of determining whether a corporation claiming to be a regulated investment company is a personal holding company. Every regulated investment company shall maintain in the internal revenue district in which it is required to make return of income a complete record of all transactions which affect the net income, and thus not be liable for any income tax for the taxable year provided it otherwise satisfies the requirements of Supplement Q.

(f) The terms "Supplement Q net income," "Supplement Q surtax net income," and "capital gain dividend" are defined in section 362 (b) (1), (2) and (7) respectively.

§ 39.362-4 Additional information required in return of shareholders. (a) Any person who fails or refuses to comply with the demand of a regulated investment company for the written statements which § 39.362-3 requires the company to demand from its shareholders as a part of his income tax return a statement showing, to the best of his knowledge and belief—

(1) The number of shares actually owned by him at any and all times during the period for which the return is filed in any company claiming to be a regulated investment company;

(2) The dates of acquisition of any such stock during such period and the names and addresses of persons from whom it was acquired;

(3) The dates of disposition of any such stock during such period and the names and addresses of the transferees thereof;

(4) The names and addresses of the members of his family (as defined in section 39.362-3 (a) (2)), the names and addresses of his partners, if any, in any partnership; and the maximum number of shares, if any, actually owned by each in any corporation claiming to be a regulated investment company at any time during the last half of the taxable year of such company;

(5) The names and addresses of any corporation, partnership, trust, or estate in which he has a beneficial interest to the extent of at least 10 percent at any time during the period for which such return is made, and the number of shares of such corporation claiming to be a regulated investment company actually owned by each;

(b) The maximum number of shares (including the number and face value of securities convertible into stock of the corporation) in any domestic corporation claiming to be a regulated investment company to be considered as constructively owned by such transferees at any time during the last half of the corporation's taxable year, as provided in section 39.362-3 (a) (2) (vii), inclusive, and § 39.362-3 (a) (2) (vii), and the amount and date of receipt of each dividend received during such period from every corporation claiming to be a regulated investment company.

§ 39.362-2 RULES AND REGULATIONS
(c) Nothing in this section or § 39.362-3 shall be construed to relieve regulated investment companies or their shareholders from the duty of filing information returns required by the provisions-prescribed under sections 147 and 148.

§ 39.362-5 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 362 (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 1222 (b) for the taxable year, and prior to the close of such taxable year, the portion of each distribution which shall be treated as a capital gain dividend is defined in section 1222 (b). The election shall be made by the taxpayer by treating the dividend (or portion thereof) to which such election applies as paid during the taxable year in computing the Fictitious Q net income and its Supplement Q net income, or if the dividend (or portion thereof) to which such election applies 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 treated as a capital gain dividend shall be only that proportion of the amount so designated which exceeds the excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated.

Example: (1) X Company, a regulated investment company, had a net income (and earnings or profits for the calendar year 1952) of $100,000, and paid a total dividend of $200,000 (and earnings or profits of $100,000). On January 1, 1952, the company had a net capital gain of $155,000. On March 31, 1953, the company declared a dividend of $200,000 payable to shareholders on May 15, 1953, of $65,000 payable to shareholders on March 31, 1953, as a dividend paid by it during the taxable year 1952. On March 31, 1953, X Company distributes the entire amount of the dividend. On April 15, 1953, X Company files its Federal income tax return for the taxable year 1952. During the year 1952 the company distributed to shareholders taxable dividends aggregating $155,000.

On March 6, 1953, the company declared a dividend of $65,000 payable to shareholders on March 31, 1953. On March 18, 1953, X Company files its Federal income tax return in which it includes $10,000 of the total dividend of $65,000 to be paid to shareholders on March 31, 1953, as a dividend paid by it during the taxable year 1953. On March 31, 1953, X Company distributes the entire amount of the dividend. On April 15, 1953, the election under section 362 (b) (8) is valid only to the extent of $15,000, being $5,000 out of earnings and profits for 1953, and the remainder ($60,000) as a distribution out of the earnings and profits of the company for the taxable year 1953. The distribution of $65,000 on October 31, 1953, $37,000, out of earnings and profits for the year 1953. Assuming that the only other distribution by the company during 1953 is a distribution of $675,000 paid as a dividend on October 31, 1953, the total amount of the dividend declared during the calendar year 1953, is to be treated as taxable dividends to the shareholders. Of this $675,000 $28,000 was distributed out of the earnings or profits of the company for the taxable year 1952, and the remaining $647,000 as a distribution out of the earnings and profits for the year 1953. The distribution of $65,000 on October 31, 1953, is, of course, a taxable dividend out of the earnings and profits for the year 1953.

(d) A dividend (or portion thereof) with respect to which an election has been made under section 362 (b) (8) and which the company desires to designate as a capital gain dividend need not be so designated with respect to the portion of each distribution which is actually made to shareholders in the taxable year in which the election is made. Such designated capital gain dividends are to be aggregated with the designated capital gain dividends actually paid during such taxable year (not including such dividends with respect to which a prior election has been made under section 362 (b) (8) for the purposes of section 362 (b) as having been paid during the taxable year 1952.

§ 39.362-6 Distribution of dividends after close of taxable year. Section 362 (b) (8) provides that:

(1) In determining under section 362 (b) (8) whether 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 net long-term and net short-term capital gains.

(2) In computing the Supplement Q net income and the Supplement Q net income, and

(3) In determining the amount of capital gain dividends paid during the taxable year, thereof will be treated for the purposes of section 362 (b) as having been paid during the taxable year 1952. Such dividend (or part thereof) will be treated as a dividend paid during the taxable year 1952, and will be treated as a taxable dividend to shareholders for the taxable year in which such distribution is received by them.

Example: (1) X Company, a regulated investment company, had a net income (and earnings or profits for the calendar year 1952) of $100,000, and paid a total dividend of $200,000 (and earnings or profits of $100,000). On January 1, 1952, the company had a net capital gain of $155,000. On March 31, 1953, the company declared a dividend of $200,000 payable to shareholders on May 15, 1953, of $65,000 payable to shareholders on March 31, 1953, as a dividend paid by it during the taxable year 1952. On March 31, 1953, X Company distributes the entire amount of the dividend. On April 15, 1953, the election under section 362 (b) (8) is valid only to the extent of $15,000, being $5,000 out of earnings and profits for 1953, and the remainder ($60,000) as a distribution out of the earnings and profits of the company for the taxable year 1953. The distribution of $65,000 on October 31, 1953, $37,000, out of earnings and profits for the year 1953. Assuming that the only other distribution by the company during 1953 is a distribution of $675,000 paid as a dividend on October 31, 1953, the total amount of the dividend declared during the calendar year 1953, is to be treated as taxable dividends to the shareholders. Of this $675,000 $28,000 was distributed out of the earnings or profits of the company for the taxable year 1952, and the remaining $647,000 as a distribution out of the earnings and profits for the year 1953. The distribution of $65,000 on October 31, 1953, is, of course, a taxable dividend out of the earnings and profits for the year 1953.
SUPPLEMENT R—EXCHANGES AND DISTRIBUTIONS IN OBLIGE NCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

§ 39.371 Statutory provisions; exchanges and distributions in obedience to orders of the Securities and Exchange Commission, recognition of gain or loss.

Sec. 371. Nonrecognition of gain or loss—

(a) Exchanges of stock or securities only. No gain or loss shall be recognized by a transferor if stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are transferred in cancellation or redemption of stock or securities in the corporation of which the transferor is a member. If any corporation which is a member is a member of the holding company system of which the transferor corporation is necessary or appropriate to the purposes of such system, the gain, if any, to the recipient shall not be recognized.

(b) Exchanges and sales of property by corporations. No gain shall be recognized by a transferor corporation which is a registered holding company or a majority-owned subsidiary company to another corporation which is a member of the same system group in exchange for other property, and the exchange is made by the transferor corporation in obedience to an order of the Securities and Exchange Commission.

(c) Distribution of stock 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 majority-owned subsidiary company, stock or securities (other than stock or securities which are nonexempt property), without the surrender by such shareholder of stock or securities in such corporation, no gain, if any, to the recipient of the stock or securities so distributed shall be recognized.

(d) Transfers within system groups. (1) No gain or loss shall be recognized by a corporation which is a member of a system group (A) if such corporation transfers property to another corporation which is a member of the same system group in exchange for other property, and the exchange by such corporation is made in obedience to an order of the Securities and Exchange Commission, or (B) if there is distributed to a shareholder in such corporation, a share of stock in a corporation which is a member of the same system group, property, without the surrender by such shareholder of stock or securities in such corporation making the distribution, and the distribution is made in obedience to an order of the Securities and Exchange Commission. If an exchange or distribution to a corporation which is a member of the system group is in excess of the fair market value of such stock or securities, no gain shall be recognized, under any of the provisions of this paragraph, if any, to the recipient shall not be recognized.

(e) Exchanges not solely in kind. (1) If an exchange is within the provisions of paragraph (d) of this subsection consists in whole or in part in the retirement or cancellation of securities representing in excess of his ratable share of the corporation. If any corporation which is a member is a member of the holding company system of which the transferor corporation is necessary or appropriate to the purposes of such system, the gain, if any, to the recipient shall not be recognized.

(f) Non-application of other provisions. If an exchange or distribution made in obedience to an order of the Securities and Exchange Commission is 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 the provisions of paragraph (d) of subsection (b)), then the provisions of this section only shall apply.

(g) Termination of requirement. If any corporation which is a member is a member of the holding company system of which the transferor corporation is necessary or appropriate to the purposes of such system, the gain, if any, to the recipient shall not be recognized.

§ 39.371-1 Terms used. The following terms, when used in this section and §§ 39.371-2 to 39.371-1, inclusive, shall have the meanings assigned to them in section 379: "Order of the Securities and Exchange Commission"; "holding company"; "holding-company system"; "associate company"; "majority-owned subsidiary company"; "sys-

§ 39.371-2 Purpose and scope of exception. (a) The general rule is that the entire amount of gain or loss from the sale or exchange of property is to be recognized (see section 112 (o) ) and that the entire amount received as a dividend is to be included in gross income (see sections 23 (a) and 115) Exceptions to the general rule are provided in section 112 (b) (8) with respect to exchanges, sales, and distributions specifically described in section 371. Section 371 provides that the extent to which gain or loss is not to be recognized on an exchange or sale, or the receipt of a distribution, made in obedience to an order of the Securities and Exchange Commission, which is issued to establish the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79k (b) ) Section 115 (o) provides that a distribution in liquidation of a corporation shall be treated as a dividend to each distributee such an amount of the gain recognized under such paragraph (1) as is not in excess of the distributee's pro-rata share of the distributed earnings and profits of the corporation accumulated after February 28, 1935. The remainder, if any, of the gain recognized under such paragraph (1) shall be taxed as a gain from the exchange of property.

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as an exchange, and such a distribution is to be so treated under the provisions of Supplement R (sections 371 to 373, inclusive). 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 of a geographical integration into a particular public utility holding-company system. For specific requirements with respect to an order of the Securities and Exchange Commission, see section 371 (d).

(b) The requirements for nonrecognition of gain or loss as provided in section 371 are precisely stated with respect to the following four general types of transactions:

1. The exchange that is provided for in section 371 (a) in which stock or securities in a registered holding company or a majority-owned subsidiary company are exchanged for stock or securities.

2. The exchange that is provided for in section 371 (b) in which a registered holding company or a majority-owned subsidiary company exchanges property for property.

3. The distribution that is provided for in section 371 (c) in which stock or securities are distributed to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company.

4. The provisions of nonrecognition for transfers within 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 described in section 371 (a) are prescribed in section 371 (e).

(c) These exceptions to the general rule are to be strictly construed as in the case of the other exceptions in section 112. Unless both the purpose and the specific requirements of Supplement R (sections 371 to 373, inclusive) are clearly met, the case of gain or loss resulting from the exchange, sale, or distribution will not be postponed under Supplement R. Moreover, even though a taxable transaction occurs in connection or simultaneous with a realization of gain or loss to which nonrecognition is accorded, nevertheless, as under the various provisions of section 112, nonrecognition will not be accorded to such taxable transaction. In other words, the provisions of section 371 do not extend in any case to gain 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, in an exchange, sale, or distribution specifically described in section 371.

(d) 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 described 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 these results. Although the time of recognition may be postponed or the reduction in basis may be affected, the tax is collectible at the time of recognition of the gain or loss, as defined in section 372 (b), but only if all of the following requirements are satisfied:

1. The transferor corporation is, under the definition in section 373 (b) a registered holding company or an associate company of a registered holding company.

2. The transfer is in accordance with orders of the Securities and Exchange Commission (as defined in section 373 (a)) the order of which satisfies the requirements of section 371 (f).

3. The transferor corporation has filed the required consent to the regulations under section 372 (a) (2) (see paragraph (g) of this section) and

4. The entire amount of the gain, as determined under paragraph (d), can be applied in reduction of basis under section 372 (a) (2).

(b) Nonrecognition of gain; no nonexempt proceeds. No gain is recognized to the transferor corporation. The transferor corporation is, under the definition in section 373 (b) a registered holding company or an associate company of a registered holding company. Such transfer is in accordance with orders of the Securities and Exchange Commission (as defined in section 373 (a)) and such order satisfies the requirements of section 371 (f).

(c) The transferor corporation has filed the required consent to the regulations under section 372 (a) (2) (2) (see paragraph (g) of this section) and

(d) The entire amount of the gain, as determined under paragraph (d), can be applied in reduction of basis under section 372 (a) (2).

(e) Nonrecognition of gain; nonexempt proceeds. If the transaction would be within the provisions of paragraph (b) of this section if it were not for the fact that the property received in exchange consists in whole or in part of nonexempt property, as defined in section 373 (e) then no gain is recognized if such nonexempt property, or an amount equal to the fair market value of such nonexempt property at the time of the transfer.

1. It is within the required 24-month period for property other than nonexempt property or

2. It is invested within the required 24-month period as a contribution to the capital, or as paid-in surplus, of another corporation.

but only if the expenditure or investment is made in accordance with an order of the Securities and Exchange Commission (as defined in section 373 (a)) which satisfies the requirements of section 371 (f) and which requires that such expenditure or investment 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; and

4. The required consent, waiver, and bond have been executed and filed. See paragraphs (g) and (h) of this section.

(d) Recognition of gain in part; insufficient expenditure or investment in case of nonexempt proceeds. If the transaction would be within the provisions of paragraph (e) of this section if it were not for the fact that the amount expended or invested is less than the fair market value of the nonexempt property transferred, or if the exchange of the gain, if any, is recognized, but in an amount not in excess of the amount by which the fair market value of such nonexempt property at the time of the transfer exceeds the amount so expended and invested.
(c) Items treated as expenditures for the purpose of paragraphs (c) and (d) of this section. For the purposes of paragraphs (c) and (d) of this section, the following are treated as expenditures for property other than nonexempt property:

(1) A distribution in cancellation or redemption (except a distribution having the effect of a dividend) of the whole or a part of the transferor's own stock (not acquired on the transfer)

(2) A payment in complete or partial retirement or cancellation of securities representing indebtedness of the transferor or a complete or partial retirement or cancellation of such securities which is a part of the consideration for the transfer; and

(3) If, on the transfer, a liability of the transferor is assumed, or property of the transferor is transferred subject to a liability, the amount of such liability.

(f) In recognition of gain or loss, respectively, within the provisions of paragraph (c) (2), the amount not in excess of the amount which would be payable if the corporation did not make the required expenditure or investment within the required 24-month period.

§ 39.371-5 Distribution solely of stock or securities. If, without any surrender of his stock or securities as defined in section 372 (f) shareholders of a corporation which is a registered holding company or a majority-owned subsidiary company receive stocks or securities in such corporation or acquired by 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 if the distribution is made without the recognition of any gain or loss realized from the discharge of indebtedness of a member of a system group as the result of the acquisition in exchange, sale, or distribution of its own bonds, notes, or other evidences of indebtedness which were acquired by another member of the same system group for a consideration less or more than the issuing price thereof (with proper adjustments for amortization of premiums or discounts).

(d) The provisions of paragraph (d) of this section may be illustrated by the following example:

Example. Suppose that the A Corporation and the B Corporation are both members of the same system group; that the A Corporation holds at a cost of $200 a bond issued by the B Corporation at par, $1,000; and that the A Corporation and the B Corporation entered into an exchange subject to the provisions of section 371 (d) (1) in which the $1,000 bond of the B Corporation is transferred from the A Corporation to the B Corporation. The $800 basis of the cost to the A Corporation which would have been the basis available to the B Corporation if the property transferred to it had been something other than its own securities (see §39.372-6) will, in this type of transaction, deduct the cost to the B Corporation of effecting a retirement of its own $1,000 bond. The 6100 gain of the B Corporation, reflected in the retirement will therefore be recognized.

(e) No exchange or distribution may be made without the recognition of gain or loss as provided for in section 371 (d) (1) unless all the corporations which are parties to such exchange or distribution are acting in obedience to an order of the Securities and Exchange Commission. If an exchange or distribution is within the provisions of section 371 (d) (1) and also may be considered to be within some other provisions of section 371, it shall be considered that only the provisions of section 371 (d) (1) apply and that the nonrecognition of gain or loss upon such exchange or distribution is by virtue of that section.

§ 39.371-7 Sale of stock or securities received upon exchange by members of system group. (a) Section 371 (d) (2) provides that to the extent that a corporation received upon an exchange by corporations which are members of the same system group consists of stock or securities issued by the corporation from which property or stock or securities may, under certain specifically described circumstances, be sold to a party not a member of the system group, without the requirement of a sale or exchange of the property or stock, or securities.
The nonrecognition of gain or loss is limited, in the case of stock which is preferred as to both dividends and assets. The stock or securities must have been received upon an exchange with respect to which section 371(d)(1) operated to prevent recognition of gain or loss upon any party to the exchange. Nonrecognition of gain or loss upon the sale of such stock or securities is permitted only if the proceeds derived from the sale are applied in retirement of any of the stocks or securities of the selling corporation which were outstanding at the time the exchange was made. It is also essential to nonrecognition of gain or loss upon the sale that both the sale of the stock or securities and the application of the proceeds derived therefrom be made in accordance to an order of the Securities and Exchange Commission. If any part of the proceeds derived from the sale is not applied in making the required retirement or cancellation of stock or securities and if the amount of such proceeds, otherwise than pursuant to the provisions of section 371(d)(2), the gain resulting from the sale shall be recognized, but in an amount not in excess of the proceeds which are not so applied. In any event, the amount of such proceeds, otherwise than pursuant to the provisions of section 371(d)(2), the gain resulting from the sale shall be recognized, but in an amount not in excess of the proceeds which are not so applied. 

§ 39.371-8 Exchanges in which money or other nonexempt property is received.

(a) Under section 371(e)(1), if in any exchange in which section 371(d)(1) and (2) are otherwise satisfied, a corporation receives money or other nonexempt property, the fair market value of such property is deemed to be recognized, regardless of what was done with the proceeds.

(b) The amount not in excess of the proceeds which were outstanding at the time the exchange was made, which were applied in retirement of the stock or securities of the corporation which is a registered holding company or a majority-owned subsidiary are exempt from stock or securities as provided for in section 371(a) which is received by the taxpayer money or other nonexempt property, in addition to property permitted to be received without recognition of gain.

(1) The gain, if any, to the taxpayer, is to be recognized in an amount not in excess of the sum of the money and the fair market value of the other nonexempt property, but

(2) The loss, if any, to the taxpayer, from such an exchange is not to be recognized to any extent.

(c) If money or other nonexempt property is received from a corporation in an exchange described in paragraph (a) of 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(e)(2), there shall be taxed to each distributee his ratable share of such dividend, such an amount of the gain recognized on the exchange as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 23, 1913.

§ 39.371-9 Requirements with respect to order of Securities and Exchange Commission.

(a) The order of the Securities and Exchange Commission must recite that the exchange, expenditure, distribution, or sale is necessary or appears to be necessary to the public interest, including the public interest in an effective and nonrepetitive manner of the provisions of section 11(b) of the Public Utility Holding Company Act of 1935 (15 U. S. C. 796(b)).

(b) The order shall specify and itemize the stocks and securities and other property (including money) which are ordered to be acquired, transferred, received, or sold upon such exchange, acquisition, expenditure, distribution, or sale, and, in the case of such acquisition, the investment to be made, so as clearly to identify such property.

(c) The exchange, acquisition, expenditure, investment, distribution, or sale shall be made in obedience to such order and shall be completed within the time prescribed in such order.

These requirements were not designed merely to simplify the administration of the code of this section and they are not to be considered as pertaining only to administrative matters. Each one of these requirements is of the essence, and must be met if gain or loss is not to be recognized upon the transaction.

§ 39.371-10 Nonapplication of other provisions of the Internal Revenue Code.

(a) Section 371(g) of the Code is that an exchange, sale, or distribution which is within section 371 shall, with respect to the nonrecognition of gain or less and the determination of basis, be governed only by Supplement R (sections 371 to 372 inclusive) the purpose being to prevent overlapping of the provisions of such supplement and other provisions of the Internal Revenue Code. In other words, if by virtue of section 371 any portion of an exchange, sale, or distribution might have been under section 112 if Supplement R had not been enacted; and similarly, the basis in the hands of such person of the property received by him on such exchange shall be the basis provided by section 372, regardless of what the basis of such person might have been under section 112 if Supplement R had not been enacted. On the other hand, if section 371 does not provide for the nonrecognition of any portion of a person's gain or loss (whether or not such person is another party to the same transaction referred to above), then the gain or loss of such person shall be recognized or nonrecognized to the extent provided for by other provisions of the Code as if Supplement R had not been enacted. The name and address of the corporation from which the stock or securities were received in the exchange.

§ 39.371-11 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) upon an exchange, shall, if the exchange is made with a corporation acting in obedience to an order of the Securities and Exchange Commission, file as 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

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(INCLUDING MONEY) RECEIVED FROM THE EXCHANGE. THE AMOUNT OF EACH KIND OF STOCK OR SECURITIES AND OTHER PROPERTY RECEIVED SHALL BE SET FORTH ON 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 OBEYANCE 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 ENDING WITH THE YEAR IN WHICH THE EXCHANGE WAS MADE A COMPLETE STATEMENT OF THE COST OR OTHER DISPOSITION MADE OF SUCH STOCK OR SECURITIES AND OTHER PROPERTY ACQUIRED CONSEQUENT TO THE EXCHANGE.

(c) EACH SHAREHOLDER WHO RECEIVES STOCK OR SECURITIES OR OTHER PROPERTY (INCLUDING MONEY) UPON A DISTRIBUTION MADE BY A CORPORATION IN OBEYANCE TO AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION FOR THE PURPOSE OF DISPOSING OF ITS BUSINESS OR IN THE RETIREMENT OR CANCELLATION OF ITS STOCK OR SECURITIES SHALL FILE AS A PART OF HIS INCOME TAX RETURN FOR THE TAXABLE YEAR IN WHICH SUCH DISTRIBUTION WAS RECEIVED A COMPLETE STATEMENT OF ALL FACTS PERTINENT TO THE NONRECOGNITION OF GAIN UPON SUCH DISTRIBUTION, INCLUDING—

(1) THE NAME AND ADDRESS OF THE CORPORATION FROM WHICH THE DISTRIBUTION IS RECEIVED;

(2) A STATEMENT OF THE AMOUNT OF STOCK OR SECURITIES OR OTHER PROPERTY RECEIVED UPON THE DISTRIBUTION, INCLUDING (WHERE APPLICABLE) A STATEMENT OF ALL DISTRIBUTIONS MADE DURING THE TAXABLE YEAR IN WHICH THE DISTRIBUTION WAS RECEIVED;

(3) IF THE SHAREHOLDER IS A CORPORATION, A STATEMENT SHOWING AS TO EACH CLASS OF ITS STOCK THE NUMBER OF SHARES AND PERCENTAGE OWNED BY ANY PERSON OR CORPORATION, THE VOTING RIGHTS AND VOTING POWER, AND THE PREFERENCE (IF ANY) AS TO BOTH DIVIDENDS AND ASSETS;

(4) A STATEMENT SHOWING AS TO EACH CLASS OF ITS STOCK THE NUMBER OF SHARES AND PERCENTAGE OWNED BY ANY OTHER CORPORATION, THE VOTING RIGHTS AND VOTING POWER, AND THE PREFERENCE (IF ANY) AS TO BOTH DIVIDENDS AND ASSETS;


(6) A STATEMENT SHOWING AS TO EACH CLASS OF ITS Stock THE NUMBER OF SHARES AND PERCENTAGE OWNED BY ANY OTHER CORPORATION, THE VOTING RIGHTS AND VOTING POWER, AND THE PREFERENCE (IF ANY) AS TO BOTH DIVIDENDS AND ASSETS;

(7) THE TERM “EXCHANGE” SHALL, WHEREVER OCCURRING IN THIS PARAGRAPH, BE READ AS “EXCHANGE, EXPENDITURE, OR INVESTMENT.”

(c) EACH SHAREHOLDER WHO RECEIVES STOCK OR SECURITIES OR OTHER PROPERTY (INCLUDING MONEY) UPON A DISTRIBUTION MADE BY A CORPORATION IN OBEYANCE TO AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION SHALL FILE AS A PART OF HIS INCOME TAX RETURN FOR THE TAXABLE YEAR IN WHICH SUCH DISTRIBUTION WAS RECEIVED A COMPLETE STATEMENT OF ALL FACTS PERTINENT TO THE NONRECOGNITION OF GAIN UPON SUCH DISTRIBUTION, INCLUDING—

(1) THE NAME AND ADDRESS OF THE CORPORATION FROM WHICH THE DISTRIBUTION IS RECEIVED;

(2) A STATEMENT OF THE AMOUNT OF STOCK OR SECURITIES OR OTHER PROPERTY RECEIVED UPON THE DISTRIBUTION, INCLUDING (WHERE APPLICABLE) A STATEMENT OF ALL DISTRIBUTIONS MADE DURING THE TAXABLE YEAR IN WHICH THE DISTRIBUTION WAS RECEIVED;

(3) IF THE SHAREHOLDER IS A CORPORATION, A STATEMENT SHOWING AS TO EACH CLASS OF ITS STOCK THE NUMBER OF SHARES AND PERCENTAGE OWNED BY ANY PERSON OR CORPORATION, THE VOTING RIGHTS AND VOTING POWER, AND THE PREFERENCE (IF ANY) AS TO BOTH DIVIDENDS AND ASSETS;

(4) A STATEMENT SHOWING AS TO EACH CLASS OF ITS STOCK THE NUMBER OF SHARES AND PERCENTAGE OWNED BY ANY OTHER CORPORATION, THE VOTING RIGHTS AND VOTING POWER, AND THE PREFERENCE (IF ANY) AS TO BOTH DIVIDENDS AND ASSETS;


(6) A STATEMENT SHOWING AS TO EACH CLASS OF ITS Stock THE NUMBER OF SHARES AND PERCENTAGE OWNED BY ANY OTHER CORPORATION, THE VOTING RIGHTS AND VOTING POWER, AND THE PREFERENCE (IF ANY) AS TO BOTH DIVIDENDS AND ASSETS;

(7) THE TERM “EXCHANGE” SHALL, WHEREVER OCCURRING IN THIS PARAGRAPH, BE READ AS “EXCHANGE, EXPENDITURE, OR INVESTMENT.”

§ 39.372

Statutory provisions: basis of property acquired in exchange and distributions made in obedience to orders of the Securities and Exchange Commission.

B sec. 372a. Basis for determining gain or loss—(a) Exchanges generally—(1) Exchanges subject to the provisions of section 371(a), if the property was acquired upon an exchange subject to the provisions of section 371(a) or (b), the same as in the case of the property exchanged, increased in the amount of any money received by the taxpayer and decreased in the amount of gain or loss from a subsequent disposition of such stock or securities and other property received on the exchange or distribution, in both cases subject to the provisions of section 371(a) to be received without the recognition of gain or loss, and in part of nontaxable property, the basis prescribed in this section shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such nontaxable property (other than money) an amount equivalent to its fair market value at the time of the exchange.
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 the consideration in whole or in part for the transfer of the property to the transferor is a subsidiary; or (c) 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) prior to its amendment by the Revenue Act of 1942 and in a taxable year beginning before January 1, 1942, if no part of the gain or loss upon such exchange was recognized under such subsection.

§ 39.372-2 Basis for determining gain or loss. (a) Section 113 (a) (7) provides that if property is acquired in a taxable year beginning before January 1, 1942, in any manner other than subsection (a) of section 371, the basis acquired is the same as the basis of the property transferred by the transferor to the transferee but shall not apply to property acquired by a corporation as a result of its formation or liquidation or for stock or securities issued to its shareholders or for the acquisition of stock or securities issued to its shareholders, or in consideration for stock or securities issued by such corporation.

(b) If, in an exchange of stock or securities as described in section 371 (a) or in an exchange of property for property as described in section 371 (b) prior to its amendment by the Revenue Act of 1942 and in a taxable year beginning before January 1, 1942, the stock or securities were received in an amount which the transferor corporation was necessary or appropriate to the integration or simplification of the holding-company system of which the transferor corporation is a member, the basis of such stock or securities shall be the same as in the case of the property transferred by the transferor to the transferee but shall not apply to property acquired by a corporation as a result of its formation or liquidation or for stock or securities issued to its shareholders or in consideration for stock or securities issued by such corporation.

§ 39.372-3 Basis for determining gain or loss. (a) Section 113 (a) (7) provides that if property is acquired in a taxable year beginning before January 1, 1942, in any manner other than subsection (a) of section 371, the basis acquired is the same as the basis of the property transferred by the transferor to the transferee but shall not apply to property acquired by a corporation as a result of its formation or liquidation or for stock or securities issued to its shareholders or in consideration for stock or securities issued by such corporation.
an amount equivalent to its fair market value at the date of the exchange.

(c) Section 371 (e) provides that no loss may be recognized on an exchange of stock or securities for stock or securities as described in section 371 (a) or on an exchange of property for property as described in section 371 (b) prior to January 1, 1942.

(d) Section 372 (a) does not apply in ascertaining the basis of property acquired by the category of its stock or securities as the consideration in whole or in part for the transfer of the property to it. For the rule in such cases, see section 372 (b).

§ 39.372-3 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 regulations relating thereto, which are required to be made with respect to the cost or other basis of property section 372 (a) (2) provides that a further adjustment shall be made in any case in which there shall have been a nonrecognition 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 at the time of transfer immediately after the transfer and of the property acquired within 24 months after such transfer by an expenditure or investment to which section 371 (b) relates, and of which the property is in the hands of the transferor immediately after the transfer, the time of reduction is the day of the transfer, and in all other cases the time of reduction is the date of acquisition. The effect of applying an amount in reduction of basis upon any other disposition of such property shall be determined in a manner similar to that provided herein.

(b) General rule. (1) 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.

(2) The first category consists of all property of a character subject to the allowance for depreciation under section 23 (b) which is either in the hands of the transferor immediately after the transfer, or is acquired within 24 months after such transfer by an expenditure or investment not in consideration in whole or in part of gain, under section 371 (b) if any of the property in such category has a basis capable of reduction, the reduction must first be made before applying the 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.

(3) 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 that category. The reduced cost or other 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) at such time of each unit of property of the taxpayer in that category bears to the aggregate of the adjusted cost or other basis of all the property of the taxpayer in that category is equal to the amount of the decrease shall not be more than the amount of the adjusted cost or other basis of all the property of the taxpayer in that category.

(4) In applying the rule to each category of the transferor immediately after the transfer, the time of reduction is the day of the transfer, and in all other cases the time of reduction is the date of acquisition. The effect of applying an amount in reduction of basis of property under section 371 (b) (5) is to reduce by such amount the basis for determining gain upon sale or other disposition, the basis for determining loss upon sale or other disposition, the basis for depreciation and for determining gain, and for determining loss, and any other adjustment which the Internal Revenue Code prescribes shall be the same as any of such bases.

For the purposes of the application of this paragraph to property under section 371 (b) property is not considered as having a basis capable of reduction if

(1) It is money, or

(2) If its adjusted basis for determining gain at the time the reduction is to be made is zero, or becomes zero at any time in the application of section 371 (b).

§ 39.372-4 Basis of property acquired by corporation under section 371 (a), 371 (b) or 371 (e) as contribution of capital or surplus, or in consideration for its own stock or securities. If, in connection with an exchange of property 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 as described in section 371 (e) property is acquired by a corporation by the issuance of its stock or securities, the basis of such property shall be determined under section 371 (b) if the corporation issued its stock or securities as part or solely in consideration for the property acquired, the basis of the property in the hands of the acquiring corporation is the basis of the property in the hands of the transferor, or is acquired within 24 months of the transfer, or is acquired by reason of gain not recognized by reason of gain not recognized, and the Commissioner, then the consent filed on Form 982A shall (except as otherwise provided in this subparagraph) be deemed to be a consent to the application of such general rule, and such general rule shall apply in the determination of the basis of the taxpayer's property. If, however, the taxpayer specifically states on such form that it does not consent to the application of the general rule, then, in the absence of a closing agreement, the document filed shall not be deemed a consent within the meaning of the last sentence of section 371 (b).

§ 39.372-5 Basis of stock or securities acquired by shareholder upon tax-free distribution under section 371 (a)

(a) Under section 372 (a) if there was distributed 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 property) and if by virtue of section 371 (c) no gain was recognized by the shareholder upon such distribution, then the basis of the stock in respect of which the distribution was made must be appor tioned between such stock and the stock or securities so distributed to the shareholder.

(b) The basis of the old shares and the stock or securities received upon the distribution shall be determined in accordance with the provisions of section 371 (a) (1) 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 stock in respect of which the distribution is made, the stock or other basis of such stock in the hands of the transferor or a cancellation or a subdivision thereof (including those issued, \hfill\text{etc.}\)
§ 39.373-1 Definitions—(a) Order of the Securities and Exchange Commission. (1) An order of the Securities and Exchange Commission as defined in section 373 (a) must be issued after May
32, 1953 (the date of the enactment of the Radio Act of 1927) and must be issued under the authority of section 11 (b) or 11 (e) of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79b (b)). In determining the implications of section 11 (b) of such Act in all cases the order must become or have become final in accordance with law.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1939:
(1) To require by order, after notice and opportunity for hearing, that each registered holding company and each subsidiary thereof, shall take such action as the Commission shall find necessary to limit the operations of such holding company and subsidiary company so that which such company is a part of, a single integrated public-utility system, and to such other extent as to the Commission, the assets so possessed, or as economically necessary or appropriate to the operations of such integrated public-utility systems. Moreover, the Commission shall permit a registered holding company to continue to control one or more additional public-utility systems, if, after notice and opportunity for hearing, it finds that—
(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;
(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country, and
(C) The continued combination of such systems under the control of such holding company (considering the state or part or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility system, or in a contiguous foreign country, and

(a) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of such holding company or holding company system with such holding company to take such action as the Commission shall find necessary in order that such holding company or such subsidiary company with respect to each of its subsidiaries companies which itself has a subsidiary company which is a part of a single integrated public-utility system. For the purpose of fairly and equitably distributing voting power among the security holders, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a subsidiary company of a holding company, or whose principal business is that of a public-utility company.

The Commission may by order revoke or to enjoin any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions 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 26.

(2) Section 11 (b) of the Public Utility Holding Company Act of 1935 provides:

To require a company which owns or operates facilities used for the generation, transmission, or distribution of electrical energy for sale, other than 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.

(2) 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 (15 U. S. C. 79b (a)) (9) to mean a company which owns or operates facilities used for the generation, transmission, or distribution of electrical energy for sale, other than 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.
directly or indirectly by such holding company and all mutual service companies of which it is a member, and (3) any other subsidiary company thereof is a member company. The term "mutual service company" means a company approved as a mutual service company under section 13 of the Public Utility Holding Company Act of 1935 (15 U. S. C. 78b) (the "member company") is defined by section 2 (a) (14) of such act (15 U. S. C. 78b (a) (14)) to be a company which is a member of an association or group of companies mutually served by a mutual service company.

(b) The term "subservient holding company or subsidiary company" means a company which must directly or indirectly own directly or indirectly at least 50 percent of the specified stock of such company, which is a majority-owned subsidiary company.

(c) "Majority-owned subsidiary company." The term "majority-owned subsidiary company" is defined in section 373 (d) (since a corporation, in order to be a member of a system group or a majority-owned holding company or a majority-owned subsidiary company.

(d) (1) 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 assumption of debts or other liabilities (including guarantees, extensions of credit or other obligations) subject to which the property was transferred and including the amount of any consideration in the form of evidences of indebtedness owned by the transferor. 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 $100,000, 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 assumes an indebtedness of $100,000 owed by the X Corporation to another company, the A Corporation; or

(iii) 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 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 corporation which is an instrumentality of a government or subdivision thereof).

(e) (1) Stock or securities which are acquired by each of the members of a system group which acquired such stock or securities after February 28, 1938, or 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 accordance with an order of the Securities and Exchange Commission (as defined in section 373 (a) ) or were acquired with the authorization or approval of the Securities and Exchange Commission under any section of the Public Utility Holding Company Act of 1938, and are not non-exempt property within the meaning of section 373 (a).

(2) The term "money, and the right to receive money not evidenced by a security other than a obligation described as non-exempt property in section 373 (e) (2) or (3)"

(3) The term "the right to receive money" includes, among other items, amounts recoverable under accounts, balances, credits, and accounts in respect of rents, damages, and rights to refunds of taxes.

(f) Stock or securities. The term stock or securities means defined in section 373 (f) for the purposes of sections 371 to 373, inclusive. As therein defined, the term includes including trust certificates and stock rights warrants.

**SUPPLEMENT S—TAX ON SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS**

§ 32.391 Statutory provisions; personal service corporations; applicability of Supplement S.

(d) Application of Supplement S. If a personal service corporation elects not to be subject to the excess profits tax for any taxable year, then Supplement S 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. For definition of a personal service corporation and for method of election, see section 449 and the regulations thereunder.

§ 32.392 Statutory provisions; personal service corporations; undistributed Supplement S net income.

(b) Undistributed Supplement S net income. 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 dividends paid during the taxable year. For the purposes of this section the amount of dividends paid shall be computed in the same manner as provided in subsections (d) (e) (f) (g), and (h) of section 27 for the purpose of the basic surtax credit provided in section 27.

§ 32.392-1 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.

§ 32.393 Statutory provisions; personal service corporations; supplement S net income.

(c) Supplement S net income. For the purposes of this chapter "Supplement S net income" means the net income, except that there shall be added as additional deductions—

(1) The Federal income tax payable under this chapter for the taxable year; and

(2) In lieu of the deduction allowed by section 23 (q), contributions or gifts, payment of which is made within the taxable year, to or for the use of persons described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 per cent of the corporation's total income, computed in the manner of this subsection and section 23 (q). For the purposes of this section, the net income shall be computed without regard to section 47 (e).

§ 32.393
§ 39.393-1 Supplement S net income.

(a) The term "Supplement S net income" means the net income as defined in section 21, but computed without the deduction allowed under section 23 (q) minus the sum of the following:

(1) The Federal income tax payable under chapter 1 for the taxable year; and

(2) The amount of contributions or gifts made to or for the use of donees described in section 23 (q) for the purpose thereof specified, to an amount which does not exceed 15 percent of the net income of the corporation computed without the benefit of sections 23 (q) and 23 (b).

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, as defined in section 21, is computed on the basis of the period of the taxable year, and is not placed on an annual basis under the provisions of section 47 (a).

(b) The deductions allowed under section 39.393 (b) are contributions or gifts made to or for the use of donees described in section 23 (q) and are in lieu of deductions otherwise allowable under section 23 (q) and are allowable only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records.

(c) The provisions of paragraphs (g) and (h) of § 39.23 (o)-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 amount and the approximate date of the actual payment of the contribution or gift, (2) the substantiation of the claims for deductions when required by law, (3) the basis for calculation of the amount of a contribution or gift which is other than money are equally applicable to claims for deduction of amounts of contributions or gifts by corporations under section 393.

(d) 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 1953 a net income, as computed under chapter 1, $100,000. The Federal income tax payable under chapter 1 for that year amounts to $93,300. Contributions or gifts payment of which is made during the taxable year to or for the use of donees described in section 23 (q) for the purposes therein specified amount to $85,000. The Supplement of the corporation is $76,700, computed as follows:

<table>
<thead>
<tr>
<th>Supplement S net income...</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Federal income tax on income...</td>
<td>$93,300</td>
</tr>
<tr>
<td>Contribution or gift...</td>
<td>$85,000</td>
</tr>
<tr>
<td>Net income computed without the benefit of any deduction for contributions...</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

§ 39.394-1 Taxability of shareholders.

If a personal service corporation is exempt from the excess profits tax imposed under subsection (f) for any taxable year by reason of an election under section 499, the undistributed Supplement S net income of the corporation shall be treated as a dividend received by those shareholders whose 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, and it shall be treated as a dividend at that time. Each such shareholder for his taxable year in which or with which the taxable year of the corporation ends, shall include in his gross income his proportionate share of such undistributed Supplement S net income as though such proportionate share had been received as a dividend on the last day of the taxable year of the corporation. Such amount is to be determined by reference to the interest of the shareholder in the corporation, that is, by reference to the number of shares of capital stock held by such shareholder and the related value of each such class of stock if there are several classes of stock outstanding. Thus, if a personal service corporation has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any other distribution may be made to the holders of the common stock, then the assumed distribution of the undistributed Supplement S net income must first be treated as a payment of the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

§ 39.394-2 Credit for interest on obligations of the United States and its instrumentalities.

Each shareholder of a personal service corporation who as of the last day of the taxable year of the corporation is required to include in his gross income his proportionate share of the undistributed Supplement S net income of the corporation for the purposes of the tax imposed by section 11 (normal tax on individuals), section 13 (normal tax on 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 marine) or section 365 (tax on regulated investment companies) shall be allowed a credit against net income as though such proportionate share had been included in the gross income of the shareholder as though such proportionate share had been included in the gross income of the corporation. Such amount is to be determined by reference to the interest of the shareholder in the corporation, that is, by reference to the number of shares of capital stock held by such shareholder and the related value of each class of stock if there are several classes of stock outstanding. Thus, if a personal service corporation has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any other distribution may be made to the holders of the common stock, then the assumed distribution of the undistributed Supplement S net income must first be treated as a payment of the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

§ 39.394-3 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, such undi-
determined and withheld by the corporation had its undistributed Supplement S net income actually paid in cash to its shareholders as a dividend on the last day of the taxable year.

Supplement T—Individuals with adjusted gross income of less than $2,000

§ 39.400 Statutory provisions; tax under Supplement T—imposition of tax.

<table>
<thead>
<tr>
<th>Adjusted gross income (Sec. 395)</th>
<th>And the number of exemptions (Sec. 395)</th>
<th>The tax shall be</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>At least 3</td>
<td></td>
</tr>
<tr>
<td>$500</td>
<td>100</td>
<td>$.75</td>
</tr>
<tr>
<td>$5,000</td>
<td>200</td>
<td>$17.50</td>
</tr>
<tr>
<td>$20,000</td>
<td>300</td>
<td>$75.00</td>
</tr>
</tbody>
</table>

Table II—Taxable years beginning after Oct. 31, 1950, and before Jan. 1, 1952

<table>
<thead>
<tr>
<th>Adjusted gross income (Sec. 395)</th>
<th>And the number of exemptions (Sec. 395)</th>
<th>The tax shall be</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>At least 5</td>
<td></td>
</tr>
<tr>
<td>$500</td>
<td>100</td>
<td>$.75</td>
</tr>
<tr>
<td>$5,000</td>
<td>200</td>
<td>$17.50</td>
</tr>
<tr>
<td>$20,000</td>
<td>300</td>
<td>$75.00</td>
</tr>
</tbody>
</table>

Table III—Taxable years beginning January 1, 1951, and ending December 31, 1951

<table>
<thead>
<tr>
<th>Adjusted gross income (Sec. 395)</th>
<th>And the number of exemptions (Sec. 395)</th>
<th>The tax shall be</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>At least 7</td>
<td></td>
</tr>
<tr>
<td>$500</td>
<td>100</td>
<td>$.75</td>
</tr>
<tr>
<td>$5,000</td>
<td>200</td>
<td>$17.50</td>
</tr>
<tr>
<td>$20,000</td>
<td>300</td>
<td>$75.00</td>
</tr>
</tbody>
</table>

§ 39.395—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 with respect to such proportionate part, be treated as a distribution actually made by the corporation and as a reinvestment in the corporation by the shareholder. It shall, however, be so treated only to the extent to which such amount included 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 made before the expiration of seven years after the date prescribed by law for the filing of his return.

§ 39.395—5 Statutory provisions; personal service corporations; nonresident alien individuals and foreign corporations; payment of shareholder's tax.

Sec. 395. Nonresident alien individuals and foreign corporations. In the case of a shareholder taxable under section 211 (a) or 321 (a), his distributive share of the undistributed Supplement S net income of the corporation required to be included in the gross income of the shareholder shall be considered as a dividend received by him from sources within the United States.

[Sec. 395 as added by sec. 602, Second Rev. Act 1940]

Sec. 395. Shareholder's tax paid by corporation. If a personal service corporation is exempt for any taxable year under section 449 from excess profits tax, it shall, at the time of filing its return, pay to the collector an amount equal to the amount that would be required by section 149 (b) or section 144 to be deducted and withheld by the corporation if any amount required by this Supplement to be included in the gross income of the shareholder had been, on the last day of the taxable year of the corporation, paid to the shareholder in cash as a dividend. Such amount shall be collected and paid 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 in the face of the return.

[Sec. 395, as added by sec. 602, Second Rev. Act 1940; amended by sec. 304 (f), Excess Profits Tax Act 1940]

§ 39.395—5 Tax of certain shareholders paid by the corporation. Since a shareholder's proportionate share of the undistributed Supplement S net income of a corporation electing not to be subject to the excess profits tax imposed under subchapter D of chapter 1, taxable to such shareholder, the corporation is required, at the time of filing its income tax return under chapter 1, to pay to the district director an amount equal to the amount that would be required by section 149 (b) or section 144 to be

§ 39.400
### Table III—Taxable Years Beginning After Dec. 31, 1932

<table>
<thead>
<tr>
<th>Adjusted Gross Income per Individual</th>
<th>And the Number of Exemptions</th>
<th>Adjusted Gross Income per Individual</th>
<th>And the Number of Exemptions</th>
<th>Adjusted Gross Income per Individual</th>
<th>And the Number of Exemptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>0</td>
<td>$5,000</td>
<td>0</td>
<td>$10,000</td>
<td>0</td>
</tr>
<tr>
<td>$5,000</td>
<td>0</td>
<td>$25,000</td>
<td>0</td>
<td>$50,000</td>
<td>0</td>
</tr>
<tr>
<td>$25,000</td>
<td>0</td>
<td>$100,000</td>
<td>0</td>
<td>$200,000</td>
<td>0</td>
</tr>
<tr>
<td>$100,000</td>
<td>0</td>
<td>$500,000</td>
<td>0</td>
<td>$1,000,000</td>
<td>0</td>
</tr>
<tr>
<td>$500,000</td>
<td>0</td>
<td>$2,500,000</td>
<td>0</td>
<td>$5,000,000</td>
<td>0</td>
</tr>
<tr>
<td>$2,500,000</td>
<td>0</td>
<td>$12,500,000</td>
<td>0</td>
<td>$50,000,000</td>
<td>0</td>
</tr>
<tr>
<td>$12,500,000</td>
<td>0</td>
<td>$62,500,000</td>
<td>0</td>
<td>$250,000,000</td>
<td>0</td>
</tr>
<tr>
<td>$62,500,000</td>
<td>0</td>
<td>$312,500,000</td>
<td>0</td>
<td>$1,250,000,000</td>
<td>0</td>
</tr>
</tbody>
</table>

**The Tax shall be—**

### RULES AND REGULATIONS

**§ 38.400–1 Scope and application of Supplement T**

(1) In lieu of the taxes imposed by sections 11 and 12, an individual may elect to pay the tax imposed by section 409 if his adjusted gross income is less than $8,000, regardless of the sources from which such income is derived and regardless of whether such income is computed on the cash basis or on the accrual basis.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

**Example.** A is employed at a salary of $5,000 for the calendar year 1932. In the course of his employment, he incurred travel expenses of $750 for which he was reimbursed during the year. Such items constitute his sole income for 1932. In such case the gross income is $5,750 but the amount of $750 is deducted from gross income in the determination of adjusted gross income and thus A's adjusted gross income for 1932 is $4,600. Hence, the adjusted gross income being less than $9,000, he may elect to pay his tax for 1932 under Supplement T.

**§ 38.400–1**
§ 39.401-1 Rules for application of tables in section 400. (a) The term "number of exemptions" means the number of exemptions allowed under section 25 (b) and subsections of sections 11 and 12. One exemption is allowed for the taxpayer; one exemption for his spouse if a joint return is made, or both. The tax is calculated by reference to the column of such table appropriate to such number of exemptions and, in certain cases, appropriate to the column of such table containing the tax if the taxpayer is single (and not married) or kind of return (whether single, head of household, and hence, with two exemptions, or married and files a separate return, the head of a household) or married and files a separate return, in the second of which is shown the tax if the taxpayer is a head of a household, and in the third of which is shown the tax if a joint return is filed. In the case of double or triple columns, the tax shall be determined by reference to the applicable column.

(b) The application of this section may be illustrated by the following examples:

Example (1). A, a married man whose duties as an employee require traveling away from his home, has as his sole gross income a salary of $5,450 for the calendar year 1952. His travel expenses, including costs of meals and lodgings away from his home, were $750, and hence, his adjusted gross income is $4,700. His wife, B, has as her sole income dividends of $800, and thus the aggregate adjusted gross income of A and B is $4,500. A has two dependent children neither of whom has any income. A and B file a joint return for 1952 on Form 1040, electing not to use the optional return Form 1040A. In such case four exemptions are allowable. The adjusted gross income falls within the tax bracket $4,000-$4,500. By referring to such tax bracket in Table II and to the column headed "A therein, the tax is found to be $155.

Example (2). C, a married man, has as his sole income wages of $5,500 in 1952 and has two dependent children, both of whom have income. His wife, D, has adjusted gross income of $600. C files a separate return for 1952 and is entitled to claim three exemptions. The tax, within the bracket $4,500-$5,000, and hence, with three exemptions his tax is $330. No exemption is allowed with respect to D since D has gross income and a joint return was not filed.

Example (3). D, a married man with no dependents, attains the age of 65 years on September 1, 1952. If the aggregate adjusted gross income of D and his wife for 1952 is less than $5,000, he is entitled to claim three exemptions, one for each taxpayer and one additional exemption for D because of his age. Since the adjusted gross income of D and his wife falls within the tax bracket $4,000-$4,500, the tax on a joint return is $365.

Sec. 403. Credits not allowed. For credits against tax and against net income not allowed, in the case of a taxpayer who elects to pay the tax imposed by this supplement, because of the fact that such election constitutes an election to take the standard deduction, see section 29 (aa) (4).

[Sec. 403 as added by sec. 102 (a), Rev. Act 1941; amended by sec. 9 (a), Individual Income Tax Act 1944]

§ 39.404. Certain taxpayers ineligible. This supplement shall not apply to a nonresident alien individual, to a citizen of the United States entitled to the benefits of section 251, to an estate or trust, or to an individual making a return for a period of less than twelve months on account of a change in the accounting period. For provisions making both husband and wife ineligible to elect to pay the tax imposed by this supplement if either does not elect to take the standard deduction, see section 29 (aa) (4).

[Sec. 404 as added by sec. 102 (a), Rev. Act 1941; amended by sec. 219 (c), Rev. Act 1942; sec. 102 (b), Rev. Act 1943; sec. 5 (a), Individual Income Tax Act 1944]

§ 39.404–1 Taxpayers to whom Supplement T is inapplicable.—(a) In general. The provisions of this supplement are inapplicable to a taxpayer if such taxpayer is ineligible to file a return and pay the tax under Supplement T:

(1) A nonresident alien individual;

(2) A citizen of the United States entitled to the benefits of section 251;

(3) An estate or trust;

(4) An individual who makes a return for a period of less than 12 months on account of a change in the accounting period;

(5) An individual for whom a return is required for a fractional part of a year under section 149 (a)

(b) Husband and wife. For provisions making both husband and wife ineligible to elect to pay the tax under Supplement T if either spouse does not elect to take the standard deduction, see section 29 (aa) (4)

SUPPLEMENT U—TAXATION OF BUSINESS INCOME OF CERTAIN SECTORS 101 ORGANIZATIONS


Sec. 421. Imposition of tax—(a) In general. There shall be levied, collected, and paid for each taxable year beginning after December 31, 1950:

(1) Upon the supplement U net income (as defined in subsection (c)) of every organization described in section 421 (b) (1), a normal tax of 25 percent of the supplement U net income, and a surtax of 22 percent of the supplement U net income in excess of $25,000, except that (A) in the case of taxable years beginning before April 1, 1954, and ending after March 31, 1954, the normal tax shall be 25 percent of the supplement U net income, and (B) in the case of taxable years beginning after March 31, 1954, the normal tax shall be 25 percent of the supplement U net income, and a surtax of 22 percent of the supplement U net income, and a surtax computed at the rate and in the manner provided in section 11 and a surtax computed at the rates and in the manner provided in section 12 (b). In making such computations for the purposes of this section, the term “the amount of the net income in excess of the credits against the net income provided in section 25” as used in section 11 shall be read as “the amount of the supplement U net income” and the term “the amount of the supplement U net income” as used in section 12 (b) shall be read as “supplement U net income” as used in section 11.

(2) Upon the supplement U net income of every trust described in subsection (b) (2), a normal tax computed at the rate and in the manner provided in section 11 and a surtax computed at the rates and in the manner provided in section 12 (b). In making such computations for the purposes of this section, the term “the amount of the net income in excess of the credits against the net income provided in section 25” as used in section 11 shall be read as “the amount of the supplement U net income” and the term “the amount of the supplement U net income” as used in section 12 (b) shall be read as “supplement U net income” as used in section 11.

(b) Organizations subject to tax—(1) Organizations taxable as corporations.—(A) Organizations exempt under section 101 (1), (6), (7) and (14). The taxes imposed by subsection (a) (1) in the case of any organization (other than a church, a convention or association of churches, or a trust described in paragraph (9)) which is exempt, except as provided in this supplement, from taxation under this chapter by reason of paragraph (1), (6), (7) or (14) of section 101. Such taxes shall also apply in the case of a corporation described in section 101 (14) if the income is payable to an organization which itself is subject to the tax imposed by subsection (a) (1) or to a convention or association of churches.

(B) Supplement U net income. The taxes imposed by subsection (a) (1) shall apply in the case of any college or university which is exempt, except as provided in this supplement, from taxation under this chapter by reason of paragraph (6) of section 101 and which, if it were not for such exemption, would be subject to the provisions of supplement E.

(c) Definition of Supplement U net income. The term “Supplement U net income” means the amount by which the unrelated business net income (as defined in section 491) exceeds the credits against tax and against net income not allowed, taxpayers ineligible.

(d) Foreign organizations. The Supplement U net income of an organization described in subsection (b) (1) or (2) which is a foreign organization is the amount of such income derived from sources within the United States that is subject to tax under section 421 (a) (1) in the case of a trust taxable under Supplement E or by reason of paragraph (6) or (7) of section 101. A corporation exempt from taxation under section 101 (14), holding property for an organization exempt from tax and organized or incorporated under the laws of one or more such colleges or universities, is also subject to the Supplement U tax under section 421 (a) (1).

(2) The taxes imposed by section 421 (a) (1) apply in the case of any corporation wholly owned by one or more such colleges or universities. As here used, the word “government” includes any foreign government (to the extent not contrary to any treaty obligation of the United States and all domestic governments (the United States and any of its Territories or possessions, any State, and the District of Columbia) Elementary and secondary schools operated by such governments are not subject to the Supplement U tax.
(3) Churches and associations or conventions of churches are exempt from the Supplement U tax. The exemption is applicable only to an organization which itself is a church or an association or convention of churches. Religious organizations, including religious orders, if not themselves churches or conventions of churches, and all other organizations which are organized or operated under church auspices, are subject to the Supplement U tax, whether or not they carry out a religious, educational, or charitable function approved by a church. For example, an incorporated university exempt from tax under section 101 (6) of the Internal Revenue Code, all deductions directly connected with such income.

(4) Notwithstanding section 23 (a) (2) which provided for the assessment of the Supplement U tax whether or not it was organized by or operated under the auspices of a church.

(b) The taxes imposed by section 421 (a) (2) shall apply in the case of any trust which is exempt, except as provided in Supplement U, from taxation under chapter 1 by reason of section 101 (6) and which, if it were not for such exemption, would be subject to the provisions of Supplement E of such chapter.

§ 39.421-3 Provisions generally applicable to Supplement U tax—(a) Assesment and collections. Since the taxes imposed by section 421 are taxes imposed by chapter 1 of the Internal Revenue Code, all provisions of law and of the regulations in this part applicable to the taxes imposed by chapter 1 are applicable to the assessment and collection of the taxes imposed by section 421. For the requirement as to the filing of returns, see paragraph (b) of this section. Organizations subject to the tax imposed by section 421 (a) (1), (2), (3), and (4) and subject to the Supplement U tax, unless such organization has gross income, subject to the Supplement U tax whether or not it was organized by or operated under the auspices of a church.

(c) Taxable years, method of accounting, etc. The taxable year (fiscal year or calendar year, as the case may be) of any taxpaying organization shall be determined without regard to the fact that such organization may have been exempt from tax during any prior period. See section 421 (a) with respect to the tax imposed by section 421 (a) (2).

(d) The terms "preceding taxable year" and "preceding taxable years" as used in the definitions of section 421 (b) shall not include any taxable year for which the organization was not subject to the provisions of this supplement.

(e) The filing of Form 990-T shall be for Form 990-T. The return shall be filed for each taxable year by every organization, otherwise exempt from tax under section 101 (1) (6) (7) or (16) and subject to the Supplement U tax, which has gross income, included in computing unrelated business net income for such taxable year, of $1,000 or more. The return shall be filed for each taxable year by every governmental college or university and by every corporation wholly owned by such a college or university, which is subject to the Supplement U tax and which has gross income included in computing unrelated business net income for such taxable year, of $1,000 or more. The return shall be filed for each taxable year by every governmental college or university and by every corporation wholly owned by such a college or university, which is subject to the Supplement U tax and which has gross income included in computing unrelated business net income for such taxable year, of $1,000 or more. The organization of the duty of filing other returns required under chapter 1 of the Internal Revenue Code.

(f) The net operating loss deduction provided in section 23 (c) (5) shall be allowed, except that:

(A) The net operating loss for any taxable year, the amount of the net operating loss carry-back or carry-over for any taxable year, and the net operating loss deduction for any taxable year shall be determined under section 23 (c) after taking into account the full amount of income or deduction which is excluded under this supplement in computing the unrelated business net income of the organization.

(B) The terms "preceding taxable year" and "preceding taxable years" as used in the definition of section 421 (b) shall not include any taxable year for which the organization was not subject to the provisions of this supplement.

(c) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(d) In the case of an organization operating for the purpose of fundamental research which is not included in the organization's gross income, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(e) In the case of any organization described in section 421 (b) (2), the so-called "charitable contribution" deduction allowed by section 23 (a) (2) and (3) shall be allowed (whether or not directly connected with the carrying on of the trade or business) or taxable year for which the organization was not subject to the provisions of this supplement.

(f) In the case of any organization described in section 421 (b) (1), the so-called "charitable contribution" deduction allowed by section 23 (a) (2) and (3) shall be allowed (whether or not directly connected with the carrying on of the trade or business) or taxable year for which the organization was not subject to the provisions of this supplement.

(g) For the requirement as to the filing of returns, see paragraph (b) of this section. Organizations subject to the tax imposed by section 421 (a) (1), (2), (3), and (4) and subject to the Supplement U tax, unless such organization has gross income, subject to the Supplement U tax whether or not it was organized by or operated under the auspices of a church.

(h) The returns of Supplement U tax shall be on Form 990-T. The return shall be filed for each taxable year by every organization, otherwise exempt from tax under section 101 (1) (6) (7) or (16) and subject to the Supplement U tax, which has gross income, included in computing unrelated business net income for such taxable year, of $1,000 or more. The return shall be filed for each taxable year by every governmental college or university and by every corporation wholly owned by such a college or university, which is subject to the Supplement U tax and which has gross income included in computing unrelated business net income for such taxable year, of $1,000 or more. The organization of the duty of filing other returns required under chapter 1 of the Internal Revenue Code.

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1954, be allowed a deduction in an amount equal to the portion of the gross income of such partnership from such unrelated trade or business which such organization is required (by a provision of a written contract executed prior to January 1, 1950, which provision expressly deals with the disposition of the gross income of the partnership) to pay within the taxable year in discharge of indebtedness incurred by such organization in acquiring its share of such trade or business, or to irrevocably set aside within the taxable year for the discharge of such indebtedness (to the extent that such amount has been so paid or set aside) it is treated as if such payment were made prior to January 1, 1950, for the purpose of carrying on such trade or business, and (2) substantially all the assets used in carrying on such trade or business were acquired by it or by its members prior to such date. As used in the preceding sentence, the word "indebtedness" does not include indebtedness incurred after January 1, 1950.

(b) Unrelated trade or business. The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 421 (a), any trade or business which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the earnings derived from such exercise or performance) by such organization of its charitable, educational, or other purpose or function. For purposes of computing the deduction allowed under section 101 (or, in the case of an organization described in section 101 (6)), except that such term shall not include any trade or business—

(1) In which substantially all the work in carrying on such trade or business is performed for the organization without compensation;

(2) Which is carried on, in the case of an organization described in section 101 (6) or in the case of a college or university described in section 101 (b) (1) (B), by the organization primarily for the convenience of its members, students, patients, officers, or employees; or

(3) Which is the selling of merchandise, substantially all of which has been received by the other organization on a wholesale or consignment basis.

The term "unrelated trade or business" means, in the case of a trust computing its unrelated business net income under this section for any taxable year, any trade or business regularly carried on by such trust or by a partnership of which it is a member. A publishing business carried on by an organization during any taxable year beginning before January 1, 1953, is, without regard to this sentence, an unrelated trade or business, but before the beginning of the third succeeding taxable year the business is carried on by it (or by a successor who acquired such business in a liquidation which would constitute a tax-free exchange under section 112 (b) (6)) in such manner that the organization is substantially related to the exercise or performance by such organization (or such successor) of its educational, charitably, or other purpose described in section 101 (6), such publishing business shall not be considered, for the taxable year, as an unrelated trade or business. [Sec. 422 as added by sec. 101 (a), Rev. Act 1950; amended by secs. 289 (b), 347, 348, Rev. Act 1951]

§ 39.422-1 Definition of unrelated business net income—(a) General rule. The unrelated business net income which is subject to the provisions of Supplement U tax as the gross income, derived by any organization to which Supplement U applies, from any unrelated trade or business regularly carried on by it, less the deductions allowed by section 23 of the Code which are directly connected with the carrying on of such trade or business, subject to certain exceptions, additions, and limitations referred to below. In the case of an organization which regularly carries on two or more unrelated businesses, the aggregate of its unrelated business net income is the aggregate of its gross income from all such unrelated businesses, less the aggregate of the deduction allowed with respect to all such unrelated businesses, or of which it is a member, which is allocable to the Supplement U tax, see §§ 39.421-3, and for rules applicable to the determination of the adjusted basis of property, see paragraph (a) of §§ 39.423-5.

(b) Exceptions, additions, and limitations. Whether a particular item of income falls within any of the exceptions, additions, and limitations provided in section 422 shall be determined by all the facts and circumstances of each case. For example, if a payment termed "rent" by the parties is in fact a return of profits by a partner or a share of the profits retained by the trade or business, any such payment is not within the exception for rent. The exceptions, additions, and limitations provided in section 422 are as follows:

(1) Dividends, interest and annuities. All dividends, interest, and annuities, and the deductions directly connected therewith, shall be excluded in computing unrelated business net income.

(2) Royalties. Royalties, including overriding royalties, and all deductions directly connected with such income shall be excluded in computing unrelated business net income. Mineral royalties shall be excluded whether measured by production or by sales of minerals, or by overriding royalties, and all deductions directly connected therewith, such payment is not within the exception for rent. The exceptions, additions, and limitations provided in section 422 shall be determined by all the facts and circumstances of each case. For example, if a payment termed "rent" by the parties is in fact a return of profits by a partner or a share of the profits retained by the trade or business, any such payment is not within the exception for rent. The exceptions, additions, and limitations provided in section 422 are as follows:

(5) Net operating losses. The net operating loss deduction provided in section 23 (a) shall be allowed in computing unrelated business net income. However, the net operating loss carry-back or carry-forward to which the taxpayer is subject to the provisions of Supplement U shall be determined under section 122 without taking into account any income of or from unrelated business. The exclusion under section 422 (a) (5) applies with respect to gains and losses from involuntary conversions, casualties, etc.

(6) Research. (1) Income derived from research for the United States or any of its agencies or instrumentalities...
or a State or political subdivision thereof, and all deductions directly connected with such income shall be included in computing unrelated business net income.

(ii) In the case of a college, university, or hospital engaged in research performed for any person and all deductions directly connected with such income shall be excluded in computing unrelated business net income.

(iii) In the case of a corporation operated primarily for the purpose of carrying on fundamental research (as distinguished from applied research) the results of which are freely available to the general public, all income derived from research performed for any person and all deductions directly connected with such income shall be excluded in computing unrelated business net income.

(iv) For the purpose of this section, the term "research" does not include activities of a type ordinarily carried on as an unincidental part of ordinary commercial or industrial operations, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc. The term "fundamental research" does not include research carried on for the primary purpose of commercial or industrial application.

(7) Charitable, etc., contributions.

(i) In computing the unrelated business net income of a trust described in section 421 (b) (2) or of an organization described in section 421 (b) (1) there shall be deducted from gross income and all deductions directly connected with the carrying on of the trade or business.

(ii) The deduction shall be limited to 15 percent, if computed under section 23 (o) or 5 percent, if computed under section 23 (q) of the unrelated business net income computed without benefit of such deduction. In the case of a trust described in section 421 (b) (2) distributions made pursuant to the trust instrument to a beneficiary described in section 23 (o) shall be treated in the same manner as gifts or contributions.

(iii) The contribution, whether made by a trust or other exempt organization, must be paid to another organization to be allowable. For example, a university exempt from tax under section 101 (6) operating an unrelated business shall be allowed a deduction, not in excess of 5 percent of its unrelated business net income, for gifts or contributions to another university for educational work but shall not be allowed any deduction for amounts expended in administering its own educational program.

§ 39.422-2 Organizations that are members of partnerships.—(a) In general. In the event an organization to which such supplies are a member of a partnership regularly engaged in a trade or business which is an unrelated trade or business with respect to such organization, the organization shall include in computing its unrelated business net income so much of its share (whether or not distributed) of the partnership gross income as is derived from such trade or business and its share of the deductions attributable thereto. For this purpose, both the gross income and the deductions shall be computed with respect to the business of the partnership for the exceptions, additions, and limitations referred to in section 422 (a) and in § 39.422-1. For example, if an exempt educational institution is a partner in a partnership which owns and operates a factory and if such partnership also holds stock in a corporation, the exempt organization shall include in computing its unrelated business net income its share of the gross income from the operation of the factory, but not its share of any dividends received by the partnership from the corporation. If the taxable year of the organization differs from that of the partnership, the amounts included or deducted in computing unrelated business net income shall be based upon the income and deductions of the partnership for each taxable year of the partnership ending within or with the taxable year of the organization.

(b) Special rule. For a special rule, apply the provision in respect to taxable years beginning before January 1, 1954, with respect to unrelated trades or businesses carried on in partnership by certain educational organizations described in section 2813 (a) (2) see the last two sentences of section 422 (a).

§ 39.422-3 Definition of unrelated trade or business.—(a) In general. (1) As used in section 422 (a) the term "unrelated trade or business" includes only income from an unrelated trade or business regularly carried on, and the term "trade or business" has the same meaning as it has in section 23 (o) (1).

(2) The income of an exempt organization is subject to the Supplement U tax only if two conditions are present with respect to such income. The first condition is that the income must be from a trade or business which is regularly carried on by the organization. The second condition is that the trade or business must not be substantially related to the exempt purposes of the organization. The trade or business must be substantially related to the exempt purpose merely because incidental use is made of the trade or business in order to further the exempt purpose. For example, the manufacture and sale of a product by an exempt college would not become substantially related merely because students as part of their educational program perform clerical or bookkeeping functions in the business. In some cases, the business may be substantially related because it is a necessary part of the exempt activity. For example, in the case of an organization exempt under section 101 (6) for rehabilitation of handicapped persons, the business of selling articles made by such persons as a part of their rehabilitation training would not be considered an unrelated business since such business is a necessary part of the rehabilitation program.

(b) Exceptions. Section 422 (b) specifically states that the term "unrelated trade or business" does not include—

(1) Any trade or business in which substantially all the work in carrying on such trade or business is performed by the organization without compensation; or

(2) Any trade or business carried on by an organization exempt under section 101 (6) or by a governmental college or university; or

(3) Any trade or business which consists of a merchandise or a service performed primarily for the convenience of its members, students, patients, officers, or employees; or

(4) Any trade or business which consists of a merchandise or a service performed primarily for the benefit of such deduction. In the case of an educational organization, the purpose for which the organization is granted exemption is not furthered (other than through the production of income) the purpose for which the organization is granted exemption. In the usual case the nature and size of the trade or business makes its performance by the organization impracticable or inappropriate.

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An example of the operation of the first of the exceptions mentioned above would be an exempt orphanage operating a retail store and selling to the general public, where substantially all the work in carrying on such business is performed by its residents, and only those members of the organization are employed, without compensation. An example of the second limitation would be a laundry operated by a college for the purpose of providing work experience for its students and the clothing of students. The third exception applies to so-called "thrift shops" operated by a tax-exempt organization where those dealing to benefit such organization are not on its payroll. This rule applies to books, furniture, etc., to be sold to the general public with the proceeds going to the exempt organization.

(c) Special rule respecting publishing businesses. For a special rule, applicable only with respect to taxable years beginning before January 1, 1953, with respect to publishing businesses carried on by an organization, see section 422(b).

§ 39.423 Statutory provisions; treatment of Supplement U lease in determination of unrelated business net income.

SEC. 423. Supplement U lease—(a) Definition of Supplement U lease. The term "Supplement U lease" means a lease for a term of more than five years of real property by an organization (or by a partnership of which it is a member) in whose close of the lessor's taxable year there is a supplement U lease indebtedness (as defined in subsection (b)) with respect to the real property subject to such lease.

(b) Definition of Supplement U lease indebtedness. The term "Supplement U lease indebtedness" means, with respect to any real property leased for a term of more than five years, the unpaid amount of any indebtedness incurred by the lessor with respect to the promises covered by such lease, at any time during the term of such lease if

(1) The indebtedness incurred by the lessor in acquiring or improving such property if such indebtedness would not have been incurred but for such acquisition or improvement;

(2) The indebtedness incurred prior to the acquisition or improvement of such property if such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Where real property is acquired subject to a mortgage or other similar lien, the amount of the indebtedness required to be considered as an indebtedness for purposes of this subsection is of the amount determined under clause (A) of paragraph (3) of the sum determined under paragraph (1) of such paragraph.

(c) Deductions allowable. The sum referred to in paragraph (3) is the sum of the following deductions allowable under sections 111 and 112:

(A) Taxes and other expenses paid or accrued during the taxable year upon or with respect to the real property subject to the Supplement U lease.

(B) Interest paid or accrued during the taxable year on the Supplement U lease indebtedness.

(2) A reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescence) of the real property subject to such lease.

Where only a portion of the real property is subject to the Supplement U lease, there shall be taken into account under subsection (a) only those amounts which are properly allocable to the premises covered by such lease.

(see sec. 423 as added by sec. 301 (a), Rev. Act 1950)

§ 39.423-1 Definition of Supplement U lease—(a) In general. The term "Supplement U lease" means any lease, with certain exceptions discussed in paragraph (c) of this section, for a term of more than five years of real property by an organization subject to Supplement U (or by a partnership of which it is a member) if at the close of the organization's taxable year there is a Supplement U lease indebtedness as defined in section 423(b) and § 39.423-2, with respect to such property.

For the purpose of section 423, the term "real property" and the term "promises" include personal property of the lessor tax-exempt organization leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate for a term of six years or more.

For amounts of Supplement U rents and deductions to be included in computing unrelated business net income, see § 39.423-3.

(b) Special rules. (1) In computing the term of the lease, the period for which a lease may be renewed or extended by reason of an option contained therein shall be counted as part of the term. For example, a 3-year lease with an option for renewal for another 3-year period is a lease for a term of 6 years. Another example is the case of a 1-year lease with option of renewal for another such term, where the parties at the end of each year renew the arrangement. In this case, dur-
ing the fifth year (but not during the first four years) the lease falls within the 5-year rule, since the lease then involves five years time accordingly from the sixth year. In determining the term of the lease, an option for renewal of the lease is taken into account whether or not the executed option depends upon conditions or continuation.

(2) If the property is acquired subject to a lease, the term of such lease shall be considered to begin on the date of such acquisition, and where a tax-exempt organization purchases, in whole or in part, with borrowed funds, real property subject to a 10-year lease which has three years left to run, and such lease contains no right of renewal or extension, the lease shall be considered a 5-year lease and hence does not meet the definition of a Supplement U lease in section 423 (a) and paragraph (a) of this section. However, if this lease contains an option to renew for a period of three years or more, it is a Supplement U lease.

(c) Exceptions. (1) A lease shall not be considered a Supplement U lease if such lease is entered into primarily for a purpose which is substantially related (made from reasonable income or funds, or the use makes it of the rents derived) to the exercise or performance of such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption. For example, where a tax-exempt hospital leases real property owned by it to an association of doctors for use as a clinic, the rent derived under such lease would not be included in computing unrelated business net income if the clinic is substantially related to the carrying on of hospital functions. See §39.422-3 for principles applicable in determining whether there is a substantial relationship to the exempt purposes of an organization.

(2) A lease is not a Supplement U lease if the purpose for which it is being primarily designed for occupancy and occupied by the tax-exempt organization.

(3) If a lease for more than five years to a tenant for only a portion of the real property, and the lease in the real property is rented during the taxable year under a lease for more than five years to any other tenant of the tax-exempt organization, leases of the real property for more than five years shall be considered as Supplement U leases during the taxable year only if—

(i) The rents derived from the real property during the taxable year under such leases represent 50 percent or more of the total rents derived during the taxable year from the real property or the area of the premises occupied under such leases, at any time during the taxable year, 50 percent or more of the total area of the real property rented at such time, and

(ii) The rent derived from the real property during the taxable year from any tenant under such a lease, or from a group of tenants (under such leases) who are either members of an affiliated group (as defined in section 141) or are partners, represents more than 10 percent of the total rents derived during the taxable year from such property or the area of the premises occupied by any one such group, or a group of tenants, represents at any time during the taxable year more than 10 percent of the total area of the real property rented at such time.

(d) The following subparagraph (3) of this paragraph may be illustrated by the following example:

Example. In 1953 an educational organization, which is on the calendar year basis, leases a first floor apartment building using funds borrowed for that purpose, and immediately leases for a 10-year term the first floor to a real estate development company to sublet for stores and shops. As fast as the new apartments are completed, they are rented on an annual basis. At the end of 1957 all except the tenth and eleventh floors are rented. These two floors are completed at 1958 and rented. Assume that in 1952 and each subsequent taxable year through 1957, and the taxable year 1951, the gross rental for the first floor represents at any time during the taxable year more than 10 percent of the total gross rents derived during the taxable year from the building. Under the terms of the lease, the first floor would be considered to be a Supplement U lease for all the taxable years 1952, 1953, 1954, 1955, and 1956.

§39.423-2 Supplement U lease indebtedness—(a) Definition. The term, "Supplement U lease indebtedness", means, with respect to any real property leased by a tax-exempt organization for a term of more than five years, the unpaid amount of the indebtedness of the lessor tax-exempt organization in connection with such real property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of the indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

See paragraph (f) of this section with respect to subsidiary corporations.

(b) Exceptions. The rules of paragraph (a) of this section respecting Supplement U leases also cover certain cases where the leased property itself is not subject to an indebtedness. For example, they apply to cases such as the following:

Example (1). A university pledges some of its investment securities with a bank for a loan and uses the proceeds of such loan and incurrence of the indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Example (2). The building itself in Example (1) in this paragraph is later mortgaged to raise funds to replace the pledged securities, the lease would continue to be a Supplement U lease.

Example (3). If a scientific organization mortgaged its laboratory building to replace working capital used in remodeling another one of its buildings, the building held by its subsidiary corporation, which otherwise is free of indebtedness and is subject to a lease that has less than five years to run, and it can reasonably be expected that the lease inasmuch as the indebtedness though incurred subsequent to the improvement of such property would have been incurred but for such improvement, and the incurrence of the indebtedness was reasonably foreseeable at the time of such acquisition or improvement and the organization reduced its working capital below the amount necessary to continue current operations.

(c) Lease of part of property. Where only a portion of the real property is subject to a Supplement U lease, proper allocation of the indebtedness applicable to the whole property must be made to the premises covered by the lease.

(d) Property acquired subject to lien. Where real property is acquired subject to a mortgage or similar lien, whether the acquisition be by gift, bequest, devise, or purchase, the amount of the indebtedness secured by such mortgage or lien is a Supplement U lease indebtedness (unless paragraph (e) of this section applies) even though the lessor does not assume or agree to pay the indebtedness. For example, a university pays $100,000 for real estate valued at $300,000 and subject to a $200,000 mortgage. For the purpose of the Supplement U tax, the result is the same if $200,000 of borrowed funds had been used to buy the property.

(e) Exceptions. (1) Where real property was acquired by gift, bequest, or devise, before July 1, 1950, subject to a mortgage or similar lien, the amount of such mortgage or similar lien shall not be considered as an indebtedness of the lessor tax-exempt organization incurred in acquiring such property. An indebtedness not otherwise covered by this exception is not brought within the exception by reason of a transfer of the property between a parent and its subsidiary corporation.

(2) Where real property was acquired by gift, bequest, or devise, before July 1, 1950, subject to a mortgage or similar lien, the amount of such mortgage or similar lien shall not be considered as an indebtedness of the lessor tax-exempt organization incurred in acquiring such property. An indebtedness not otherwise covered by this exception is not brought within the exception by reason of a transfer of the property between a parent and its subsidiary corporation.

(3) In the case of a corporation described in section 101 (14) all of the stock of which was acquired before July 1, 1950, by an organization described in paragraph (1), (2), and (3) of section 101 (and more than one-third of such stock was acquired by such organization by gift or bequest), any indebtedness incurred by such corporation before July 1, 1950, and any indebtedness incurred by such corporation on or after such
date in improving real property in accordance with the terms of a lease entered into before such date, with respect to either such lease under such corporation or such section 101 (1) (d), or (7) organization, shall not be considered indebtedness described in section 423 (b) and in this section.

(6) Subsidary corporations. The provisions of section 423 are applicable whether or not a subsidiary corporation of the type exempt under section 101 (14) is availed of in making the Supplemental U lease. For example, a parent organization borrows funds to purchase realty and sets up a separate section 101 (14) corporation as a subsidiary to hold the property. Such subsidiary corporation leases the property for a period of more than five years, collects the rents and pays over all of the income, less expenses, to the parent organization. The parent organization being liable for the indebtedness. Under these assumed facts, the lease by the section 101 (14) subsidiary corporation would be subject to the tax as respects such subsidiary corporation, and the rental income would be subject to the tax, whether or not the subsidiary itself assumes the indebtedness and whether or not the property is subject to the indebtedness.

§ 39.423-3 Treatment of rent from Supplement U lease—(a) General rule. There shall be included with respect to each Supplement U lease, as an item of gross income, an amount which is the same percentage (but not in excess of 100 percent) of the total rents derived during the taxable year under such lease as—

(1) The amount of the Supplement U lease indebtedness at the close of the taxable year of the lessor tax-exempt organization, with respect to the premises covered by such lease, and

(2) The adjusted basis of such premises at the close of such taxable year.

The basis (unadjusted) of property is determined under section 113 (a) and the adjusted basis of property is determined under section 113 (b). The determination of the adjusted basis of property is not affected by the fact that the organization was exempt from tax for prior taxable years. Proper adjustment must be made under section 113 (b) for the entire period since the acquisition of the property. Thus, adjustment must be made for depreciation for all prior taxable years. If at any time the organization was exempt from tax for any of such years. Similarly for taxable years during which the organization is subject to Supplemental U, the fact that only a portion of the deduction for depreciation taken into account under section 423 (d) does not affect the amount of the adjustment for depreciation.

(b) Examples. The application of this section may be illustrated by the following examples, in each of which it is assumed that the taxpayer makes its returns under Supplement U on the basis of the calendar year, and that the lease is not substantially related to the purpose for which the organization is granted exemption from tax.

Example (1). Assume that a tax-exempt organization owns a 4-story building, that in 1952 it rents the first floor of the building to a trade or business, an amount which, under the lease, is payable from funds, and leased the building for a period of 25 years. Assume further that the adjusted basis of the building at the close of 1952 is $650,000. If, at the close of 1952, $250,000 of the indebtedness incurred to acquire the property is outstanding, since this is two-fifths of the adjusted basis of the building at the close of 1952, two-fifths of the adjusted basis of the building during 1952 shall be included as an item of gross income in computing unrelated business net income. If, at the close of a subsequent taxable year, the outstanding indebtedness is $600,000 and the adjusted basis of the building is $650,000, one-fourth of the gross rental for such taxable year shall be included as an item of gross income in computing unrelated business net income for such taxable year.

Example (2). Assume that a tax-exempt organization owns a 4-story building, that in 1952 it rents the first floor of the building to a trade or business, an amount which is insufficient to improve the whole building, and that thereafter in 1953 rents the first floor of the building to another trade or business, under a 6-year lease at a rental of $4,000 a year. The second, third, and fourth floors of the building are leased on a yearly basis during 1953.

Assume also, that the adjusted basis of the building at the close of 1952 (after reflecting the expenditures for improving the building) is $250,000, allocable equally to the four floors of the building. Under these facts, only one-fourth of the real property is subject to a Supplemental U lease. The percentage which is taken into account is determined by the ratio which the allocable part of the Supplemental U lease indebtedness bears to the allocable part of the adjusted basis of the real property, that is, the ratio which one-fourth of the $300,000 Supplemental U lease indebtedness outstanding at the close of 1952, or $250,000, bears to one-fourth of the adjusted basis of the Supplemental U lease premises at the close of 1952 or $250,000. The percentage of rent which is Supplemental U lease indebtedness for 1952 is, therefore, one-half (the ratio of $200,000 to $400,000), and this amount of $2,000 is considered an item of gross income derived from an unrelated trade or business.

§ 39.423-4 Percentage of deductions taken into account. (a) The same percentage used in determining the portion of the rent and the portion of the deductions taken into account with respect to the Supplemental U lease in computing unrelated business net income. See § 39.423-3 for the determination of such percentage. Such percentage is applicable only to the sum of the following deductions allowable under section 23:

(1) Taxes and other expenses paid or accrued during the taxable year upon or with respect to the real property subject to the Supplemental U lease;

(2) Interest paid or accrued during the taxable year on the Supplemental U lease indebtedness;

(3) A reasonable allowance for excluding from the income of the type exempt under section 421 the income from unrelated business for use of the real property subject to such lease.

Where only a portion of the real property is subject to the Supplemental U lease, there shall be taken into account only those amounts of the above-listed deductions which are properly allocable to the premises covered by such lease.

(b) The deductions allowable under section 423 (d) and under paragraph (a) of this section with respect to the Supplemental U lease are not limited by the amount included in gross income with respect to the rent from such lease, but deduction of such deductions over such gross income shall be applied against other items of gross income in computing unrelated business net income taxable under section 421 (a).

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

Example. Assume the same facts as those in example (1) in paragraph (b) of § 39.423-3. Assume also that for 1953 the organization pays taxes of $4,000 on the property, interest of $6,000 on its Supplemental U lease indebtedness, and that the depreciation allowable for 1953 under section 28 (a) is $50,000. Under the facts set forth in such example (1) and in this example, the deductions to be allowed are $2,000 for 1952 and $3,000 for 1953. Under these facts, only one-fourth of the real property is subject to a Supplemental U lease. The percentage which is taken into account is determined by the ratio which the allocable part of the Supplemental U lease indebtedness bears to the allocable part of the adjusted basis of the real property, that is, the ratio which one-fourth of the $300,000 Supplemental U lease indebtedness outstanding at the close of 1952, or $250,000, bears to one-fourth of the adjusted basis of the Supplemental U lease premises at the close of 1952 or $250,000.

The percentage of rent which is Supplemental U lease indebtedness for 1952 is, therefore, one-half (the ratio of $200,000 to $400,000), and this amount of $2,000 is considered an item of gross income derived from an unrelated trade or business.

§ 39.424 Statutory provisions; credit for taxes on foreign countries and possessions of the United States.

Sec. 424. Taxes of foreign countries and possessions of the United States. The amount of income, war-profit, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of an organization subject to the tax imposed by section 421 (a) to the extent provided in section 131; and in the case of the tax imposed by section 421 (a), the term "normal-tax net income" and the term "net income" as used in section 131 shall be read as "Supplemental U net income".

Sec. 424 as added by sec. 301 (a), Rev. Act 1950.

SUBPART D—TAX ON SELF-EMPLOYMENT INCOME (SUBCHAPTER E, CHAPTER 1, INTERNAL REVENUE CODE)

§ 39.426 Statutory provisions; rate of tax on self-employment income.

Sec. 420. Rate of tax. In addition to other taxes, there shall be levied, collected, and paid to the United States, after December 31, 1959, upon the self-employment income of every individual, a tax as follows:

(1) In the case of any taxable year beginning after December 31, 1959, and before January 1, 1964, the tax shall be equal to 1% per centum of the amount of the self-employment income for such taxable year.

(2) In the case of any taxable year beginning after December 31, 1959, and before January 1, 1964, the tax shall be equal to 2% per centum of the amount of the self-employment income for such taxable year.

(3) In the case of any taxable year beginning after December 31, 1959, and before January 1, 1965, the tax shall be equal to 3% per centum of the amount of the self-employment income for such taxable year.

(4) In the case of any taxable year beginning after December 31, 1959, and before January 1, 1970, the tax shall be equal to 5% per centum of the amount of the self-employment income for such taxable year.

(5) In the case of any taxable year beginning after December 31, 1969, the tax shall be equal to 4% per centum of the amount of the self-employment income for such taxable year.
§ 39.480-1 Tax on self-employment income.

(a) There is imposed, in addition to other taxes, a tax upon the self-employment income of every individual at the rates prescribed in section 10.60. This tax shall be levied, assessed, and collected as a tax on self-employment which is in excess of $400. Since the tax on self-employment income is part of the income tax, it is subject to the provisions of The Tax Court of the United States to the same extent and in the same manner as the other taxes under chapter 1 of the Code. However, this tax is not required to be taken into account in computing any deficiency, overpayment, or tax. Since the tax on self-employment income is part of the income tax, it is subject to the provisions of The Tax Court of the United States to the same extent and in the same manner as the other taxes under chapter 1 of the Code. However, this tax is not required to be taken into account in computing any deficiency, overpayment, or tax.

(b) In general, self-employment income consists of the net earnings from self-employment which are attributable thereto, unless such earnings are excluded in computing the net earnings from self-employment as defined in subsection (a), attributable to the special rules discussed in paragraphs (4) and (5).

(c) Trade or business. The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 1323. Thus, the performance of services by an individual as an employee (other than services described in section 1325) (b) (i) (B) performed by an individual who has attained the age of eighteen.

(d) The performance of services by an individual as an employee or an employee representative as defined in section 1323; or

(e) The performance of services by a duly ordained, commissioned, or licensed minister in the exercise of his ministry. Thus, the performance of services by an individual in the exercise of his profession as a physician, lawyer, dentist, ophthalmologist, veterinarian, chiropodist, Christian Science practitioner, architect, certified public accountant, accountant registered or licensed as an accountant, under State or municipal law, full-time practicing public accountant, funeral director or professional engineer; or any performance of services by a partnership.

§ 39.481 Statutory provisions; net earnings from self-employment, self-employment income, and trade or business; definitions.

Sec. 481. Definitions. For the purposes of this subchapter—

(a) Net earnings from self-employment. The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this chapter which are attributable to such trade or business and his distributive share of losses, other than any losses attributable to the performance of services by an individual as an employee (other than services described in section 1325), of any partnership in which he is a partner, including any partnership losses otherwise attributable to the performance of services by an individual as an employee (other than services described in section 1325), less any losses attributable to the performance of services by an individual as an employee (other than services described in section 1325), attributable to the special rules discussed in paragraphs (4) and (5).

(b) Self-employment income. The term "self-employment income" means the net earnings from self-employment derived by an individual (other than a nonresident alien individual) during any taxable year ending within or with his taxable year.

(c) Included in net earnings from self-employment. Included in net earnings from self-employment for the purpose of this subchapter is any income or gain derived from the sale or exchange of a capital asset, (A) from the cutting of timber, or the disposal of timber or coal, if section 117 (1) is applicable to such gain or loss, or (B) from the sale, exchange, or other disposition of property if such property is not (i) stock in trade or other property of a kind which would properly be included in the net earnings from self-employment provided in section 9 (a) (2), (ii) property held primarily for sale to customers in the ordinary course of a trade or business, or (iii) property distributed to such individual as a partner or employee (other than services described in section 1325) (b) (i) (B) performed by an individual who has attained the age of eighteen, or (iv) property of a kind which would properly be included in the net earnings from self-employment provided in section 9 (a) (2), (v) property attributable to the trade or business were carried on exclusively for the purpose of generating rental income from property (including personal property and real property) and deductions attributable to such property, including personal property and real property (including personal property and real estate) located in the United States. Net earnings from self-employment of such partner shall be included in computing the net earnings from self-employment of the spouse of such partner. If the distributions attributable to the trade or business were carried on exclusively for the purpose of generating rental income from property (including personal property and real property) and deductions attributable to such property, including personal property and real property (including personal property and real estate) located in the United States.

(d) Included in net earnings from self-employment. Included in net earnings from self-employment for the purpose of this subchapter is any income or gain derived from the sale or exchange of a capital asset, (A) from the cutting of timber, or the disposal of timber or coal, if section 117 (1) is applicable to such gain or loss, or (B) from the sale, exchange, or other disposition of property if such property is not (i) stock in trade or other property of a kind which would properly be included in the net earnings from self-employment provided in section 9 (a) (2), (ii) property held primarily for sale to customers in the ordinary course of a trade or business, or (iii) property distributed to such individual as a partner or employee (other than services described in section 1325), (b) (i) (B) performed by an individual who has attained the age of eighteen, or (iv) property of a kind which would properly be included in the net earnings from self-employment provided in section 9 (a) (2), or (v) property attributable to the trade or business were carried on exclusively for the purpose of generating rental income from property (including personal property and real property) and deductions attributable to such property, including personal property and real property (including personal property and real estate) located in the United States.
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employment. Likewise, if a taxpayer engaged in a trade or business of selling property on the installment plan elects under the provisions of section 44, to use the installment basis in computing income for the purpose of the taxes under sections 11 and 12, he must use the same basis in determining net earnings from self-employment.

(2) The trade or business must be carried on by the individual, either personally or through an agent or employee. Accordingly, income derived from a trade or business carried on by an estate or trust is not included in determining the net earnings from self-employment of the individual beneficiaries of such estate or trust.

(3) Where an individual is engaged in more than one trade or business within the meaning of section 481 (c) and § 39.481–3, his net earnings from self-employment consist of the aggregate of the net income and losses (computed subject to the special rules provided in this section) from all trades or businesses carried on by him. Thus, a loss sustained in one trade or business carried on by an individual will operate to offset the income derived by him from another trade or business.

(4) The net earnings from self-employment of an individual include, in addition to the earnings from a trade or business carried on by him, his distributive share of the ordinary net income or ordinary net loss from any trade or business carried on by each partnership of which he is a member. An individual's distributive share of the ordinary net income or ordinary net loss of a partnership shall be computed under section 183, subject to the special rules set forth in section 481 (a) and in this section and to the exclusions provided in section 481 (c) and in § 39.481–3.

(5) If the taxable year of a partner differs from that of the partnership, the partner shall compute his net earnings from self-employment, his distributive share of the ordinary net income or ordinary net loss of the partnership for its taxable year ending with or within the taxable year of the partner, and include in determining his net earnings from self-employment his distributive share of the ordinary net income or ordinary net loss of the partnership.

(6) For the purpose of determining net earnings from self-employment, a partnership is one which is recognized as such for income tax purposes. For income tax purposes, the term "partnership" includes not only a partnership as known at common law, but also, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any trade or business, financial operation, or venture, which is not within the meaning of the Internal Revenue Code, a trust, estate, or a corporation.

(7) The net earnings from self-employment of a partner include his distributive share of the ordinary net income or ordinary net loss of the partnership of which he is a member, irrespective of the nature of his membership. Thus, in determining his net earnings from self-employment, a limited or managing partner includes his distributive share of the ordinary net income or ordinary net loss of the partnership.

(c) Excluded from net earnings. For the purpose of computing net earnings from self-employment, the gross income derived by an individual from a trade or business carried on by him, the allowable deductions attributable to such trade or business, and the individual's distributive share of the ordinary net income or ordinary net loss from any trade or business carried on by each partnership of which he is a member shall be computed in accordance with the following special rules:

(1) Rentals from real estate. (i) Rentals from real estate (including personal property leased with the real estate) and the deductions attributable thereto, unless such rentals are received by an individual in the course of a trade or business as a real-estate dealer, are excluded. Whether or not an individual is engaged in the trade or business of a real-estate dealer is determined by the application of the rules followed in determining whether an individual is engaged in a trade or business, as described in sections 11 and 12. In general, an individual who is engaged in the business of selling real estate to customers with a view to the gains and profits that may be derived from future sales his business is a real-estate dealer. On the other hand, an individual who merely holds real estate for investment or speculation and receives rentals therefrom is not considered a real-estate dealer. Where a real-estate dealer holds real estate for investment or speculation in addition to real estate held for sale to customers in the ordinary course of his business, only the rentals from the real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, and the deductions attributable thereto, are included in determining net earnings from self-employment; the rentals from the real estate held for investment or speculation, and the deductions attributable thereto, are excluded.

(ii) Payments for the use or occupancy of entire private residences or living quarters in dwelling units in building complexes classified as rentals from real estate. Except in the case of real-estate dealers, such payments are excluded in determining net earnings from self-employment even though such payments are in part attributable to personal property furnished under the lease.

(iii) Payments for the use or occupancy of space in multi-family buildings which are not used in connection with the trade or business of the real-estate dealer, and which are not classified as rentals from real estate. Payments for the use or occupancy of space in multi-family buildings which are used in connection with the trade or business of the real-estate dealer, and which are classified as rentals from real estate, are included in determining net earnings from self-employment.

(2) Income from agricultural activity. (i) Income derived from any trade or business in which the trade or business was carried on by an individual from a trade or business as a real-estate dealer is not considered net earnings from self-employment. Accordingly, income derived from a trade or business carried on by an individual will not operate to offset the income derived by him from another trade or business.

(ii) Payments for the use or occupancy of space in multi-family buildings which are not used in connection with the trade or business of the real-estate dealer, and which are not classified as rentals from real estate. Payments for the use or occupancy of space in multi-family buildings which are used in connection with the trade or business of the real-estate dealer, and which are classified as rentals from real estate, are included in determining net earnings from self-employment.

(iii) This rule has no application where the nonagricultural services are

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performed in connection with an enterprise which constitutes a trade or business separate and distinct from the trade or business conducted as an agricultural enterprise. An enterprise such as a roadside automobile service station on farm premises constitutes a trade or business separate and distinct from the agricultural enterprise, and the gross income derived from such service station, together with the deductions attributable thereto, are included in determining net earnings from self-employment.

(3) Dividends and Interest. (i) All dividends on shares of stock are excluded unless they are received by an individual in the course of his trade or business as a dealer in stocks or securities.

(ii) Interest on any bond, debenture, note, or certificate, or other evidence of indebtedness, issued with interest coupons or in registered form by an individual is a dealer in stocks or securities, unless such interest is exempt under section 25(a) from the normal tax imposed by section 11, that is, interest on obligations of the United States and its instrumentalities, is not included in net earnings from self-employment even though received in the course of a trade or business as a dealer in stocks or securities.

(iii) Dividends and interest of the character of a capital gain or loss for purposes other than determining net earnings from self-employment, if section 117(j) is applicable, is included in net earnings from self-employment even though such interest is received in the course of a trade or business as a dealer in stocks or securities, unless such interest which is exempt under section 25(a) from the normal tax imposed by section 11, that is, interest on obligations of the United States and its instrumentalities, is not included in net earnings from self-employment even though received in the course of a trade or business as a dealer in stocks or securities.

(iv) A dealer in stocks or securities is a merchant of stocks or securities with an established place of business, regularly engaged in the business of purchasing stocks or securities and reselling them to customers; that is, he is one who as a merchant buys stocks or securities and resells them to customers with a view to the gains and profits that may be derived therefrom. Persons who buy and sell or hold stocks or securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, are not dealers in stocks or securities.

(4) From disposition of property. (i) There is excluded any gain or loss: (a) Which is considered as gain or loss from the sale or exchange of a capital asset; (b) From the cutting of timber or the disposal of lumber, coal, or other material whether a gain or loss is treated under the ordinary course of a trade or business, held primarily for sale to customers, if section 117(j) is applicable to such gain or loss; and (c) From the sale, exchange, involuntary conversion, or other disposition of property if such property is neither (1) Stock in trade or other property of a kind which would properly be included in inventory if on hand at the close of the taxable year, nor (2) Property held primarily for sale to customers in the ordinary course of a trade or business, if section 117(j) is applicable to such property and such holding is material whether a gain or loss is treated under the ordinary course of a trade or business, held primarily for sale to customers, if section 117(j) is applicable to such gain or loss; or (3) Property held primarily for sale to customers, if section 117(j) is applicable to such property and such holding is material whether a gain or loss is treated under the ordinary course of a trade or business, held primarily for sale to customers, if section 117(j) is applicable to such gain or loss.

(ii) In case of a partnership. Even though a portion of an individual's distributive share of the ordinary net income or ordinary net loss from a trade or business carried on by a partnership is community property income or loss under the community property laws applicable to such share, all of such distributive share shall be included in computing the net earnings from self-employment of such partner; no part of such share shall be taken into account in computing the net earnings from self-employment of the spouse of such partner. In any case in which the husband and wife are partners in a trade or business conducted as a partnership, the distributive share of the ordinary net income or ordinary net loss of each spouse is included in computing the net earnings from self-employment of that spouse.

(iii) Puerto Rico. A resident of Puerto Rico, whether or not a bona fide resident thereof during the taxable year, is a merchant if, during the taxable year, he is one who as a merchant buys stocks or securities, unless such interest which is exempt under section 25(a) from the normal tax imposed by section 11, that is, interest on obligations of the United States and its instrumentalities, is not included in net earnings from self-employment even though received in the course of a trade or business as a dealer in stocks or securities.

(b) Maximum self-employment income. The maximum self-employment income of an individual for any taxable year (whether a period of 12 months or less) is $3,600. If an individual is paid wages as defined in section 1426(a), the maximum self-employment income is the excess of such wages over $3,600.

§ 39.481-2 Self-employment income—(a) In general. Except for the exclusions in paragraphs (b) and (c) and the exception in paragraph (d) of this section, any income which qualifies as "income from self-employment" means the net earnings from self-employment of an individual.
are paid, and the individual has $5,000 of net earnings from self-employment, he has $3,600 of self-employment income for such taxable year. If, in addition to having $5,000 of net earnings from self-employment, such individual has $1,000 of wages, he has only $2,600 of self-employment income for the taxable year. For the purpose of this limitation, the term "wages" includes reimbursement paid to an employee for services covered by an agreement entered pursuant to section 218 of the Social Security Act (42 U. S. C. 418) which section provides for extension of the Federal old-age and survivors insurance system to State and local government employees under voluntary agreements between the States and the Secretary of Health, Education, and Welfare (Federal Security Administrator before April 11, 1953).

(a) Minimum net earnings from self-employment. Self-employment income does not include earnings from the self-employment of an individual when the amount of such earnings for the taxable year is less than $400. Thus, an individual having only $300 of net earnings from self-employment for the taxable year would not have any self-employment income. However, an individual having net earnings from self-employment of $400 or more for the taxable year may have less than $400 of self-employment income. This would occur in a case in which the amount of the individual's net earnings from self-employment were more for a particular year and the individual also receives more than $3,200 but less than $3,600 of wages during that taxable year. For example, if an individual has net earnings from self-employment of $1,000 for a taxable year and also receives wages of $3,400 during that taxable year, his self-employment income for that taxable year is $0.00.

(d) Nonresident aliens. A nonresident alien individual never has self-employment income. For the purpose of the tax on self-employment income, an individual is a citizen of the United States but who is a resident of the Virgin Islands or of Puerto Rico is not considered to be a nonresident alien individual. While a nonresident alien individual who derives income from a trade or business carried on within the United States, Puerto Rico, or the Virgin Islands (whether by agents or employees, or by a partnership of which he is a member) may be subject to the applicable income tax on such income, such nonresident alien individual will not be subject to the tax on self-employment income, since any net earnings which he may have from self-employment do not constitute self-employment income.

§ 39481-3 Trade or business. (a) In general. It is a trade or busi-
ness for all purposes of the Act unless it is shown that the individual is engaged in an occupation or business substantially similar to the one described in paragraphs (b) (c) (d) (e) and (f) of section 191 of this chapter, the term "trade or business" for the purpose of the tax on self-employment income, shall have the same meaning as when used in section 218. An individual engaged in one of the excluded activities specified in this section may also be engaged in a non-excluded trade or business. Whether or not he is also engaged in an included trade or business will be dependent upon all of the facts and circumstances in the particular case.

(b) Public office. The performance of the functions of a public office does not constitute a trade or business. The term "public office" includes any elective or appointive office of the United States or of any State, of any political subdivision, or of a wholly owned instrumentality of any one or more of the foregoing. For example, the President, the Vice President, a governor, a mayor, the Secretary of State, a member of Congress, a State representative, a county commissioner, a judge, a county sheriff, a county registrar of deeds, or a notary public performs the functions of a public office.

(c) Employees. The performance of service by an individual as an employee, as defined in sections 39481-16 of this chapter, is a trade or business. The term "employee" includes any elective or appointive office of the United States or of any political subdivision or of a wholly owned instrumentality of any one or more of the foregoing. For example, a pastor of a church in the exercise of his office.

(d) Employment income. The performance of services in an employment capacity, at any fixed or definite price, or on a commission basis, or at any other rate or on any other method, does not constitute a trade or business.

(e) Ministers or members of religious orders. The performance of service by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a religious order in the exercise of duties required by such order does not constitute a trade or business. The duties of ministers include the ministration of sacramental functions and the conduct of religious worship, and the control, administration, and management of properties, such as real or personal, of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination.

(f) Members of certain professions. (1) The performance of service by an individual in the exercise of his profession as a physician, lawyer, dentist, osteopath, veterinarian, chiropractor, naturopath, optometrist, Christian Scientist, or psychologist, is not an excluded trade or business. Whether or not he is also engaged in an included trade or business will be dependent upon all of the facts and circumstances in the particular case. (2) Public accountant, accountant registered or licensed as an accountant under State or municipal law, full-time practicing public accountant, funeral director, or undertaker is not an excluded trade or business. This exclusion applies only if the individual meets the legal requirements, if any, for practicing his profession in the place where he performs the service. Thus, an accountant who is neither certified, registered, nor licensed but who is publicly engaged in the practice of accounting on a full-time basis is treated as engaged in the full-time practice of accounting, and the term "lawyer" means an individual who is legally qualified to practice law and the term "professional engineer" means an engineer legally qualified to practice before the public under State or Federal law.

(3) In the case of a partnership engaged in the practice of any of the designated professions, the partnership shall not be considered as carrying on a trade or business for the purpose of the tax on self-employment income, and none of the distributive shares of the ordinary net income or the ordinary net loss of such partnership shall be included in computing net earnings from self-employment of any member of the partnership. On the other hand, where a partnership is engaged in a trade or business not within any of the designated professions and contributes his distributive share of the ordinary net income or the ordinary net loss of such partnership in computing his net earnings from self-employment, irrespective of whether such partner is also engaged in the practice of one or more of such professions and contributes his professional services to the partnership.

§ 39481-4 Employee and wages. For the purpose of the tax on self-employment income, the term "employee" and the term "wages" shall have the same meanings as when used in the Federal Insurance Contributions Act. For an explanation of these terms, see Regulations 128 (Part 408 of this chapter).

§ 39482.Statutory provisions; returns for tax on self-employment income; cross references.

Sec. 453. Miscellaneous provisions. Every individual (whether resident or nonresident alien individuals having no earnings from self-employment of $600 or more for the taxable year shall make a return containing such information for the year as to income, gains, and losses from all sources, and the nature and amount of any other income, gains, and losses. For an explanation of these terms, see Regulations 128 (Part 408 of this chapter).
purpose of carrying out the provisions of this subchapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe. Such return shall be con-
sidered a return under section 51 (a). In the case of a husband and wife filing a joint return under section 51 (b), the tax imposed by the provisions shall not be computed on the aggregate income but shall be the sum of the taxes computed un-
der this subchapter on the separate self-em-
ployment income of each spouse.

(b) Title of subchapter. This subchapter may be known as the "Self-Employment Contributions Act."

(c) Effective date in case of Puerto Rico. For effective date in case of Puerto Rico, see section 3511.

(d) Collection of taxes in Virgin Islands and Puerto Rico. For provisions relating to collection of taxes in Virgin Islands and Puerto Rico, see section 3511.

[Sec. 482 as added by sec. 203 (a), Social Security Act Amendments 1950]

§ 39.492-1 Returns—(a) In general. Every individual, other than a nonresi-
dent alien, earning a total of $400 or more from self-employment of $400 or more for the taxable year shall make a return on Form 1040 in accordance with the in-
structions thereof, or issued therewith, and the provisions applicable to this return imposed by section 51 (a) shall be applicable to this return. Such return shall be consid-
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(b) Joint returns. (1) In the case of a husband and wife filing a joint return under section 51 (b), the tax on self-employment income is computed on the separate self-employment income of each spouse, and not on the aggregate of the two amounts. The requirement of section 51 (b) to file a return in the case of a joint return the tax on self-employment income of the aggregate income of the spouses is not applicable with respect to the tax on self-employment income. Where the husband and wife has not earned from self-employment of $400 or more, it will be necessary for each to complete separately a schedule C of Form 1040 with respect to such net earnings, despite the fact that a joint return is filed. If the net earnings from self-employment of either the husband or the wife are less than $400, such net earnings are subject to the tax on self-employment income, even though they must be shown on the joint return for the purpose of the taxes imposed by sections 11 and 12.

(2) Except as otherwise expressly provided, section 51 (b) is applicable to the return of the tax on self-employment income; therefore, the liability with re-
spect to such tax in the case of a joint return is joint and several.

(c) Self-employment tax account numbers. Every individual making a return of net earnings from self-employment is re-
quired to show thereon his social secu-

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rity account number, or, if he has no such account number, to make applica-
tion therefor on Form SS-5 before the filing of such return. However, the

§ 39.501 Statutory provisions; definition of personal holding company—(a) General rule. For the pur-
pouses of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) Gross income requirement. At least 93 per centum of its gross income for the taxable year is "personal income" as defined in section 502; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1953, then, for each sub-
sequent taxable year, the minimum percent-
anceum required by paragraph (2) shall be 50 per centum. In lieu of 63 per centum, until a taxable year during which the less than 75 per centum of the income of the corporation during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through other foreign corporations.

(2) Stock ownership requirement. At any time during the last half of the taxable year more than 50 per centum of the outstanding stock is owned, directly or in-
directly, by or for more than five individuals.

(b) Exceptions. The term "personal holding company", as defined in section 531, does not include—

(1) A corporation exempt from taxation under section 101.

(2) A bank as defined in section 104.

(3) A life insurance company.

(4) A regulated investment company.

(5) A foreign personal holding company as defined in section 351.

(6) A personal finance company under State supervision, 60 per centum or more of the gross income of which is interest received from loans made to individuals in accordance with the provisions of applicable State law if at least 93 per centum of such gross income is interest income (1) received from individuals, each of whom indebtedness to such company did not at any time during the taxable year exceed the limits prescribed for small loans by such law (or, if there is no such limit, $5,000), and (2) not payable in advance or compounded and computed only on unpaid balances, and if the loans to a person, who is a shareholder in such company during the taxable year by or for whom 10 per centum or more in value of its outstanding stock is owned directly or indirectly through other foreign corporations by an individual, stock owned by the members of his family as defined in section 503 (a).

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or more State statutes providing for the
direct regulation of such business, 80 per
cent of the capital, surplus, or undivided
profits of which is lawful, interest, discount or other au-
thorized charges (received from loans matur-
ing in not more than thirty-six months made to
individuals, or on unpaid balances, which is
equal to simple interest at the rate of 3 per
cent per month not payable in advance and
compounding or carrying, an amount not less
than 60 per cent of the gross Income is
lawful, interest, discount or other authorized
charges, arising out of the	

(1) A loan or investment corporation, a sub-
stantial part of the business of which consists
of receiving funds not subject to check and
evidenced by installment or fully paid certifi-
cates of indebtedness or evidence of
payment, and making loans and discounts, and
the loans to a person who is a shareholder in
such corporation, or to any member of his
family as defined in section 503 (a) (3).

(2) An insurance company, actively and reg-
ularly engaged in the business of purchasing
or discounting accounts or notes receivable,
or installment obligations, or making loans
secured or unsecured, or purchasing
chattel mortgages, or chattel lease agreements,
arising out of the	

(A) Purchasing or discounting accounts
or notes receivable, or installment obliga-
tions evidenced or secured by contracts of
conditional sale, chattel mortgages, or
chattel lease agreements, arising out of the
sale of goods or services for the purpose of
the transfer of title to the goods or services;
(B) Making loans, maturing in not more
than thirty-six months, to, and for the busi-
dess purposes of, persons engaged in trade
or business, secured by—

(1) Accounts or notes receivable, or install-
ment obligations, described in subparagraph
(a) above;
(2) Warehouse receipts, bills of lading,
trust receipts, chattel mortgages, bonds, bills
or factor's bills, covering or evidencing the
borrower's inventories;
(3) A purchase or charge on property used
in the borrower's trade or business;

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of the average funds employed by the com-
pany during such taxable year;
(G) Making loans in accordance with the
provisions of applicable State law, secured
by chattel mortgages on tangible personal prop-
terty, the original amount of which is not
less than $5,000, and the aggregate principal
amount of which, together with any one or more
loans to the same borrower at any time
during the taxable year of the company does
not exceed $5,000; and
(H) If the amount of the gross
income of the company is derived from one or
more of the classes of transactions described
in subparagraphs (A), (B), (C), (D), (E), (F),
and (G) of this paragraph, purchasing,
discounting, or lending, under the security of,
installment obliga-
tions of individuals, or install-
ment obligations of borrower or
borrower acquired such obligations either	

in such corporation during such taxable
year, the loans to a person who is a shareholder
or borrower acquired such obligations either
to transactions of the classes described in
subparagraphs (A), (B), (C), (D), (E), (F),
and (G) of this paragraph, or as a result of loans
made by such transferor or borrower. In accordance
with the provisions of clauses (i) and (ii) of para-
graph 6 (B) of this subsection, if
the loans so supplied at all times bear an agreed
rate of interest, discount, or other authorized
charges, arising out of the

(A) A loan or investment corporation, a sub-
stantial part of the business of which consists
of receiving funds not subject to check and
evidenced by installment or fully paid certifi-
cates of indebtedness or evidence of
payment, and making loans and discounts, and
the loans to a person who is a shareholder in
such corporation, or to any member of his
family as defined in section 503 (a) (3).

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(A) Purchasing or discounting accounts
or notes receivable, or installment obliga-
tions evidenced or secured by contracts of
conditional sale, chattel mortgages, or
chattel lease agreements, arising out of the
sale of goods or services for the purpose of
the transfer of title to the goods or services;
(B) Making loans, maturing in not more
than thirty-six months, to, and for the busi-
dess purposes of, persons engaged in trade
or business, secured by—

(1) Accounts or notes receivable, or install-
ment obligations, described in subparagraph
(a) above;
(2) Warehouse receipts, bills of lading,
trust receipts, chattel mortgages, bonds, bills
or factor's bills, covering or evidencing the
borrower's inventories;
(3) A purchase or charge on property used
in the borrower's trade or business;

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of the average funds employed by the com-
pany during such taxable year;
(G) Making loans in accordance with the
provisions of applicable State law, secured
by chattel mortgages on tangible personal prop-
terty, the original amount of which is not
less than $5,000, and the aggregate principal
amount of which, together with any one or more
loans to the same borrower at any time
during the taxable year of the company does
not exceed $5,000; and
(H) If the amount of the gross
income of the company is derived from one or
more of the classes of transactions described
in subparagraphs (A), (B), (C), (D), (E), (F),
and (G) of this paragraph, purchasing,
discounting, or lending, under the security of,
installment obliga-
tions of individuals, or install-
ment obligations of borrower or
borrower acquired such obligations either
to transactions of the classes described in
subparagraphs (A), (B), (C), (D), (E), (F),
and (G) of this paragraph, or as a result of loans
made by such transferor or borrower. In accordance
with the provisions of clauses (i) and (ii) of para-
graph 6 (B) of this subsection, if
the loans so supplied at all times bear an agreed
rate of interest, discount, or other authorized
charges, arising out of the

(A) Purchasing or discounting accounts
or notes receivable, or installment obliga-
tions evidenced or secured by contracts of
conditional sale, chattel mortgages, or
chattel lease agreements, arising out of the
sale of goods or services for the purpose of
the transfer of title to the goods or services;
(B) Making loans, maturing in not more
than thirty-six months, to, and for the busi-
dess purposes of, persons engaged in trade
or business, secured by—

(1) Accounts or notes receivable, or install-
ment obligations, described in subparagraph
(a) above;
(2) Warehouse receipts, bills of lading,
trust receipts, chattel mortgages, bonds, bills
or factor's bills, covering or evidencing the
borrower's inventories;
(3) A purchase or charge on property used
in the borrower's trade or business;
fleeted 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.

(d) The rules stated in paragraphs (b) and (c) of this section are equally applicable in determining the stock ownership requirement specified in section 502 (e) relating to personal service contracts, service contracts, and the use of corporation property. 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.

§ 39.502 Statutory provisions; personal holding company income; definition.
Sec. 501. Personal holding company income. For the purposes of this section, the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends. Interest (other than interest constituting rent as defined in subsection (d)), royalties, dividends (other than mineral, oil, or gas royalties), annuities.

(b) Stock and securities transactions. Except in the case of regular dealers in stock or securities, the sale or exchange of stock or securities.

(c) Commodities transactions. Gains from futures transactions in any commodity or subject to the rules of a board of trade or commodity exchange. This subsection shall not apply to gams by a producer, processor, merchant, or handler of the commodity which arise 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.

(d) Estates and trust. Amounts includible in computing the net income of the corporation under Supplement B of chapter I; and gains or other dispositions of any interest in an estate or trust.

(e) Personal service contracts. (1) Amounts includible in computing the net income of the corporation to which the corporation is furnishing personal services; if 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 the contract; and (2) amounts received from the sale or other disposition of such a contract. This subsection shall apply with respect to amounts received for services under a contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(f) Use of corporation property by shareholders. Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 per centum 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 sublease or other arrangement.

(g) Rents. Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection the term "rents" means compensation, however described, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property is held primarily for sale to customers in the ordinary course of its trade or business was cost or revalued by the corporation. It does not include amounts constituting personal holding company income under subsection (1), (2), (3), (5), or (7) of section 502 (g).

Mineral, oil, or gas royalties, unless (1) constituting 50 per centum or more of the gross income, and (2) the deductions allowable under section 22 (c) (relying to expenses) other than compensation for personal services rendered by shareholders, constitute 15 per centum or more of the gross income.

§ 39.502-1 Personal holding company income. The term "personal holding company income" means the portion of the gross income which consists of the following:

(a) Dividends. The term "dividends" includes dividends as defined in section 115 (a) and amounts required to be included in gross income under section 377 (b). See § 39.115(b).

(b) Interest (other than interest constituting rent). The term "interest" means any amounts, includible in gross income, received for the use of money loaned or flanked. It does not include interest constituting rent (see paragraph (f) of this section).

(c) Royalties (other than mineral, oil, or gas royalties). The term "royalties" includes amounts received for 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 other disposals of stock or securities received by an operating company. As used in this paragraph the term "overriding royalties" means amounts received from the operator of a company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

(d) Annuities. The term "annuities" includes amounts only to the extent includible in the computation of gross income. (See section 22 (b) (2).)

(e) Gains from the sale or exchange of stock or securities as used in section 502 (b) applies to all gains (including gains from liquidating distributions (other than distributions from capital) from the sale or exchange of stock or securities includible in gross income. The term "stock or securities" as used in section 502 (b) includes stock or securities of stock or interest in any corporation (including any joint-stock company, insurance company, association, or other organization classified as a corporation by the Internal Revenue Code) certificates of interests or participation in any profit-sharing agreement, or in any oil, gas, or other mineral royalty, or lease, collateral trust certificates, voting trust certificates, stock rights or warrants, bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, obligations issued by or on behalf of a Government, 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 in the ordinary course of a trade or business. The term "regular dealer in stock or securities" means corporations with an established place of business regularly engaged in the purchase of stock or securities for the purpose of furnishing such services. Such corporate customers, but such corporations are not dealers with respect to stock or securities held for speculation or investment.

(f) Gains from futures transactions in commodities. Gains from futures transactions in commodities include 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 contracts or gains by a producer, processor, merchant, or handler of the commodity, which arise 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, personal holding company income includes gains on futures contracts which are speculative. Futures contracts representing true hedges against price fluctuations in spot goods are not speculative transactions, though not concurrent with the conduct of its business in the manner in which such business is customarily and usually conducted by others. In general, personal holding company income includes gains on futures contracts which are not hedges against spot transactions are speculative unless they are hedges against concurrent futures or forward sales or purchases.

(g) Income from estates and trusts. The income from estates and trusts which is to be included in personal holding company income consists of the income from estates and trusts which is required to be included in the gross income of the corporation under sections 161 to 169, inclusive, together with the gains derived from the conversion of the sales or other disposition of any interest in an estate or trust.

(h) Amounts received under personal service contracts. (1) 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 furnishing personal services, and amounts received from a sale or other disposition of such a contract.

(i) 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 the contract; and

(ii) At some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who is to perform, or may be designated (by name or by description) as the one to perform, such services. For this purpose the stock ownership must be determined as pro-

§ 39.502-1
RULES AND REGULATIONS

provided in section 503 and the regulations thereunder and § 39.501–3 (d)

(2) The application of section 502 (e) may be illustrated by the following examples:

Example (1). A, whose profession is that of an actor, 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, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation elected to include the amount received under the contract in section 501 and paragraph (f) of § 39.501-6, or $15,000 received by the M Corporation from the O Corporation in consideration of which the O Corporation was to pay the M Corporation $50,000 a year. The $50,000 received by the M Corporation from the O Corporation constitutes personal holding company income.

Example (2). The N Corporation, the entire outstanding capital stock of which is owned by four individuals, is engaged in engineering. The N Corporation entered into a contract with the O Corporation to perform services for the O Corporation. In consideration of which the O Corporation was to pay the N Corporation $50,000, a person who was to perform the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $50,000 received by the N Corporation from the O Corporation does not constitute 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, family, and partnership.

(2) Family and partnership ownership. An individual shall be considered as owning the stock owned, directly or indirectly, by the whole or half blood) spouse, ancestors, and lineal descendants. 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.

(3) Options. If any person has an option to acquire stock of such stock shall be considered as owned by such person. For the purposes of paragraphs (2) and (3) of section 501 and paragraph (a)-6 of § 39.503 and the regulations thereunder and § 39.501–3 (d)

(1) 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 in the form of land or water, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the course of its trade or business was sold or exchanged by the corporation, but do not include amounts constituting personal holding company income from section 501(c) of paragraph (1) of this section. However, rents do not constitute personal holding company income if constituting 50 percent or more of the gross income of the corporation.

(2) Mineral, oil, or gas royalties. The income from mineral, oil, or gas royalties is to be included as personal holding company income, unless the aggregate amount of such royalties constitutes 50 percent or more of the gross income of the corporation for the taxable year and the aggregate amount of deductions allowable for expenses under section 23 (a) (other than compensation for personal services) paid by the shareholders of the corporation equals 15 percent or more of the gross income of the corporation for the taxable year.

(b) Amounts received under a personal service contract or from the sale of any property owned in whole or half blood) spouse, ancestors, and lineal descendants.

(2) 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. 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, the M Corporation shall be considered as being owned equally by A and B as the individuals owning the beneficial interest therein. See also §§ 39.503 (a)–6.

§ 39.503 (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), (c), and paragraph (i) of § 39.501–3, or

(b) Amounts received under a personal service contract or from the sale of any property owned in whole or half blood) spouse, ancestors, and lineal descendants.

APPLICATION

(1) A corporation is illustrated in example (a) of § 39.503 (c)–1. The A Corporation at some time during the last half of the taxable year, had 1,800 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 1,350 were held by 81 shareholders as follows:

Example. The M Corporation at some time during the last half of the taxable year, had 1,800 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 1,350 were held by 81 shareholders as follows:
Section 39.503

§ 39.503 (a)–6 Constructive ownership as actual ownership. (a) In determining the ownership of stock for any of the purposes set forth in § 39.503 (a)–1, (2), (3), (4), (5), (6), (7), (8), (9), or (11), relating to stock not owned by an individual, or the family and partnership rule provided in section 503 (a) (3) in order to make another person the constructive owner of such stock, and

(1) Stock constructively owned by a person by reason of the application of the rule provided in section 503 (a) (1), relating to stock not owned by an individual (see § 39.503 (a)–2) shall be considered as actually owned by such person for the purpose of again applying such rule or of applying the family and partnership rule provided in section 503 (a) (2) (see § 39.503 (a)–3) in order to make another person the constructive owner of such stock, and

(2) Stock constructively owned by a person by reason of the application of the option rule provided in section 503 (a) (3) (see § 39.503 (a)–4) shall be considered as actually owned by such individual for the purpose of again applying such rule in order to make another individual the constructive owner of such stock. (See § 39.503 (a)–6.)

§ 39.503 (a)–7 Option rule in lieu of family and partnership rule. (a) If, in determining the ownership of stock for any of the purposes set forth in § 39.503 (a)–1, (2), (3), (4), (5), (6), (7), (8), (9), or (11), relating to stock not owned by an individual, or the family and partnership rule provided in section 503 (a) (3) in order to make another person the constructive owner of such stock, and

(1) Stock constructively owned by an individual by reason of the application of the family and partnership rule provided in section 503 (a) (3) (see § 39.503 (a)–3) shall be considered as actually owned by such individual for the purpose of again applying such rule in order to make another individual the constructive owner of such stock. (See § 39.503 (a)–7.)

(b) The application of this section may be illustrated by the following examples:

Example: Two brothers, A and B, each own 10 percent of the stock of the M Corporation. A's wife, AW, owns an option to acquire stock in the M Corporation. Under the rule provided in section 503 (a) (3) of the M Corporation, the constructive owner of the stock of the M Corporation is considered as actually owned by the M Corporation, the sole shareholder of the M Corporation. Such constructive ownership of the stock of the M Corporation is considered as actual ownership for the purpose of again applying such rule in order to make another individual the constructive owner of the stock of the M Corporation. Such constructive ownership of the stock of the M Corporation is considered as actual ownership for the purpose of again applying such rule in order to make another individual the constructive owner of the stock of the M Corporation. (See § 39.503 (a)–3.)

By applying the statutory rule provided in section 503 (a) (2) five individuals own more than 50 percent of the outstanding stock as follows:

<table>
<thead>
<tr>
<th>Relationships</th>
<th>Shares</th>
<th>Shares</th>
<th>Shares</th>
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</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>100</td>
<td>B</td>
<td>20</td>
<td>C</td>
<td>20</td>
</tr>
<tr>
<td>A</td>
<td>100</td>
<td>B</td>
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<td>D</td>
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</tr>
<tr>
<td>A</td>
<td>100</td>
<td>B</td>
<td>20</td>
<td>E</td>
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<td>A</td>
<td>100</td>
<td>B</td>
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</tr>
<tr>
<td>A</td>
<td>100</td>
<td>B</td>
<td>20</td>
<td>G</td>
<td>20</td>
</tr>
</tbody>
</table>

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 a constructive owner of the stock of the P Corporation.

By applying the family and partnership rule provided in section 503 (a) (3) the P Corporation may be considered as actually owned by the stock of the P Corporation owned by C, an individual, who is not a member of A's family. Such constructive ownership of the stock of the P Corporation owned by C could not again be applied in order to make another member of A's family a constructive owner of the stock of the P Corporation.

Example: B, an individual, owns all the stock of the B Corporation. B has an option to acquire all the stock of the S Corporation, owned by C, an individual, who is not a member of B's family. Under the option rule provided in section 503 (a) (3) the B Corporation may be considered as actually owned by the stock of the S Corporation owned by C. Such constructive ownership of the stock of the S Corporation owned by C could not again be applied in order to make another member of B's family a constructive owner of the stock of the S Corporation.
§ 39.503 (b) Statutory provison, owning of convertible securities treated as stock ownership.

Sec. 503. 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 502 (2), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company.

(2) For the purpose of section 502 (e) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company.

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 outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others may not be included unless all outstanding securities having a prior conversion date are also included.

§ 39.503 (b)–1 Convertible securities.

Under section 503 (b) outstanding securities of a corporation, such as bonds, debentures, or other corporate obligations, convertible into stock of the corporation (whether or not convertible during the taxable year) shall be considered as outstanding stock of the corporation for the purpose of the stock ownership requirement provided in section 501 (a) (2) but only if the effect of such consideration is to make the corporation a personal holding company. Such convertible securities shall be considered as outstanding stock for the purpose of section 502 (e) (1) relating to amounts received under personal service contracts or of section 502 (f) relating to compensation for the use of property but only if the effect of such consideration is to make the corporation a personal holding company. Such consideration of convertible securities as outstanding 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 no convertible securities shall be considered as outstanding stock unless all outstanding securities having a prior conversion date are also so considered.

For example, if outstanding securities are convertible in 1952, 1953, and 1954, those convertible in 1952 can be properly considered outstanding stock without so considering those convertible in 1952 or 1954, and those convertible in 1952 and 1953 can be properly considered as outstanding stock without so considering those convertible in 1954. However, the securities convertible in 1953 could not be properly considered as outstanding stock without so considering those convertible in 1952 and the securities convertible in 1954 could not be properly considered as outstanding stock without so considering those convertible in 1952 and 1953.

§ 39.504 Statutory provisons, undistributed subchapter A net income; defition.

Sec. 504. Undistributed subchapter A net income. For the purposes of this subchapter the term "undistributed subchapter A net income" means the subchapter A net income (as defined in section 501) minus:

(a) The amount of the dividends paid credit provided in section 37 (a) (with the benefit of paragraphs (2), (3), and (4) of section 85 (c) relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company.

(b) The amount of the dividends paid credit provided in section 26 (b) (1), by the amount of the credit provided in section 26 (b) (2) (relating to interest on certain obligations of the United States and Government corporations), but, in the computation of the dividends paid credit for the purposes of this subchapter, the amount after under subsection (c) of this section or of section 405 of the Revenue Act of 1938, the amount payable under this subchapter is considered as a dividend paid in such preceding taxable year and not in the year of distribution.

(c) Dividends paid after the close of the taxable year and before the 15th day of the following year.

(d) * * * [not applicable].

(e) The amount by which the undistributed subchapter A net income determined without reference to this subsection exceeds the amount which could be distributed on the last day of the taxable year as a dividend (1) without violating any action, regulation, rule, or prohibition or being delinquent, made, or issued, or pursuant to the direction of, the President or any agency of the United States, including the Trading With the Enemy Act of October 10, 1917, as amended, or the First War Powers Act of 1941, and (2) not subject to a lien in favor of any creditor without its reduction, under section 27 (a) (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (b) (2), relating to interest on certain obligations 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, such amounts being recompute with reference to the size and the terms of such indebtedness (see § 39.504–2), and (c) dividends paid after the close of the taxable year and before the 16th 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.

In computing the dividends paid credit for the purposes of subchapter A of chapter 2, 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.

§ 39.504–2 Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934—(a) Indeptedness. The term "indebtedness" means an obligation, absolute and not contingent, to pay, on demand or within a given time, in cash or other medium, a fixed amount.

The term "indebtedness" does not include the obligation of a corporation on its capital stock.

(b) The indebtedness must have been incurred (or, if incurred by assumption, assumed) by the taxpayer before January 1, 1934. An indebtedness evidenced by bonds, notes, or other obligations issued by a corporation is ordinarily incurred as the date such obligations are issued and the amount of such indebtedness is the amount represented by the face value of the obligations. In the case of refunding, a change in the form of an indebtedness, the giving of a new promise to pay by the taxpayer will not have the effect of changing the date the indebtedness was incurred.

(b) Amounts used or irrevocably set aside. The deduction 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. In the case of refunding, a change or other change in the form of an indebtedness, the mere giving of a new promise to pay by the taxpayer will not result in an allowable deduction if the obligations are set aside in one year, no deduction is allowable for such amounts for a later year in which actually paid. As long as all other conditions of this subsection are observed, the aggregate amount allowable as a deduction for 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 deductions are not permitted.

(c) Reasonableness of the amounts with reference to the size and terms of the indebtedness. (1) The reasonableness of the amounts used or irrevocably set aside must be determined by reference to the size and terms of the particular indebtedness and circumstances with respect to the nature, scope, conditions, amount, maturity, and other terms of the particular indebtedness must be shown in each case.

(2) 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 deduction 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.

(3) All amounts irrevocably set aside for the payment or retirement of an indebtedness in accordance with and pursuant to the terms of the obligation, for trustees required by the provisions of a mandatory sinking fund agreement, will be considered reasonable. The amount used or irrevocably set aside need not comply 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 for years prior to that in which the plan is adopted. However, if a voluntary plan was adopted before 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 establish the information required by the return, and such other information as the Commissioner may require in substantiation of the deduction claimed.

§ 39.505—Subchapter A net income. (a) 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 22 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 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 no return the "subchapter A net income" means the gross income from sources within the United States as defined in section 119 and the regulations thereunder less the deductions enumerated in section 505 (a) but subject to the qualifications, limitations, and exceptions provided in section 1 (see section 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 "subchapter A net income" shall be computed on the basis of the period included in the taxable year, and is not placed on an annual basis under section 47 (c).

(b) The "subchapter A 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, as provided in section 22 (b) (4). The "subchapter A net income" does not include interest on obligations of States or Territories of the United States or any political subdivision thereof or of the District of Columbia or of the possessions of the United States.

(c) The foreign tax credit permitted by section 901 is allowed to the taxes imposed by chapter 1 is not allowed with respect to the surtax imposed by section 509. However, the deduction of foreign taxes under section 23 (a) is permitted only on the net income as defined in section 505 (d). The deduction of foreign taxes is not allowed under section 22 (b) (4) (3). The purpose of the corporate tax imposed by chapter 1 a credit for such taxes is taken.

(d) In addition to the qualifications, limitations, and exceptions provided in section 505 (a), a personal holding company is subject to the provisions of section 505 (b) and (c) in the computation of its subchapter A net income. Section 505 (c) provides that the net operating loss deduction provided in section 22 (b) (4) shall not be allowed. Under section 505 (b) the aggregate of the deductions allowed under section 22 (a) relating to expenses, and section 23 (a) relating to depreciation, which are allocable to the operation and maintenance of the property owned or operated by the company shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner:

§ 39.505—Subchapter A net income. (a) 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 22 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 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 no return the "subchapter A net income" means the gross income from sources within the United States as defined in section 119 and the regulations thereunder less the deductions enumerated in section 505 (a) but subject to the qualifications, limitations, and exceptions provided in section 1 (see section 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 "subchapter A net income" shall be computed on the basis of the period included in the taxable year, and is not placed on an annual basis under section 47 (c).

(b) The "subchapter A 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, as provided in section 22 (b) (4). The "subchapter A net income" does not include interest on obligations of States or Territories of the United States or any political subdivision thereof or of the District of Columbia or of the possessions of the United States.

(c) The foreign tax credit permitted by section 901 is allowed to the taxes imposed by chapter 1 is not allowed with respect to the surtax imposed by section 509. However, the deduction of foreign taxes under section 23 (a) is permitted only on the net income as defined in section 505 (d). The deduction of foreign taxes is not allowed under section 22 (b) (4) (3). The purpose of the corporate tax imposed by chapter 1 a credit for such taxes is taken.

(d) In addition to the qualifications, limitations, and exceptions provided in section 505 (a), a personal holding company is subject to the provisions of section 505 (b) and (c) in the computation of its subchapter A net income. Section 505 (c) provides that the net operating loss deduction provided in section 22 (b) (4) shall not be allowed. Under section 505 (b) the aggregate of the deductions allowed under section 22 (a) relating to expenses, and section 23 (a) relating to depreciation, which are allocable to the operation and maintenance of the property owned or operated by the company shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner:
(1) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on with the primary object of profit;

(3) That there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business for which it was held;

(4) That the burden of proof will rest upon the taxpayer to sustain the deduction claimed. If, in computing its subchapter A net income, the corporation 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 the additional deductions together with a complete statement of the facts and circumstances pertinent to its claim and the arguments on which it relies. The statement shall contain:

(a) A description of the property;

(b) The cost or other basis to the corporation with respect to which the deduction is claimed and the depreciation applicable to the estate as provided in section 405 (b) and § 39.505-1;

(c) A copy of the contract, lease or rental agreement; and

(d) The name and address of the person from whom acquired and the date thereof;

(e) The name and address of the person to whom leased or rented, or the person permitted to use the property, and the number of shares of stock, if any, held by such person and the members of his family;

(f) 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 depreciation sustained on, the property for such years;

(g) Evidence that the rent or other compensation was the highest obtainable and, if none was received, a statement of the reasons therefor;

(h) A copy of the contract, lease or rental agreement;

(i) The purpose for which the property was used;

(j) 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;

(k) A statement of any reasons which existed for the expectation that the operation of the property would be profitable, or a statement of the necessity for the use of the property in the business of the corporation, and the reasons why the property was acquired, and

(l) Any other information pertinent to the computation of subchapter A net income, undisubstituted subchapter A net income, and

surplus. The method of computation of the subchapter A net income, the undisubstituted subchapter A net income, and the surplus under subchapter A of chapter 2 may be illustrated as follows:

(a) The following facts exist with respect to the corporation holding company which is on the cash receipts and disbursements basis, for the calendar year 1952:

(1) The net income, as computed under chapter 1, amounts to $500,000.

(2) Federal income tax imposed by sections 13 and 15 (after certain credits under section 26) amounted to $25,655, and was paid in installments—$25,500 on March 15, 1952; $15,555 on June 15, 1952; $10,000 on September 15, 1952; $10,000 on December 15, 1952.

(3) Contributions or gifts payment of which is mandatory or for the use of donates described in section 23 (q) for the purposes therein specified amount to $50,000, of which $10,000 is in arriving at the net income under chapter 1.

(4) Rent in the amount of $10,000 was received from the corporation which is in charge 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 annual depreciation on the depreciable property of the estate amounts to $5,000.

(5) The corporation has not established its right to claim the entire amount of the expenses, and depreciation allocable to the estate as provided in section 405 (b) and § 39.505-1.

(6) Dividends paid by the corporation to its shareholders during the taxable year which are allowable as a credit under section 11 (a) amount to $200,000.

(7) The amount used during the year to such credit shall not exceed the portion of such dividends, as defined in subsection (c), not in excess of $2,000, plus 75 per centum of the amount of such dividends in excess of $2,000 but such credit shall not exceed the amount of the dividend so established which is not paid on or before the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be. Such credit shall be allowed as of the date the claim for deficiency dividend credit is filed under subsection (d). The amount of such credit shall be 6% per centum of the amount of deficiency dividends, as defined in subsection (c), not in excess of $2,000, plus 75 per centum of the amount of such dividends in excess of $2,000 but such credit shall not exceed the amount of the dividend so established which is not paid on or before the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be.

(b) Credit or refund of deficiency paid. When the Commissioner has determined that there is a deficiency with respect to the tax imposed by this subchapter and the corporation has paid any portion of such asserted deficiency and it has been paid in full:

(1) By a decision of the Board of Tax Appeals which has become final; or

(2) By a closing agreement made under section 7809 or

(3) By a final judgment in a suit against the United States for refund—

(A) If such suit is brought within six months after the corporation became entitled to bring suit, and

(B) If claim for refund was filed within six months after the payment of such amount:

that such portion of the amount so paid was the whole or a part of a deficiency at the time when paid, then there shall be credited or refunded to the corporation an amount equal to 6% per centum of the amount of such deficiency dividends not in excess of $2,000, plus 75 per centum of the amount of such dividends in excess of $2,000, but such credit or refund shall not exceed the portion so paid by the corporation. Such credit or refund shall be made in accordance with and subject to subsection (b) or subsection (c) thereof. No interest shall be allowed on any such credit or refund. No credit or refund shall be made under subsection (a) with respect to any amount of tax paid after the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be.

§ 39.505-2. Illustration of computation of subchapter A net income, undisubstituted subchapter A net income, and

Dividends paid March 1, 1952 (subject to limitation in sec. 504)

Undistributed subchapter A net income

Amount taxable at 80 percent

Amount taxable at 85 percent

Surtax on $3,000 at 76 percent

Surtax on $5,200 at 82 percent

§ 39.506. Statutory provisions; credits and refunds for deficiency dividends.

Sec. 506. Deficiency dividends—credits and refunds—(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 which has become final; or

(2) By a closing agreement made under section 7809; or

(3) By a final judgment in a suit against the United States for refund—

(A) If such suit is brought within six months after the corporation became entitled to bring suit, and

(B) If claim for refund was filed within six months after the payment of such amount:

that such portion of the amount so paid was the whole or a part of a deficiency at the time when paid, then there shall be credited or refunded to the corporation an amount equal to 6% per centum of the amount of such deficiency dividends not in excess of $2,000, plus 75 per centum of the amount of such dividends in excess of $2,000, but such credit or refund shall not exceed the portion so paid by the corporation. Such credit or refund shall be made in accordance with and subject to subsection (b) or subsection (c) thereof. No interest shall be allowed on any such credit or refund. No credit or refund shall be made under subsection (a) with respect to any amount of tax paid after the date of the closing agreement, or the date the decision of the Board or the judgment becomes final, as the case may be.
puting the tax under this subchapter for a taxable year or for any part of such year and succeeding years. The deficiency must be established, and the allowance of the credit is subject to the following conditions, qualifications, and limitations:

(a) The corporation is required under section 506 (c) within 30 days after the date of the closing agreement or the date upon which the decision of the Tax Court or court becomes final, to file a notice of its intention to claim a deficiency dividends credit, which notice shall specify the amount of the credit intended to be claimed.

(b) The credit is subject to the following conditions, qualifications, and limitations:

1. The provision of payment of a dividend, see § 327 (b)–2.

2. Additional credit or refund for prior taxable year. * * * (Note applicable).

3. The purpose for which the credit under subsection (a) or the amount claimed, shall be stated. The amount of the credit, allowable under subsection (a), is not to exceed the amount of the deficiency on the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for appealing 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.

4. The date of the closing agreement, made under section 3760, is the date such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary, except that a closing agreement with respect to a final determination of tax liability for past years becomes final upon the date of its approval by the Commissioner.

5. The purpose for which the credit under subsection (a) or the amount claimed, shall be stated. The amount of the credit, allowable under subsection (a), is not to exceed the amount of the deficiency on the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for appealing 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.

6. The date of the closing agreement, made under section 3760, is the date such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary, except that a closing agreement with respect to a final determination of tax liability for past years becomes final upon the date of its approval by the Commissioner.

7. The purpose for which the credit under subsection (a) or the amount claimed, shall be stated. The amount of the credit, allowable under subsection (a), is not to exceed the amount of the deficiency on the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for appealing 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.

8. The date of the closing agreement, made under section 3760, is the date such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary, except that a closing agreement with respect to a final determination of tax liability for past years becomes final upon the date of its approval by the Commissioner.

9. The purpose for which the credit under subsection (a) or the amount claimed, shall be stated. The amount of the credit, allowable under subsection (a), is not to exceed the amount of the deficiency on the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for appealing 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.

10. The date of the closing agreement, made under section 3760, is the date such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary, except that a closing agreement with respect to a final determination of tax liability for past years becomes final upon the date of its approval by the Commissioner.
(4) Under section 506 (a) the deficiency dividends credit shall not exceed the portion of the deficiency (not counting the interest, additional amounts, and additions to the tax, provided by law) which is not paid on or before the date of the closing agreement, or the date the decision of The Tax Court or the judgment becomes final, as the case may be.

(b) **Form of notification.** The notice of intention to have dividends considered as deficiency dividends for the purposes of the allowance of credit under section 506 (a) shall be made with the requisite declaration on Form 975, copies of which, upon request, may be procured from any district director of internal revenue.

(c) **Contents of notification.** The notification 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; and
2. The place and date of incorporation; and
3. The amount of the unpaid deficiency with respect to which the tax imposed by such chapter is stayed for a period of 60 days after the date of the closing agreement, or the date upon which The Tax Court decision becomes final, as the case may be; and
4. The place and date of incorporation; and
5. Such other information as may be required by the notification form.

(d) **Time for filing notification.** The notification required by section 506 (c) (1) and this section shall be filed with the Commissioner of Internal Revenue, Washington 25, D. C., attention Audit Service Branch, Audit Division, within 30 days after the date of the closing agreement, or the date upon which the decision of The Tax Court or judgment becomes final, as the case may be.

(e) **Claim for deficiency dividends credit.** For claims for deficiency dividends credits, see § 39.506-5.

§ 39.506-4 **Credit or refund of deficiency paid.** If the Commissioner has determined that there is a deficiency with respect to the tax imposed by subchapter A of chapter 2 and the corporation has paid any portion of such asserted deficiency to the corporation, under certain circumstances, is entitled to a credit or refund of such deficiency. The amount of the credit or refund is computed at the rates prescribed in section 506 for the taxable year for which the deficiency was established, and the allowance of the credit or refund is subject to the following conditions, qualifications, and limitations:

(a) **Amount of credit or refund.** It must be established that the amount for which credit or refund is sought was the whole or a part of a deficiency at the time paid, and such fact must be established as provided in section 506 (b) (1) (2) or (3).

(b) **Corporation is required under section 506 (d) within 60 days after the date of the closing agreement or the date upon which the decision of The Tax Court or the judgment becomes final, as the case may be.**
prescribed notification of intention to 
seek the benefit of section 506, the 
collection of the established deficiency, 
to the extent of the amount of the credit 
specified by the corporation in such not-
ification if not in excess of the amount 
allowable under section 506 (a) 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) 
effects 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 Commis-
sioner. The Code further provides that 
where collection has been stayed as 
above indicated no claim or proceeding 
in court shall be begun for the collect-
tion of the amount stayed during the 
period for which it is stayed. The 
Commissioner, notwithstanding the provi-
sions of section 272 (b) may refrain 
from assessing the subchapter A de-
finiency (plus interest, additional 
amounts, and additions to the tax) until 
the claim for the deficiency dividends 
credit 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 for the 
amount assessed will be collected in the 
usual manner.

§ 39.507 Statutory provisions; mean-
ing of terms used.
Sec. 507. Meaning of terms used—(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. Any corporation which is 
engaged in the business of an insurance 
company, whether its profits or losses 
are realized in whole or in part as income, as defined in section 204 (b) (1), 
increased by the amount of losses incurred, 
as defined in section 204 (b) (4), and the 
amount of expenses incurred, as defined 
in section 204 (b) (7), and decreased by the 
amount deductible under section 204 (c) (7) 
(relating to tax-free interest).

§ 39.508 Statutory provisions; admin-
istrative provisions.
Sec. 508. Administrative provisions. All 
provisions of law (including penalties) 
applicable in respect of the taxes imposed by 
chapter 1, shall insofar as not inconsistent 
with this subchapter, be applicable in respect of 
the tax imposed by this subchapter except 
that the provisions of section 131 shall not 
be applicable.

§ 39.508–1 Return and payment of tax. 
A separate return is required for the 
surtax imposed by section 506. Such 
returns are filed on Form 1120. 
In the case of a personal holding 
company which is a domestic corporation, 
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 on its re-
turn imposed by chapter 1 will be exempt 
from the tax imposed by subchapter A of 
chapter 2 if the corporation is a foreign 
corporation, and the same provisions of law 
relating to the period of limitations for assessment and collection 
which govern the taxes imposed by chap-
ter 1 also apply to the surtax imposed 
under subchapter A of chapter 2. How-
ever, 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 sur-
tax imposed under subchapter A of chap-
ter 2. If the corporation subject to 
section 506 fails to file a return, the 
tax may be assessed at any time. If the 
Commissioner finds a deficiency in respect of 
the tax imposed by section 506, he is 
required to follow the same procedure 
which applies to the income tax imposed 
under chapter 1. The penalties 
applicable to the income taxes imposed 
under chapter 1, as well as the provisions of chapter 2 relating to interest and 
additions to the tax, also apply to the 
surtax imposed by section 506. The 
administrative provisions applicable 
to the surtax imposed by section 506 are 
not confined to the making of a return in 
chapter 1 but embrace all administrative 
provisions of law which have any ap-
lication to income taxes.

§ 39.509–2 Determination of tax; ass-
essment, collection. The determina-
tion, assessment, and collection of the 
tax imposed by section 506, and the ex-
amination of returns and claims in con-
nection therewith, will be made under 
such procedure as may be prescribed 
from time to time by the Commissioner.

§ 39.509–511 Statutory provisions; im-
proper accumulation of surplus; for-
ereign personal holding companies; pub-
llicity of returns; cross references.
Sec. 509. Improper accumulation of sur-
plus. For surtax corporations which 
accumulate or retain undue surplus on 
sharholders, see section 1602.

Sec. 510. Foreign personal holding com-
panies. For provisions relating to foreign 
personal holding companies and their 
shareholders, see Supplement P of chapter 1.

Sec. 511. Publicity of returns. For provi-
sions with respect to publicity of returns 
under this subchapter, see subsection (a) 
(2) of section 55.

SUBPART F—ADMINISTRATIVE PROVISIONS 
DISCOVERY OF TAX LIABILITY

§ 39.3604 Statutory provisions; re-
turns as to formation, etc., of for-
ereign corporation.

Sec. 3604. Returns as to formation, etc., of 
foreign corporations—(a) Requirement. 
Every person engaging in the business of a 
foreign corporation shall file with the Commis-
sioner, with the approval of the Secretary, 
any return, account, affidavit, bank, 
trust company, financial institution, or 
other person, who aids, assists, counsels, 
or advises in, or with respect to, the 
formation, organization, or reor-
person in whole or in part through the medium of subordinates or employees (including, in the case of a corporation, the officers thereof) the return of the employer required to be filed by the full or partial employee, as within the possession or knowledge or under the control of such subordinates or employees.

(2) Employees. The obligation of a subordinate or employee (including, in the case of a corporation, the officers thereof) to file a return with respect to any advice given; or with respect to the formation, organization, or reorganization of a foreign corporation, given as an incident to his employment, will be satisfied if a complete and accurate return as prescribed by this section and §§ 39.3604-2 and 39.3604-3, is made by the employer setting forth all of the information within the possession or knowledge or under the control of such subordinate or employee. Clerks, stenographers, and other subemployees, rendering aid or assistance solely of a clerical or mechanical character in or with respect to the formation, organization, or reorganization of a foreign corporation, are not required to file returns by reason of such services.

(3) Partners. In the case of a partnership, the owner, or any member thereof) to file a return with respect to any advice given; or with respect to the formation, organization, or reorganization of a foreign corporation, by or for any member thereof) to file a return with respect to any advice given; or with respect to the formation, organization, or reorganization of a foreign corporation, given as an incident to his employment, will be satisfied if a complete and accurate return as prescribed by this section and §§ 39.3604-2 and 39.3604-3, is made by the employer setting forth all of the information within the possession or knowledge or under the control of such partner or employee. Clerks, stenographers, and other subpartners, rendering aid or assistance solely of a clerical or mechanical character in or with respect to the formation, organization, or reorganization of a foreign corporation, are not required to file returns by reason of such services.

(4) Attorneys at law. An attorney at law not required to file a return with respect to any advice given in or with respect to the formation, organization, or reorganization of a foreign corporation, given as an incident to his employment, will be satisfied if a complete and accurate return as prescribed by this section and §§ 39.3604-2 and 39.3604-3, is made by the client setting forth all of the information within the possession or knowledge or under the control of such attorney at law. Clerks, stenographers, and other subemployees, rendering aid or assistance solely of a clerical or mechanical character in or with respect to the formation, organization, or reorganization of a foreign corporation, are not required to file returns by reason of such services.

(5) Returns jointly made. If two or more persons assist, advise, or counsel in or with respect to the formation, organization, or reorganization of a foreign corporation, any two of more of such persons may, in lieu of filing several returns, jointly execute and file one return.

(e) Penalties. For criminal penalties for failure to file the returns required by this section, §§ 39.3604-2 and 39.3604-3, and by section 3604 (e) see section 3604 (e).

§ 39.3604-2 Form of return. The returns under §§ 39.3604-1 shall be made on Form 589. Such forms may be procured from the district director of internal revenue. Each person should carefully prepare his return so as to set forth fully and clearly the information called for therein. Returns which have not been so prepared will not be accepted as meeting the requirements of the Code.

§ 39.3604-3 Contents of returns and declaration. (a) Every return shall, in accordance with the provisions of §§ 39.3604-1, 39.3604-2, and this section and the instructions on the form, set forth the following information to the full extent possible within the knowledge or possession or under the control of the person required to file the return:

(1) The name and address of the person (or persons) to whom and the person (or persons) for whom or on whose behalf the aid, assistance, counsel, or advice given;
(2) A complete statement of the aid, assistance, counsel, or advice given;
(3) The name and address of the foreign corporation and the country under the laws of which it was formed, organized, or reorganized;
(4) The month and year when the foreign corporation was formed, organized, or reorganized;
(5) A statement of the manner in which the formation, organization, or reorganization of the foreign corporation was effected;
(6) A complete statement of the reasons for, and the purposes sought to be accomplished by, the formation, organization, or reorganization of the foreign corporation;
(7) A statement showing the classes and kinds of assets transferred to the foreign corporation in connection with its formation, organization, or reorganization, including a detailed list of any stock or securities included in such assets, and a statement showing the names and addresses of the persons who were the owners of such assets immediately prior to the transfer;
(8) The names and addresses of the shareholders of the foreign corporation at the time of the completion of its formation, organization, or reorganization, showing the classes of stock and number of shares held by each;
(9) The name and address of the person (or persons) having custody of the books of account and records of the foreign corporation; and
(10) Such other information as may be required by the return form.

(b) If a person aids, assists, counsels, or advises in or with respect to the formation, organization, or reorganization of more than one foreign corporation, a separate return must be filed with respect to each foreign corporation.

(c) Every return shall contain or be verified by a written declaration that it is made under the penalties of perjury.

DETERMINATION OF TAX LIABILITY

§ 39.3612 Statistical provisions; returns executed by Commissioner or district director

Sec. 3612. Returns executed by Commissioner or district director.

(a) Authority of collector. If any person fails to make and file a return, the return shall be made by the attorney for the State or the United States, as may be prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise.

(b) Authority of Commissioner. In any case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise:

(1) To make return. Make a return, or
(2) To amend collector’s return. Amend any return made by a collector or deputy collector.

(c) Legal status of returns. Any return or list made and executed by a commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.

(d) Additions to tax. • • •

(3) Gross references. For additions to tax in the case of income tax, see sections 291 and 293 • • •

(e) Determination and assessment. The Commissioner shall determine and assess all taxes, other than stamp taxes, as to which returns or lists are made under the provisions of this section.

§ 39.3614-3617 Statutory provisions; examination of books and witnesses; summons from district director to produce books and give testimony; penalties; keeping of books and records and accuracy of books; failure to file returns and to pay, or list and pay, tax.

Sec. 3614. Examination of books and witnesses.—(a) To determine liability of the taxpayer. The Commissioner may by the proper officer of the district director, or of any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to add additional stools to such return, and to bring the summons and the evidence so taken to any court of competent jurisdiction for the purpose of determining the correctness of any return or for the purpose of making a return where none has been made, or authorized, by said officer or employee, or by the Bureau of Internal Revenue, including the field service, designated by him for that purpose, and may require any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to add additional stools to such return, and to bring the summons and the evidence so taken to any court of competent jurisdiction for the purpose of determining the correctness of any return or for the purpose of making a return where none has been made, or authorized, by said officer or employee, or by the Bureau of Internal Revenue, including the field service, designated by him for that purpose.

(b) To determine liability of a transferee. The Commissioner, for the purpose of determining the liability of any person acquiring interest in a transferee of the property of any person with respect to any Federal taxes imposed upon such person, is hereby authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon such liability, and may require the attendance of the transferee or transferor, or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to add additional stools to such return, and to bring the summons and the evidence so taken to any court of competent jurisdiction for the purpose of determining the correctness of any return or for the purpose of making a return where none has been made, or authorized, by said officer or employee, or by the Bureau of Internal Revenue, including the field service, designated by him for that purpose.

Sec. 3615. Summons from collector to produce books and give testimony.—(a) General and authority. It shall be lawful for the collector, subject to the provisions of this section, or of any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon such liability, and may require the attendance of the transferee or transferor, or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to add additional stools to such return, and to bring the summons and the evidence so taken to any court of competent jurisdiction for the purpose of determining the correctness of any return or for the purpose of making a return where none has been made, or authorized, by said officer or employee, or by the Bureau of Internal Revenue, including the field service, designated by him for that purpose.

Sec. 3616. Examination of books and witnesses.—(a) To determine liability of the taxpayer. The Commissioner may by the proper officer of the district director, or of any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, examine any books, papers, records, or memoranda bearing upon such liability, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to add additional stools to such return, and to bring the summons and the evidence so taken to any court of competent jurisdiction for the purpose of determining the correctness of any return or for the purpose of making a return where none has been made, or authorized, by said officer or employee, or by the Bureau of Internal Revenue, including the field service, designated by him for that purpose.
found within such State or Territory, he may enter and examine the books and papers of any person subject to tax, and he or any other officer, for the arrest of such person, and for the purpose of requiring the person to appear, to testify, or to produce books or papers, or other data, the district court of the United States for the district within which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books or papers, or other data.

To issue orders, processes, and judgments, as a matter of course, for the enforcement of internal revenue laws, see section 2729 [3530].

GENERAL COLLECTION PROVISIONS

§ 39.3653 Statutory provisions; prohibition of suits to restrain assessment or collection of tax.

Sec. 3653. Prohibition of suits to restrain assessment or collection.—(a) Tax. Except as provided in sections 372 (b), 374 (b), and 1012 (a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

(b) Liability of transferee or fiduciary. No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a taxpayer in respect of any income, war profits, excess profits, or estate tax, (2) the amount of the liability, at law or in equity, of a transferee of property of a donor in respect of any gift tax, or (3) the amount of the liability, at law or in equity, of a transferee of property of a donor in respect of any estate tax.

§ 39.3665 Statutory provisions; payment by check and money orders.

Sec. 3665. Payment by check and money orders.—(1) Certified, cashier's, and treasurer's checks and money orders.—(a) Authority to receive. It shall be lawful for collectors to receive for internal revenue taxes and in payment of stamps to be used in payment of internal revenue taxes, certified, cashier's, and treasurer's checks drawn on National and State banks and trust companies, and United States postal, bank, express, and telegraph money orders. Each such check or money order shall be endorsed and when under such regulations as the Commissioner, with the approval of the Secretary, may prescribe.

(b) Charge of Holders.—(A) Check duly paid. No person who may be indebted to the United States on account of internal revenue taxes or stamps used or to be used in payment of internal revenue taxes, who shall have tendered a certified, cashier's, or treasurer's check or money order as provisional payment therefor, in accordance with the terms of this subsection, shall be liable for the obligation to make ultimate payment thereof until such certified
cashier's, or treasurer's check or money order so received has been duly paid.

(3) Claims asserted. If any such check or money order so received is not duly paid, the United States shall, in addition to its right to exact such party or parties indebted thereby, have a lien for the amount of such check upon all the assets of the bank or issuer except the necessary costs and expenses of administration and the reimbursement to the United States of the amount expended in the redemption of the circulating notes of such bank.

(b) Other checks.—(1) Authority to receive. Collectors may receive checks in addition to those specified in subsection (a) in payment of taxes other than those payable by stamp during such time and under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe.

(2) Ultimate liability. If a check so received is not paid by the bank on which it is drawn, the person to whom such check has been tendered shall remain liable for the payment of the tax and for all penalties and interest imposed on the same as if such check had not been tendered.

[Sec. 3668 as amended by Pub. Law 541 (78th Cong.)]

§ 39.3656-1 Tax paid by check. District directors of internal revenue may accept uncertified checks in payment of income, war profits, and excess profits taxes, provided such checks are collectible at par, that is, for their full amount, without any deduction for exchange or other charges. The district director will stamp on the face of each check before deposit the words "This check is in payment of an obligation to the United States and must be paid at par. No protest" with his name and title. The day on which the district director receives the check will be considered the date of payment, so far as the taxpayer is concerned, unless the check is returned and a protest is filed. If one check is returned and a protest is filed, another check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal stating:

(a) The name of the drawer of the check;

(b) The amount of the check;

(c) The amount of any cash, money order, or other instrument included in the same remittance;

(d) The name of each person whose tax is to be paid by the remittance;

(e) The amount of the payment on account of each person; and

(f) The date of the tax paid.

§ 39.3657 Statutory provisions; payment of tax by use of Treasury notes and certificates of indebtedness.

Sec. 3657. Payment by United States notes and certificates of indebtedness. Collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States in payment of income, war profits, and excess profits taxes, and other taxes payable other than by stamp, during such time and under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe.

§ 39.3657-1 Treasury certificates of indebtedness, Treasury notes, and Treasury bills in payment of income and profits taxes. (a) Treasury certificates of indebtedness, Treasury notes, or Treasury bills of any series (not including interim receipts issued by Federal reserve banks in lieu of definitive certificates, notes, or bills) may be tendered at or before maturity in payment of income or profits taxes payable under the provisions of the Internal Revenue Code, due on the date on which such certificates, notes, or bills mature or a specified prior date, but only if such certificates, notes, or bills, according to the express terms of their issue, are made acceptable in payment of such income or profits taxes. If the taxes for which the certificates, notes, or bills are tendered in payment become due on the same date as that on which such certificates, notes, or bills mature, they will be accepted at par plus accrued interest, if any, payable with the principal (not represented by coupons attached) in payment of such taxes. If the taxes for which the certificates, notes, or bills are tendered in payment become due on a date prior to that on which the certificates, notes, or bills mature, they will be accepted at the value specified in the terms under which such certificates, notes, or bills were issued. All interest coupons attached to Treasury certificates of indebtedness or Treasury notes shall be defaced on the face of the certificate or note tendered by the taxpayer before such certificates or notes are tendered in payment of taxes.

(b) Receipts given by a district director of internal revenue for Treasury certificates of indebtedness, Treasury notes, or Treasury bills received in payment of income or profits taxes as provided in this section shall contain an adequate description of such certificates, notes, or bills, and a statement of the value, including accrued interest, if any, payable with the principal (not represented by coupons attached) at which accepted, and shall show that the certificates, notes, or bills are tendered by the taxpayer and received by the district director, subject to no condition, qualification, or reservation whatever, in payment of an amount of taxes no greater than such value. Any certificate, note, or bill offered in payment of income or profits taxes under the Internal Revenue Code subject to any condition, qualification, or reservation, or for any greater amount than the value at which acceptable in payment of taxes, as specified in the terms under which such certificate, note, or bill was issued, shall not be deemed to be duly tendered and shall be returned to the taxpayer.

(c) For the purpose of saving taxpayers the expense of transmitting such Treasury certificates of indebtedness, Treasury notes, or Treasury bills to the office of the district director of internal revenue in whose district the taxes are payable, taxpayers may pay income or profits taxes with such certificates, notes, or bills acceptable in payment of taxes may deposit such certificates, notes, or bills with a Federal reserve bank or branch, subject to the condition that the Federal reserve bank or branch shall issue a receipt in the name of the district director of internal revenue showing the payment of taxes due on such certificate, note, or bill by par or dollar face amount and stating on the face of the receipt that the certificates, notes, or bills represent taxes paid on specified date by taxpayer named therein.

§ 39.3657-2 Acceptance of Treasury Savings Notes, Series A, Series B, and Series D, in payment of income (including excess profits) taxes. (1) Notes of the United States designated as Treasury Savings Notes, Series A, Series B, and Series D, may be accepted in payment of income taxes (current and back personal and corporation taxes, and excess profits taxes) at par and accrued interest due on the maturity date of such notes (no accrual beyond the maturity date to be credited). In the case of Treasury Savings Notes, Series D, interest will be accrued to the date to which accrued interest is added, in the case of Treasury Savings Notes, Series A and Series B, interest will be accrued to the day when the taxes become due, if such day falls on the fifteenth day of a calendar month, whether the notes are received on or before that day; if the taxes are due on any other day of the month than the fifteenth, accrued interest will be credited to the accrual date next preceding the day on which the taxes are due. District directors of internal revenue are authorized and directed to accept Treasury Savings Notes, Series A and Series D, at any time and to accept Treasury Savings Notes, Series B, at any time after two months from the issue date. For example, a Treasury Savings Note, Series D, dated July 15, 1953, may be presented for credit against taxes due September 15, 1953, but a note dated August 15, 1953, may not be accepted for credit against taxes due before October 15, 1953.

(2) Such notes may be accepted only in payment of income (including excess profits) taxes (current and back) due from the original purchaser thereof or his estate. Such notes shall be in the name of the taxpayer (individual, corporation, or other entity) and may be presented for tax payment by only the taxpayer, his agent, or his estate. There is no limit upon the amount of such notes which may be accepted in payment of income (including excess profits) taxes.

(3) Such notes, inscribed in the name of a taxpayer, may be accepted in payment of income tax withheld at the source by such taxpayer and such notes inscribed in the name of a taxpayer may be accepted in payment of transfer tax on the sale of securities, capital gains tax, or estate tax or Federal inheritance tax on the value of such real or personal property.

(b) District directors of internal revenue shall not in any case allow credit to be taken on account of such notes except such notes, for an amount greater than their principal amount plus accrued interest, nor shall such notes be accepted in an amount (including accrued in-
§ 39.3658 Statutory provisions; fractional parts of a cent.

Sec. 3658. Fractional parts of a cent. In the payment of any tax or penalty under this title, the amount payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-hundredth cent or more in which case it shall be increased to 1 cent.

§ 39.3661 Statutory provisions; enforcement of liability for taxes collected or withheld.

Sec. 3661. Enforcement of liability for taxes collected. Whenever any person is required to collect any internal revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected shall not be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and the manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such amount is derived.

LIEN FOR TAXES

§ 39.3670–3673 Statutory provisions; property subject to lien; period of lien; validity against mortgagees, pledgees, purchasers, and judgment creditors; release of lien.

Sec. 3670. Property subject to lien. If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to acquire any real or personal, belonging to such person.

Sec. 3671. Period of lien. Unless another date is specifically fixed by law, the lien shall arise at the assessment in the manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which the amount is derived.

Sec. 3672. Validity against mortgagees, pledgees, purchasers, and judgment creditors—(a) Invalidity of lien without notice. Such lien shall not be valid against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector.

(1) Under State or Territorial laws. In the office in which the filing of such notice is authorized by the laws or Constitution of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office within the State or Territory; or

(2) With clerk of district court. In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office within the State or Territory; or

(3) With clerk of district court. In the office of the clerk of the United States district court for the Judicial District in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office within the State or Territory.

Sec. 3673. Release of lien. Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax, may issue a certificate of release of the lien if—

(a) Liability satisfied or unenforceable. The collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable by reason of lapses of time; or

(b) Bond accepted. There is furnished to the collector, in behalf of the taxpayer, a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, in the manner and form prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of a bond or mortgage thereon, as may be specified in the regulations.

§ 39.3673-1 Release of liens—(a) Liability satisfied or unenforceable. The district director of internal revenue in respect of which any real or personal property is charged an assessment in respect of any internal revenue tax shall issue a certificate of release of the tax lien whenever the district director finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable.

The word "unenforceable" as here used means uncollectible or enforceable as a matter of fact. Tax liabilities frequently are unenforceable in fact for the time being, due to the temporary nonpossession by the taxpayer of a discoverable property or property rights, or for the payment of the tax continues until satisfaction of the tax in full or until the expiration of the statutory period for collection, including such period as the taxpayer by consent in writing may agree with the Commissioner shall constitute the time within which the tax shall be paid. The district directors should continue to investigate carefully all cases of delinquent taxpayers where notice of lien has been filed with a view of obtaining, before the expiration of the statutory period, such written consent for the extension of the collection period, whenever it is reasonably possible that the taxpayer may be a voluntary assignee of his property, or of property rights from which the tax liability may be satisfied.

(b) Bond accepted. The district director may in his discretion issue a certificate of release of the tax lien if he furnishes and accepts a bond that is conditioned upon the payment of the amount assessed (together with all interest in respect thereof) within the time agreed upon in the bond, but not later than 2 months before the expiration of the statutory period for collection, including any period for collection agreed upon in writing by the taxpayer and the commissioner. The form of any bond so furnished shall be the standard form (Form 1131) entitled "Bonds for Release of Federal Tax Lien." Such bond shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, except that, when specifically authorized by the Commissioner, such bond may be executed by a surety or sureties, individual or corporate, other than a surety company.

§ 39.3674 Statutory provisions; partial discharge of property.

Sec. 3674. Partial discharge of property—(a) Property double the amount of the liability. Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax may issue a certificate of partial discharge of any part of the property subject to the assessment in behalf of the taxpayer, in the amount of the statutory period for collection, including such period as the taxpayer by consent in writing may agree with the Commissioner shall constitute the time within which the tax shall be paid. The district directors should continue to investigate carefully all cases of delinquent taxpayers where notice of lien has been filed with a view of obtaining, before the expiration of the statutory period, such written consent for the extension of the collection period, whenever it is reasonably possible that the taxpayer may be a voluntary assignee of his property, or of property rights from which the tax liability may be satisfied.

(b) Bond accepted. The district director may in his discretion issue a certificate of release of the tax lien if he furnishes and accepts a bond that is conditioned upon the payment of the amount assessed (together with all interest in respect thereof) within the time agreed upon in the bond, but not later than 2 months before the expiration of the statutory period for collection, including any period for collection agreed upon in writing by the taxpayer and the commissioner. The form of any bond so furnished shall be the standard form (Form 1131) entitled "Bonds for Release of Federal Tax Lien." Such bond shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, except that, when specifically authorized by the Commissioner, such bond may be executed by a surety or sureties, individual or corporate, other than a surety company.

§ 39.3674-1 Partial discharge of property—(a) Remaining property double the amount of liability. The district director may in his discretion issue a certificate of release of any part of the property subject to the lien if there is paid over to the collector in part satisfaction of the liability in respect of such tax an amount determined by the Commissioner, which shall be less than the claim, but not less than the statutory period for collection, as the Commissioner determines, to be equivalent in value to the fair market value of the property or of the interest of the United States in the part to be so discharged. In determining such valuation the Commissioner shall consider the fair market value of the property or interest in the fair market value of the part to be so discharged and to such lien thereon as may have priority to the lien of the United States.
such lien is at least double the amount of the existing liability in respect of such tax plus double the amount of all liens prior to that of the tax lien. In general, the fair market value is that amount which any one ready and willing but not compelled to buy would pay to another ready and willing but not compelled to sell the property. District directors must be conservative in determining property values and should make careful inquiry with respect thereto.

(b) Part payment of liability. (1) In no case shall a certificate discharging property from a Federal tax lien be issued under the provisions of section 3674 (b) unless there is first made a payment in such amount as the Commissioner has determined, to be applied towards satisfaction of the tax liability which gave rise to the Federal lien. In determining the amount to be paid, the Commissioner will take into consideration all the facts and circumstances of the case, including the expenses to which the Government has been put in the matter. In no case shall the amount to be paid be less than the value of the property at the time of assessment, but if the amount paid is not sufficient to discharge the liens without the consent of the lienors the amount paid shall be credited toward satisfaction of the liens in such order as the court may direct.

(2) Any person desiring that a certificate discharging property from a Federal tax lien be issued under the provisions of section 3674 (b) should present to the district director of internal revenue charged with the assessment in respect of the tax, a written application requesting that the certificate be issued. Such application should give the reasons for the request, and should clearly describe the property with respect to which the discharge is sought. In support of the request, the applicant must furnish the district director with proof sufficient to establish satisfactorily the fair market value of the property, and the amount of all liens and encumbrances thereon having priority over the Federal tax lien.

(3) The district director should review the proof, determine the accuracy of all material statements made and forward to the Commissioner a report of the case together with his recommendation. The district director's report should include a statement of the expenses of his office incident to the placing and discharging of the lien as well as his conclusions with respect to the fair market value of the property involved and the value of the Governmental lien in question, and the light of such fair market value and the amount of liens and encumbrances on the property believed to have priority over the lien of the United States. Information as to the nature and amount of such encumbrances sufficient to enable a determination to be made whether, as a matter of law, they actu-

(4) The report of the district director should also show the year or years and the dates of all assessments involved, and the amounts thereof, the office or offices in which, and the dates when, notices of the Federal tax lien or liens were filed, and any proceeding made in partial satisfaction of the tax liability. In his discretion, the district director may submit with his report whatever documentary evidence he deems to be relevant. Upon receipt of the district director's report and recommendation, the question whether a certificate of discharge may be issued and the amount to be paid as a prerequisite to its issuance, will be considered.

(5) When so authorized by the Commissioner, the district director may issue a certificate discharging from the federal tax lien the property as security for the payment of any liability for which he has been authorized to discharge the same, and when the certificate is so issued, the amount paid by the person discharging the property shall be credited toward satisfaction of the tax. The Commissioner, with the approval of the Secretary, may by regulation provide for the issuing of certificates of discharge compli-

S 39.3675-3676 Statutory provisions: effect of certificates of release or partial discharge; single bond covering release of lien and payment of income tax deficiency.

S 39.3675. Effect of certificates of release or partial discharge. A certificate of release or of partial discharge issued under this subchapter (subchapter B of chapter 36) shall be held conclusive that the lien upon the property covered by the certificate is extinguished.

S 39.3676. Single bond covering release of lien and payment of income tax deficiency. The Commissioner, with the approval of the Secretary, may by regulation provide for the issuance of a single bond to secure the discharge from a Federal tax lien and the payment of the deficiency, and for the issuance of such bond, the requirements of subsection (b) of section 3673.

S 39.3676-1 Single bond covering release of lien and payment of deficiency. In cases where the district director issues a certificate of release of tax lien and at the same time an extension of time is granted for the payment of the deficiency in tax pursuant to the provisions of section 272 (f) a single bond may be accepted by the district director conditioned upon the payment of the amount assessed (together with all interest in respect thereof) in accordance with the terms of the certificate and not later than 6 months prior to the expiration of the statutory period for collection including any period for collection agreed upon in writing by the Commissioner and the delinquent, and the bond may be used in these cases and shall be modified to meet the circumstances. Where a certificate of release of the tax lien has been issued by the district director and the bond furnished to and accepted by the district director fully protects the interests of the United States with respect to the tax assessed, no additional bond will be required.

§ 39.3677-3680 Statutory provisions; extended application of provisions relating to release or partial discharge; civil action to enforce lien on property; civil action to clear title to realty; cross references.

S 39.3677. Extended application of provisions relating to release or partial discharge. Sections 3673, 3674, 3675, and 3676 shall apply to a lien in respect of any internal revenue tax, whether or not the lien is imposed by this subchapter (subchapter B of chapter 36).

S 39.3678. Civil action to enforce lien on property—(a) Filing. In any case where there has been a failure to collect any tax, and it has become necessary to seize and sell property and rights to property, whether real or personal, or to subject any such property and rights to property owned by the delinquent, or in which he has any right, title, or interest, to the payment of such tax.

(b) Parties to proceedings. All persons having liens upon or claiming any interest in the property or rights to property sought to be subjected as aforesaid shall be made parties to such proceedings and be brought into court.

(c) Adjudication and decree. The said court shall, at the term next after the parties have been duly notified of the proceedings, unless otherwise ordered by the court, proceed to adjudicate all matters involved therein and finally determine all claims to and liens upon the property and rights to property in question, and, in all cases where claim is made by the United States therein is established, may decree a sale of such property and rights to property, to the proper officer of the court, and a distribution of the proceeds of such sale accord-

S 39.3679. Civil action to clear title to realty—(a) Obtaining leave to file—(1) Request for institution of proceedings by United States. Any person having a lien upon or any interest in the real estate described in the certificate of release of tax lien, or in any other respects has been duly filed of record in the jurisdiction in which the real estate is located, prior to the filing of notice of the lien of the United States as provided in section 3672, or any person purchasing the real estate at a sale to satisfy such prior lien or interest, may make written request to the Commissioner to authorize the filing of a civil action as provided in section 3678.
Petition to court. If the Commissioner fails to authorize the filing of such civil action within six months after receipt of such written request, such person or purchaser may, after giving notice to the Commissioner, bring a civil action in any court of the United States for the district in which the real estate is located, praying leave to file a civil action for a determination of all claims to or liens upon the real estate in question.

Court order. After a full hearing in open court, the court may in its discretion grant an order granting leave to file such civil action, in which the United States and all property is adjudged to be a party, and in which any interest in the real estate shall be made parties.

Service on United States. Service on the United States shall be had in the manner provided by sections 5 and 6 of the Act of March 2, 1897, entitled "An Act to provide for the bringing of suits against the Government of the United States," c. 359, 24 Stat. 506 (U. S. C., Title 30, secs. 762, 763), as amended.

Adjudication. Upon the filing of such civil action the district court shall proceed to adjudicate the matters involved therein, in the same manner as the cases of civil actions filed under section 3670 of this title.

(a) Account and notice to owner. The officer charged with the collection of taxes, with such interest and other expenses of collection, and with all legal and equitable liens arising from distraint of property, except such as are exempt by the preceding section, belonging to such person, or on which the lien provided in section 3670 exists, for the payment of the sum due, with Interest and penalty for nonpayment, and also of such further sum as shall be sufficient for the fees, costs, and expenses of such levy.

(b) Account and notice to owner. The officer charged with the collection shall make an account of the property sold, together with the manner of making the sale, the sums obtained, and the expenses of collection, and shall record the same in the records of the court, with a notice to the owner of the property sold, and a notice to the collector or his deputy to collect the amount due on such account.

(c) Account and notice to owner. If any person refuses to pay the same within ten days after the date of such notice, the United States shall be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest, and the United States should be advertised merely as the party in interest.

(d) Account and notice to owner. The officer charged with the collection shall make an account of the property sold, together with the manner of making the sale, the sums obtained, and the expenses of collection, and shall record the same in the records of the court, with a notice to the owner of the property sold, and a notice to the collector or his deputy to collect the amount due on such account.

(e) Account and notice to owner. The officer charged with the collection shall make an account of the property sold, together with the manner of making the sale, the sums obtained, and the expenses of collection, and shall record the same in the records of the court, with a notice to the owner of the property sold, and a notice to the collector or his deputy to collect the amount due on such account.

(f) Account and notice to owner. The officer charged with the collection shall make an account of the property sold, together with the manner of making the sale, the sums obtained, and the expenses of collection, and shall record the same in the records of the court, with a notice to the owner of the property sold, and a notice to the collector or his deputy to collect the amount due on such account.

(g) Account and notice to owner. The officer charged with the collection shall make an account of the property sold, together with the manner of making the sale, the sums obtained, and the expenses of collection, and shall record the same in the records of the court, with a notice to the owner of the property sold, and a notice to the collector or his deputy to collect the amount due on such account.
he is authorized to collect the same. The taxes imposed upon any person are not goods, chattels, or effects sufficient to satisfy the sale.

and deeds to Commissioner" records of real estate; certificates of purchase; deeds of sale; transmission of certificates and deeds to Commissioner — records of sale.

The said officer shall execute to the said purchaser, as authority for transfer of corporate the United States, and the payment of the purchase money, the officer making the seizure mentioned in the preceding-section shall give notice to the person whose estate is to be redeemed of the time and place of sale, or leaving at his last or usual place of abode, if he has any such within the collection district where he resides, a notice, in writing, stating what particular estate is to be sold, describing the same with reasonableness and particularity, and the time and place, said officer proposes to sell the same.

(b) Public notice. The said officer shall also cause a notice of the sale to be published in some newspaper within the county where such seizure is made, if any such there be, and shall also cause a like notice to be posted at some place nearest to the estate seized, and in two other public places within the county.

(c) Time and place of sale. The time of sale shall not be less than twenty nor more than forty days from the time of giving said notice. The place of said sale shall not be more than five miles distant from the estate seized, except by special order of the Commissioner.

(d) Manner of sale. At the time and place appointed, the officer making such seizure shall proceed to sell the said estate at public auction, with the same regard to minimum price, including the expense of making such levy, and all charges for advertisement. When the real estate seized consists of several distinct tracts or parcels, the officer making sale thereof shall offer each tract or parcel for sale separately, and shall, if he deems it advisable, apportion the expenses and charges aforesaid to such several tracts or parcels, or to any of them, in estimating the same.

(e) Purchasers. If no person offers for said estate the amount of said minimum price, the officer shall declare the same to be purchased by him for the United States; otherwise the same shall be declared to be sold to the highest bidder.

(f) Adjournment of sale. The said sale may be adjourned from time to time by said officer for not exceeding thirty days in all, if he shall think it advisable so to do. If the amount bid shall not be then and there paid, the officer shall forthwith proceed to again sell said estate in the same manner.

(b) After sale.—(1) Period. The owners of any real estate sold as aforesaid; their heirs, executors, or administrators, or any person having any interest therein, or a lien thereon, or any person in whose behalf, shall be permitted to redeem the land sold, or any particular tract thereof, at any time within one year after the sale is situated, a like notice, as aforesaid, to return a statement of all his proceedings to the collector, to certify the record therein.

(b) Contents. The record shall set forth the tax for which any such sale was made, the date of the seizure and sale, the name of the party assessed and all proceedings in making said sale, the amount of fees and expenses, the amount of the purchaser, and the date of the deed.

(c) Certification. The said record shall be certified by the officer making the sale.

(d) Copy to Collector. The officer shall transmit a copy of such record to the collector within the 5th day of each succeeding month, the collector shall transmit a copy of such record to the preceding month.

(e) Delivery by collector to successor. In case of the death or removal of the collector, or the expiration of his term of office from any other cause, said record shall be delivered to his successor in office.

SEC. 3701. Proceedings on distraint — (a) Notice to owner. The officer making the seizure mentioned in the preceding-section shall give notice to the person whose estate is to be redeemed of the time and place of sale, or leaving at his last or usual place of abode, if he has any such within the collection district where he resides, a notice, in writing, stating what particular estate is to be sold, describing the same with reasonableness and particularity, and the time and place, said officer proposes to sell the same.

(b) Public notice. The said officer shall also cause a notice of the sale to be published in some newspaper within the county where such seizure is made, if any such there be, and shall also cause a like notice to be posted at some place nearest to the estate seized, and in two other public places within the county.

(c) Time and place of sale. The time of sale shall not be less than twenty nor more than forty days from the time of giving said notice. The place of said sale shall not be more than five miles distant from the estate seized, except by special order of the Commissioner.

(d) Manner of sale. At the time and place appointed, the officer making such seizure shall proceed to sell the said estate at public auction, with the same regard to minimum price, including the expense of making such levy, and all charges for advertisement. When the real estate seized consists of several distinct tracts or parcels, the officer making sale thereof shall offer each tract or parcel for sale separately, and shall, if he deems it advisable, apportion the expenses and charges aforesaid to such several tracts or parcels, or to any of them, in estimating the same.

(e) Purchasers. If no person offers for said estate the amount of said minimum price, the officer shall declare the same to be purchased by him for the United States; otherwise the same shall be declared to be sold to the highest bidder.

(f) Adjournment of sale. The said sale may be adjourned from time to time by said officer for not exceeding thirty days in all, if he shall think it advisable so to do. If the amount bid shall not be then and there paid, the officer shall forthwith proceed to again sell said estate in the same manner.

SEC. 3705. Transmission of certificates and deeds to Commissioner. All certificates of purchase, and deeds of property purchased by the United States under the Internal revenue laws, on sales for taxes, or under executions issued from United States courts, which may be found in the office of the United States district attorney for the district in which the property is situated, and also in the office of the collector of the district in whose possession the same is transferred, shall be transmitted at the expiration of one year from the date of the sale, together with all the papers and evidence relative thereunto, so far as any such there be, and shall also cause a like certificate, and in accordance with the laws of the State in which such real estate is situate, to accompany the subject of sales of real estate under execution.

SEC. 3706. Statutory provisions; redemption of property; certificates of sale. In all cases of sale, as aforesaid, the certificate of such sale shall be prima facie evidence of the right of the officer to make such sale, and conclusive evidence of the regularity of his proceedings in making the sale; and as conveyance. Shall transfer to the purchaser all right, title, and interest of such delinquent in and to the property sold; and as authority for transfer of corporate stock, shall be notice, when received, to any corporation, company, or association of said transfer, and shall be authority to such corporation, company, or association of said transfer, and shall, in lieu of any original or prior certificate, which shall be void, whether canceled or not; and as receipt. Where the subject of sale is securities or other evidences of debt, shall be a good and valid receipt to the person holding the same, as against any person holding, or claiming to hold, possession of such securities or other evidences of debt.

SEC. 3700. Authority to distrain. When goods, chattels, or effects sufficient to satisfy the taxes imposed upon any person are not found by the collector or deputy collector, or by anyone authorized to assist him in the search, who is authorized to collect the same by seizure and sale of real estate.

SEC. 3701. Proceedings on distraint — (a) Notice to owner. The officer making the seizure mentioned in the preceding-section shall give notice to the person whose estate is to be redeemed of the time and place of sale, or leaving at his last or usual place of abode, if he has any such within the collection district where he resides, a notice, in writing, stating what particular estate is to be sold, describing the same with reasonableness and particularity, and the time and place, said officer proposes to sell the same.

SEC. 3703. Certificates of purchase — (c) Redemption. At the expiration of one year from the date of the sale, whether the estate was redeemed in the meantime or not, the certificate shall be void, whether canceled or not, and the estate shall be sold again, and the certificate of sale shall be void and of no effect.

SEC. 3702. Records of sale — (a) Requirement. It shall be the duty of every collector to keep a record of all sales of land made in his collection district, whether by himself or his deputies, or by another collector. And it shall be the duty of every deputy making sale, as aforesaid, to return a statement of all his proceedings to the collector, to certify the record therein.

SEC. 3705. Deeds of sale — (a) Real estate purchased by the United States. In case real estate shall be declared under section 3701 to be purchased for the United States, the officer shall immediately transmit a certificate of the purchase of the Commissioner. (b) Real estate purchased by others. Upon any sale of real estate, as provided in section 3701, and in the manner prescribed therein, the officer, making the collection and sale shall give to the purchaser a certificate of title, substantially in accordance with the provisions of law, such deed shall be considered and operate as a conveyance of all the right, title, and interest the party delinquent had in and to the real estate thus sold at the time the lien of the United States attached thereto.

SEC. 3706. Statutory provisions; authority to distrain real estate; certificates of purchase; deeds of sale; transmission of certificates and deeds to Commissioner — records of sale. When goods, chattels, or effects sufficient to satisfy the taxes imposed upon any person are not found by the collector or deputy collector, or by anyone authorized to assist him in the search, who is authorized to collect the same by seizure and sale of real estate.
**Sect. 3710.** Surrender of property subject to distraint—Requirement. Any person in possession of property, or rights to property, subject to distraint, upon which a levy has been made, shall, upon demand made by the collector or deputy collector making such levy, surrender such property or rights to such collector or deputy, unless such property or right is at the time of such demand subject to attachment or execution under any judicial process.

(b) Penalty for Violation. Any person who fails to deliver any such property or rights shall be liable in his own personal capacity for the same and, in addition, any person, including an employee of a company or corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform any act in respect of which the violation occurs.

Sect. 3711. Production of books. All persons, and officers of companies or corporations, are required to make and deliver to the collector of internal revenue having jurisdiction over the Internal Revenue District in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the tax (including penalties and interest) for the collection of which such levy was made, together with interest from the date of such levy. 

(c) Person Defined. The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform any act in respect of which the violation occurs.

Sect. 3712. Sale of indivisible property. When any property or rights to property is not divisible, so as to enable the collector to sell a part thereof to raise the whole of the tax, without violating the provisions of the subsections of section 3701, the whole of such property shall be sold, and the surplus of the proceeds of the sale, after paying allowances for the amount of the tax, interest, penalties, and additions thereto, and for the costs and charges of the distraint and sale, shall be deposited with the Treasurer of the United States as provided in section 3971.

Sect. 3713. Distrain by collector outside his district. Any collector or deputy collector may, for the collection of taxes imposed upon any person, and committed to him for collection, seize and sell any of the property or rights of such person, and committed to him for collection, located within the State in which such officer resides, notwithstanding the provisions of subsection (b) of section 3551; and his proceedings in relation thereto shall have the same effect as if they were had in his proper collection district.

Sect. 3714. Period of limitation upon distraint—(a) Length of period. For period within which distraint may be begun in case of—

- Income tax, see sections 276 (c) and 277.

(b) Date of beginning distraint. In determining the time for observing the period of limitation in respect of distraint, the distrainor shall be held to have begun—

- Upon personal property the date on which the levy upon such property is made; or
- Upon real property the time and place of sale is given to the person whose estate is to be sold.

Sect. 3715. Successive seizes. Whenever any property, personal or real, which is seized and sold by virtue of the foregoing provisions, is not sufficient to satisfy the claim of the United States for which distraint or seizure is made, the collector may, therefore, and as often as the same may be necessary, proceed to seize and sell in like manner any other property liable to seizure of the person against whom such claim exists, until the amount due him, together with all expenses, is fully paid.

Sect. 3716. Fees and charges in distraint and seizure cases. The Commissioner shall require fees and charges to be allowed in all cases of distraint and other seizures; and shall have power to determine whether any expense incurred in making any distraint or seizure was necessary.

Sect. 3725. Statutory provisions; stamping, marking, and branding seized goods.

(a) Stamping, marking, and branding seized goods. Where any whisky or tobacco, or other article of manufacture or produce, requiring brands, stamps, or marks, so required. If such stamps, or marks, so required.

Suits by United States

§ 39340. Statutory provisions; authority to commence suit.

Sect. 3740. Authorization to commence suit. No suit for the recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced, unless the Commissioner authorizes or sanctions the proceedings and the Attorney General directs that the suit be commenced.

§ 39341. Statutory provisions; authorization for regulations.

Sect. 3741. Regulations. It shall be the duty of the Commissioner, with the approval of the Secretary, to establish such regulations, not inconsistent with law, for the observance of revenue officers, respecting suits arising under the internal revenue laws in which the United States is a party, as may be deemed necessary for the safe discharge of the duties of their respective positions.

§ 39345-3748 Statutory provisions; district director's report to district attorney; suits for willful violation of law; suits for recovery of erroneous refunds; disposition of judgments for willful violations recovered, periods of limitation.

Sect. 3745. Suits for fines, penalties, and forfeitures—(a) Collector's report to district attorney. It shall be the duty of every collector of internal revenue having knowledge of any willful violation of any law of the United States relating to the revenue, within thirty days after discovering the existence of such knowledge, to file with the district attorney of the district in which any fine, penalty, or forfeiture is incurred, a statement of all the facts and circumstances of the case within his knowledge, together with the names of the victims, setting forth the provisions of law believed to be so violated on which reliance may be had for condemnation or conviction.

Sect. 3746. Suits for recovery of erroneous refunds—(a) Refunds after limitation period. Any portion of an overpayment of tax (or any interest, penalty, additional amount, or addition to such tax) refund of which is erroneously made, within the meaning of section 3714, may be recovered by suit brought in the name of the United States within two years after the making of such refund.

(b) Refunds otherwise erroneous. Any portion of an overpayment of tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be considered refund under section 3714) may be recovered by suit brought in the name of the United States within two years after the making of such refund.

Simplification and recovery by suit of underpayment of tax. Despite the provisions of subsections (a) and (b) such suit may be brought at any time within five years from the making of the refund if it appears that any part of the refund was induced by fraud or the misrepresentation of a material fact.

(4) If judgment is for any moneys recoverable by suit under this section, there shall be interest at the rate of 6 per centum per annum from the date of the payment of the refund.

Sect. 3747. Disposition of judgments and moneys recovered. All judgments and moneys recovered or received for taxes, costs, forfeitures, and penalties, shall be paid to collectors as internal revenue taxes are required to be paid.

Sect. 3748. Periods of limitation—(a) Criminal prosecutions. No prosecution, nor any proceeding, pending, instituted, tried, or punished, for any of the various offenses arising under the internal revenue laws of the United States unless the indictment was found, or information was instituted within three years next after the commission of the offense, except that the period of limitation for offenses committed against the laws of any State or Territory, or any foreign nation, before the object of the conspiracy is to attempt in any manner to evade or defeat any tax or the payment thereof, the period of limitation shall not be six years. The time during...
which the person committing any of the offenses above mentioned is absent from
the district wherein the same is committed shall not be taken as any part of the
time limited by law for the commencement of such proceedings. Where a complaint is
instituted before a commissioner of the United States within the period above limited,
the commissioner may, at the termination of the grand jury at its next session within the
district, enter an order of discharge of the commissioner.

(b) Scope of limitations. Subsection (a) of this section shall apply to offenses when-
ever committed; except that it shall not apply to any tax or deficiency in respect of
taxable periods ending subsequent to the date of the agreement in which the taxpayer,
was subject to any change in or modification of the law enacted subsequent to the date
of the agreement and applicable to any taxable period, and each closing agreement shall
so recite. Closing agreements may be executed even though the agreement may not
be entered into in accordance with the applicable provisions of law.

SUBSEC. (c). Effective date. Except as otherwise provided by law in the case of
income tax, estate, or gift taxes, the Commissioner, pursuant to regulations prescribed by the
Commissioner, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed
and collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount,
or in which the taxpayer was wrongfully conditionally entitled to refund or credit in respect of such tax.

RULES AND REGULATIONS

§ 39.3760 Statutory provisions; closing agreements.

Sec. 3760. Closing agreements.—(a) Authorization. The Commissioner (or any
officer or employee of the Bureau of Internal Revenue, including the field service, authorized
in writing by the Commissioner) is authorized to enter into closing agreements with any person relating to
the liability of such person (or the person or estate for whom he acts) in respect of any internal revenue tax
whenever such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary, within such time
as may be stated in such agreement, or later agreed to, such agreement shall be final and conclusive, and shall except
a showing of fraud or malfeasance, or misrepresentation of a material fact—

(1) The case shall not be reopened as to the matters agreed upon or the agreement
modified, by any officer, employee, or agent of the United States, and

(2) In any suit, action, proceeding, or lawsuit, such agreement, or any determination,
assessment, collection, payment, abatement, refund, or credit made in accordance there-
th with, shall not be annulled, modified, set aside, or disregarded.

§ 39.3760-1. Closing agreements relating to tax liability in respect of internal revenue taxes.

An agreement provided for in section 3760 of the Internal Revenue Code may relate to any
taxable period ending prior or subsequent to the date of the agreement.

With respect to taxable periods ending prior to the date of the agreement, the matter
agreed upon may relate to the total tax liability of the taxpayer or it may relate to one or more separate items
affecting the tax liability of the taxpayer, as for example, the amount of gross income, deductions for losses, depreciation
or depletion, or the year for which an item of income is to be included in gross income or the year for which an item of
loss is to be deducted, or the value of property on a specified date. A closing agreement may also be entered into in
order to provide a “determination under the income tax laws” as defined in section
3801 (a) (A) (A) of the Internal Revenue Code. With respect to taxable periods ending subsequent to the date
of the agreement, the matter agreed upon may relate to one or more separate items affecting the tax liability of the
taxpayer. The following, among others, are examples of this type of closing agreement:

(1) A taxpayer may sell a portion of his holdings in a particular stock. A closing agreement may be entered
into taxing the cost or other legal factor upon which the sale is determined by computing gain or loss on such sale, and, at
the same time taxing the cost or other legal factor determining the basis (unless the statute or regulations require
the use of some other factor to determine basis) of the remaining portion of the stock still held by the taxpayer upon
which gain or loss will be computed when the taxpayer sells such stock in a later year;

(2) if the taxpayer is undecided whether to sell property or hold it, or as to the
price at which to sell it, a closing agreement may be entered into enter
taining the market value of the property as of March 1, 1913, for future taxable periods,

(c) Cross references. For compromises after judgment, see R. S. c. 2469 (U. S. C.,
Title 31, section 194).

Sec. 3762. Penalties. Any person who, in connection with any compromise under
such agreement, or in connection with any closing agreement under section 3760, or offer to enter into any agreement
under section 3760, willfully-

(a) Conceals from any officer or employee of the United States, or from the
hearer or judge of the Grand Jury, any fact material to the case of a taxpayer or other person liable in respect of
the tax,

(b) Offers, makes, or accepts any inducement, to testify falsely or give false evidence
in any case under such agreement, or offer to enter into such agreement, willfully-

(c) Makes any false record or entry inany book, whether public or private, or in
deliberately misleads any such case after reference to the

(d) Falsifies or destroys any book, document, or record, or makes or signs any false or false
statement, relating to any such case after reference to the

(e) False pretenses, as for example, the amount of gross income or the year for which an item
of tax imposed by law is not taxing to the extent of $10,000 or is 

(f) Cross references. For limitations on refunds and credits in case of—

SEC. 3770. Authority to make agreements and compromises.

Statutory provisions; authority to make agreements, credits, and refunds; interest on overpayments; refunds after periods of limitation, penalties for refund periods of limitation.

Sec. 3770. Authority to make agreements, credits, and refunds.—(a) To taxpayers—

(A) Assessments and refunds; penalties for false pretenses. Except as otherwise provided by law in the case of Income war-profits, excess-profits, estate, and gift taxes, the Commissioner, pursuant to regulations prescribed by the Secretary, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed and collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in which the taxpayer was wrongfully entitled to refund or credit in respect of such tax.

(B) Credit of overpayment of one class of tax against another class of tax due. Notwithstanding any provision of law to the contrary, the Commissioner may, in his discretion, in lieu of refunding an overpayment of tax imposed by any provision of this title, credit such overpayment against any tax due from the taxpayer under any other provision of this title.

(C) Delegation of authority to collectors to make agreements and compromises; penalties. With the approval of the Secretary, the Commissioner is authorized to delegate to collectors any authority, duty, or function which the Commissioner is authorized or required to exercise or perform under paragraph (1), (2), (3), or (4) of this subsection, or under section 322 or 1027, where the amount involved (exclusive of interest, penalties, additions to the tax, and additional amounts) does not exceed $10,000.

(D) Cross references. For limitations on refunds and credits in case of—

§ 39.3762 Statutory provisions; closing agreements.

§ 39.3770-3775 Statutory provisions; authority to make agreements, credits, and refunds; interest on overpayments; refunds after periods of limitation, penalties for refund periods of limitation.
Income tax, see section 322. * * *

(b) To collectors and officers. The Commissioner, or his delegate, by the Secretary, is authorized to repay—
(1) Collections recovered. To any collector or his delegate, in full amount, such sums of money as may be recovered against him in any court, for any internal revenue tax or against him in any court, for any internal revenue tax or duty.

(2) Damages and costs. All damages and costs recovered against any collector, deputy collector, or other officer, in any court, brought against him by reason of anything done in the due performance of his official duty.

(c) Rule where no tax liability. An amount paid as tax shall not be considered not to constitute an overpayment solely by reason of the fact that there was no tax liability in respect of which such amount was paid.

Sec. 3771. Interest on overpayments—(a) Rate. Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax or tax, at the rate of 6 per centum per annum.

(b) Period. Such interest shall be allowed and paid as follows:

(1) Ornaments. In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment of a tax imposed by the Revenue Act of 1921, 42 Stat. 235, approved January 2, 1922, then to the date of the assessment of such amount.

(2) Refunds. In the case of a refund, from the date of the overpayment to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer.

The acceptance of such check shall be without prejudice to any right of the taxpayer to claim any additional overpayment and interest thereon.

(c) Additional assessment. As used in this section the term "additional assessment" means an assessment of an internal revenue tax, of the same character previously paid in part, and includes the assessment of a deficiency in respect of such tax imposed by the Revenue Act of 1924, 48 Stat. 253, or by any subsequent Revenue Act.

(d) Claims based on deduction for bad debts or worthless securities. If credit or refund of any part of an overpayment would be barred under section 322 (b), except for paragraph (a) thereof, or under section 292 (d), except for clause (2) thereof, no interest shall be allowed or paid with respect to such part of the overpayment for any period beginning after the expiration of the period of limitation provided in section 292 (b) (1) for filing a claim for refund of such part of the overpayment and ending at the expiration of six months after the date on which such claim was filed, or, in case no claim was filed and the overpayment was found by the Board, ending at the time the petition was filed with the Board.

(e) Claim-back of loss or credit. If the Commissioner determines that any part of an overpayment is attributable to the indemnification or compensation for any net operating loss deduction loss for the taxable year of any part of the net operating loss for a succeeding taxable year, no interest shall be allowed in respect of such part of the overpayment for any period before the filing of a claim for credit or refund of such part of the overpayment. If such claim is filed within sixty days of the filing of a petition with the Board, whichever is earlier; or for any period beginning with the date of filing of an application under section 760 (a) for credit or refund of the overpayment and ending with the last date the Commissioner's determination is received by the Commissioner (b); nor, in case an application is made under section 292 (a), for any period before the first day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss or unused excess profit credit, or before the date on which the return is filed, whichever is later.

(1) Estimated tax and tax withheld at source. For date of payment in respect of estimated tax and tax withheld at source on wages, see section 322 (e).

(2) Claims based upon reliance under section 760 (a). Sec. 3771 as amended by ccs. 121 (c), 153 (d), 172 (i) (5), Rev. Act 1942; ccc. 2 (b), 877 (U. S. C.), Tith. 28, section 224 [now ccs. 251 (a)].

Sec. 3772. Suits for refund—(a) Limitations—(1) Claim. No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been erroneously or illegally imposed, by the authority, unless such claim of any sum alleged to have been excessive or in any manner wrongfully collected until after the expiration of the period of limitation in which such claim may be filed, with the Commissioner, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

(2) Time. No such suit or proceeding shall be begun before the expiration of six months after the date on which such claim was filed, unless the Commissioner renders a decision thereon within that time, nor after the expiration of six months after such claim was filed, with the Commissioner, or any part of the overpayment or the filing for credit of such part of the overpayment or the filing for credit of such amount.

(b) Reconsideration after mailing of notice. Any consideration, reconsideration, or action of the Board in respect to such claim following the mailing of a notice by registered mail of disallowance shall not operate to extend the period within which suit may be begun before the expiration of six months from the date of mailing notice.

(c) Reconsideration after mailing of notice. Any consideration, reconsideration, or action of the Board in respect to such claim following the mailing of a notice by registered mail of disallowance shall not operate to extend the period within which suit may be begun before the expiration of six months from the date of mailing notice.

(d) Claims against collector a bar. A suit against the collector (or former collector) or his personal representative for the recovery of any internal revenue tax, of any penalty claimed to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been erroneously imposed, by the authority, unless such claim is filed within thirty days after such claim is found, shall be barred under section 3780 (b); nor, in case an application is made under section 292 (a), for any period before the first day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss or unused excess profit credit, or before the date on which the return is filed, whichever is later.

(e) Credit treated as payment. If the United States had been a party to such suit in applying the doctrine of res judicata, judgment in such suit in favor of the United States to recover erroneous refunds, the date of such judgment would be the date of the filing of such suit in the United States District Court for the Southern District of New York, 269, 1923, as amended by sec. 26, 1923, c. 652, section 677 (U. S. C), Tith. 28, section 224 (now ccs. 251 (a)).

Sec. 3773. Claims based on assessment or refund. If after the expiration of the period of limitation for filing suit for the recovery of any internal revenue tax (or any interest, penalty, additional amount, or addition to such tax) shall be considered erroneous—

(a) Date of payment for filing claim. If made after the expiration of the period of limitation for filing claim, therefor, unless within such period claim was filed, and such claim was filed and the overpayment was found by the Commissioner, or the overpayment was made after the expiration of the period of limitation for filing claim, unless—

(1) Within such period suit was begun by the taxpayer, or

(2) Within such period, the taxpayer and the Commissioner agreed in writing to suspend the running of the statute of limitations for filing suit from the date of the agreement to the date of final decision in one or more named excess taxes pending before the Board of Tax Appeals or the courts. If such agreement has been entered into, the running of such statute of limitations shall be suspended in accordance with the terms of the agreement.

(b) Time of reference. For procedure by the United States to recover erroneous refunds, see section 3746.

Sec. 3774. Credits after periods of limitation—(a) Period against United States. Any credit or refund of a United States tax for any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 3771, in excess of $200,000, in excess of $200,000, and

(b) Period against taxpayer. A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 3774.

§ 39.3777 Statutory provisions: reports of refunds and credits in excess of $299,000.

Sec. 3771. Reports of refunds and credits in excess of $299,000—(a) By Commissioner to Joint Committee. No refund or credit of any income, war-profits, excess-profits, social security, or estate tax shall be made until after the expiration of thirty days from the date upon which a report giving the name of the person to whom the refund or credit is to be made, the amount of such refund or credit, and a summary of the facts and the decision of the Commissioner, shall be submitted to the Joint Committee on Internal Revenue Taxation.

(b) By Joint Committee to Congress. A report of refunds and credits in excess of $299,000 shall be made by such committee of such refunds and credits, including the names of all persons and cor-
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provisions to whom amounts are credited or payments are made, together with the amounts credited or paid to each.

Any credit or refund allowed or made under section 3760 (b) or under section 124 (b) shall be made within the regular period of time for payment of taxes prescribed by section 3779 (a). In any such case, if the credit or refund, reduced by any deficiency in such tax thereafter assessed and by deficiencies in any other tax resulting from adjustments reflected in the determination of the credit or refund, is in excess of $2,000,000, there shall be submitted to the Commissioner a statement containing the matters specified in subsection (a) at such time after the making of the credit or refund as the Commissioner shall determine the correct amount of the tax.

§ 39.3779 Statutory provisions; extensions of time for payment of taxes by corporations expecting carry-backs—(a) In general. If a corporation, in any tax year, on or before September 30, 1946, files with the collector a statement, as provided in subsection (b), with respect to an expected net operating loss carry-back from such taxable year, the time for payment of all or part of any tax imposed by chapter 1 or 2 for the taxable year immediately preceding such taxable year shall be extended, to the extent and subject to the conditions and limitations hereinbefore provided in this section.

(b) Contents of statement. The statement shall refer to in subsection (a) of this section shall be sworn to in the manner prescribed by section 52 in the case of a return and shall be filed at such time and in such manner and form as the Commissioner, with the approval of the Secretary, may by regulations prescribe. Such statement shall set forth that the corporation expects to have a net operating loss carry-back, as provided in section 122 (1), from the taxable year in which such carrying back is to be made, and that the credit or refund, reduced by any deficiency in such tax after the credit or refund, is in excess of $2,000,000, there shall be submitted to the Commissioner a statement containing the matters specified in subsection (a) at such time after the making of the credit or refund as the Commissioner shall determine the correct amount of the tax.

(1) The estimated amount of the expected net operating loss or unused excess profits credit;

(2) The reasons, facts, and circumstances which cause the corporation to expect such net operating loss or unused excess profits credit;

(3) The amount of the reduction, attributable to the expected carry-back, in the aggregate of the taxes previously determined for all taxable years affected by the carry-back prior to the taxable year of the expected loss or unused credit; such taxes previously determined being ascertained in accordance with the method prescribed by section 6176, and for the taxable year immediately preceding such taxable year the time for payment of which has been extended, to the extent and subject to the conditions and limitations hereinbefore provided in this section.

(d) and such reduction being determined by applying the expected carry-back in the manner provided by law to the items on the basis of which such taxes were determined, but such reduction being decreased by the amount of any credits under section 780 properly allocable to such reduction;

(5) Such other information for the purpose of carrying out the provisions of this section as may be required by such regulations.

§ 39.3779 (d) Jeopardy. If the Commissioner believes that collection of the amount of which an extension under this section relates is in jeopardy, he shall immediately by registered mail of such extension and notice and demand shall be made by the collector for payment of such amount.

(1) Interests. In the case of an amount the time for payment of which has been extended, there shall be collected as part of the interest or additions to the tax resulting from adjustments or credits thereto, within the period of extension, a decrease in tax determined in connection with an application under section 3780 (a), interest at the rate of 5 per centum per annum to the date of such satisfaction, except that on so much of such satisfied tax as has been extended to the amount of the deficiencies assessed under section 3780 (b) and which is not so satisfied, the rate shall be only 2 per centum per annum.

(2) Upon the remainder of the amount the time for payment of which has been extended, the amount of interest from the date of such satisfaction to the date such amount is paid.

If the Commissioner determines that during the period of extension credit or refund of an overpayment has been allowed or made, or a deficiency has been assessed and credited thereon, the Commissioner may extend the time for the payment of any such overpayment or deficiency to the amount of such extension and notice and demand and satisfy such amount interest from the dates on which payments would have been required for such overpayment or deficiency to the amount of such extension and notice and demand, or a revised statement, appropriate adjustment shall be made in the interest.

§ 39.3779-1 Extensions of time for payment of taxes by corporations expecting carry-backs—(a) If a corporation files a statement with respect to an expected net operating loss carry-back or unused excess profits credit carry-back from any taxable year, such corporation may extend the time for the payment of all or any part of any tax imposed by chapter 1 or 2 for such taxable year;

(b) The tax must be shown on the return or must be assessed within the taxable year of the expected net operating loss or unused excess profits credit.

(c) The tax must be one imposed by chapter 1 or chapter 2;

(d) The tax must be shown on the return or must be assessed within the taxable year or the year of the expected net operating loss or unused excess profits credit;

(e) The tax must not have been paid or required to be paid on the statement filed under this paragraph or revised under section 3779.

(b) The time for payment of the tax is extended and the extension is provided in section 3779 upon the filing of a statement by the corporation with the district director of internal revenue where the tax is payable with respect to the expected net operating loss carry-back or unused excess profits credit carry-back. The period of extension is that provided in section 3779 (d) unless sooner terminated by action of either the Commissioner or the corporation.
§ 39.3779–2 Contents of statement. (a) The statement with respect to an expected carry-back which must be filed by a corporation in order to extend the time for payment of tax under section 3779 is to be filed on Form 1138. The statement must be filled out in accordance with the instructions accompanying the form, and all information required by the form and the instructions must be furnished by the taxpayer. The statement shall contain or be verified by a written declaration under penalties of perjury. The district director of internal revenue, upon request, will furnish a receipt for any statement filed. Such receipt will show the date the statement was filed.

(b) The reduction, attributable to the expected carry-back, in the aggregate of the taxes previously determined for all taxable years, affected by the carry-back, prior to the taxable year of the expected net operating loss or unused excess profits credits will be the excess of the decrease over the increases, attributable to the expected carry-back, in the aggregate of the taxes previously determined, in respect of the items on which the reduction is attributable, if any, reported in the carry-back. Thus, for example, if the taxpayer is affected by the carry-back, if the aggregate of the taxes previously determined, items must be taken into account in ascertaining the amount abated, credited, refunded, or the total of such amounts, may be less than the aggregate of the taxes previously determined, as defined in section 39.3773–1(a)(20).

§ 39.3779–3 Amount of tax the time for payment of which may be extended—(a) Total amount to which extension may relate. The total amount of one or more taxes the time for payment of which may be extended under section 3779 may not exceed the amount shown in item 5 (c) of Form 1138.

(b) Amount of any tax to which extension may relate. (1) The taxpayer is to specify in item 5 (j) of Form 1138 the tax or taxes and the amount thereof the time for payment of which is to be extended. In case of any one tax the amount to which an extension may relate may not exceed the amount shown in item 4 (c) of Form 1138. The time for payment of which is to be extended. In determining such reduction, a decrease, attributable to a carry-back, in any one tax, e.g., the income tax, will be offset by an increase in any other tax, e.g., the surtax on personal holding companies, resulting from such decrease.

§ 39.3779–4 Payment of remainder of tax where extension relates only to part of the tax. (a) If an extension of time relates to only part of the tax, the time for payment of the remaining amount of the tax, shall be considered to be the dates on which payments would have been required if such remainder had been the tax and the taxpayer had elected to pay the tax in installments as provided in section 56 (b).

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

Example. Corporation A, which keeps its books and makes its tax returns on the calendar year basis, filed its income tax return for 1952 on March 15, 1953. The corporation was allowed a refund of $409, and paid 40 percent of such tax, or $409, on March 15, 1953. On June 1, 1953, Corporation A, pursuant to the provisions of the tax law, extended the time for payment of $409 of such tax. The remainder of the tax due the extension, which was not then paid, is extended to the extent of the tax for purposes of determining when it is to be paid. Such remainder is to be paid in installments on each of the normal installment dates. Since the taxable year is the calendar year 1953, 40 percent of $503 is due on each of the first two installment dates and 10 percent of $503 is due on each of the last two installment dates. Since the corporation had already paid $409 of the tax, it will have nothing to pay on June 15, 1953, and it will pay $50 on September 15, 1953, and $50 on December 15, 1953.

§ 39.3779–5 Period of extension. If the time for payment of any tax for which an extension has been obtained pursuant to section 3773, such extension shall expire:

(a) On the last day of the month in which falls the last date prescribed by section 3773 (the last date granted the taxpayer) for the filing of the return for the taxable year of the expected net operating loss or unused excess profits credit; or

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(b) If an application for a tentative carry-back adjustment provided in section 3770 with respect to such loss or unused credit is filed before the expiration of the period specified in paragraph (a) of this section, on the date which notice is mailed by registered mail to the taxpayer, the Commissioner may extend the time for payment of $39,000 of the installment due on June 15, 1953, September 15, 1953, and December 15, 1953, and the time for payment of the $39,000 extended under the first statement filed on March 15, 1953, may continue to be extended under the new statement filed on March 15, 1953, will not be affected by the second statement filed on June 1, 1953. If the corporation paid $34,400 on March 15, 1953, and had not secured an extension of time under section 3779 (c) under such statement, the time for payment of such $34,400 could not be extended under the second statement filed on June 1, 1953.

(o) The corporation in paragraph (b) might file a second statement to show that it had overestimated the amount of its expected net operating loss and, accordingly, to terminate the extension with respect to part or all of the tax. The corporation might file a second statement even though its estimate of its expected net operating loss had not changed since it filed its first statement. In such a case, the corporation might have computed incorrectly the reduction, attributable to the expected net operating loss carry-back from 1953, in the tax previously determined for 1953. The time for payment of which is extended under the new statement previously filed, the extension of time shall be terminated on the date the new statement is filed as to the difference between the two amounts. See section 3779 (g) for the dates on which such difference must be paid. If a corporation pays any amount of tax, the time for payment of which was extended, prior to the date the extension would otherwise terminate, the extension with respect to such amount shall be deemed terminated, without regard to whether a new statement is filed, on the date such amount is paid. The corporation shall indicate on each new statement filed that it has already filed one or more prior statements with respect to the tax for such year. The corporation shall likewise indicate the dates each prior statement was filed and the amount of each tax the time for payment of which was extended under each prior statement.

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

Example. Corporation B, which keeps its books and makes its tax returns on a calendar year basis, filed its 1952 income tax return, showing a tax of $1,000, on March 15, 1953. At the same time the corporation filed a statement under section 3779 extending the time for payment of the entire $1,000 on the basis of an expected net operating loss carry-back from 1953. On July 1, 1953, the corporation filed a new statement indicating that it would be able to pay $800 on March 15, 1953, and Corporation B would have elected under section 3779 to pay $300 in the tax previously determined for 1953, in its income tax for 1953 would be only $600, and thus terminated the extension above the extent of $600. The time for payment of such amount extended again, and such $600 is payable as if it had been the tax for 1952 and Corporation B had elected to pay such tax in installments. That is, $600 is payable on March 15, 1953, $100 on June 15, 1953, $100 on September 15, 1953, and $40 on December 15, 1953. Interest is payable under section 3779 (1) (2) on such amounts at the rate of 6 percent per annum and is to be computed from the respective dates on which amounts were payable. Inasmuch as the March 15 and June 15 dates had already passed when Corporation B terminated the extension with respect to the $600, $300 is payable immediately upon such termination, and $40 is payable on September 15, 1953, and $40 on December 15, 1953. The fact that the corporation did not pay the $600 on March 15, 1953, and the $100 on June 15, 1953, is not to be considered such a failure to pay an installment on or before the date fixed for its payment as would make the entire tax become due under the provisions of section 3779 (b). Interest, however, will be computed upon the first $160 from March 15, 1953, and upon the $40 from June 15, 1953. See section 3779 (1) and §3.3779-10.

Example (2). If Corporation C in example (1) had shown a tax of $1,200 on its return, the other facts being the same, and, accordingly, had paid $80 on March 15, 1953, and $160 on June 15, 1953, then upon the termination as to the $400, $330 is payable immediately (i.e., $200 which in the light of the termination should have been paid on March 15, 1953, and $160 which should have been paid on June 15, 1953), and two more installments would be payable on September 15, 1953, and December 15, 1953. Interest would be computed from the dates as in example (1).

(b) The examples in paragraph (b) of this section also would apply the extension of time for the payment of the $400 were terminated by the Commissioner under section 3779 (1) because he believed that the statement filed by Corporation C under section 3779 would extend the time for payment of tax was clearly erroneous or unreasonable in a material respect. If, however, the Commissioner on July 1, 1953, terminated the extension with respect to such $400 un-
under section 3779 (b) because he believed the collection of such amount was in jeopardy, the entire $400 would be payable in full on notice and demand by the district director of internal revenue. In such case interest would be computed on $100 from March 15, 1953, on $160 from July 15, 1953, and on the remaining $200 from July 1, 1953. See section 3779 (i) and § 3.3779-9.

§ 39.3779-9. Interest. (a) Interest is payable on any amount the time for payment of which is extended under section 3779. The interest, which is determined as part of such amount, is to be computed at the rates indicated in sub-

paragraphs (1) and (2) of this paragraph from the dates on which payments would have been required if there had been no extension, and the taxpayer had elected under section 56 (b) to pay the tax in installments:

(1) At the rate of 3 percent per annum on so much of such amount as is satisfied by applying or crediting thereof, within the period of extension (see section 3779 (d)) a decrease in tax determined with respect to an application for a tentative carry-back adjustment, is applied against the §355 of its 1952 income tax for 1952. At the time for payment of which had been extended pursuant to the statement or the lesser amount than was extended in satisfaction, except that the rate

is terminated either by reason of the carry-

back adjustment prior to the last day

of the month in which falls the last date

for payment of such amount. The inter-

est is to be collected at the rate of 3 percent per annum on the $455 and at the rate of 6 percent per annum on the remain-

ing $400. The interest will be computed on the $455 and on the $160 at the rates of 6 percent and 3 percent respectively, as if 40 percent of each such amount were payable on March 15, 1953, 40 percent on September 15, 1953, and 10 percent on De-

cember 15, 1953. Interest on the $455 will run until the date the reduction in income tax for 1952 attributable to the carry-back adjustment is applied against the income tax for 1952 of which the extension was satisfied, and interest on the $160 will run until the date such $160 is paid. The penalty and interest on any such extension are to be determined in respect of an application for a tentative carry-back adjustment under section 3779.

(b) At the rate of 6 percent per annum upon the remainder of the amount the time for payment of which was ex-

tended to the date such amount is paid.

(c) Interest thus will be payable at the rate of 3 percent per annum upon any amount the time for payment of which has been extended under section 3779 to the extent that such amount is satisfied by applying or crediting thereof, within the period of extension, a de-

crease in tax determined in respect of an application for a tentative carry-back adjustment, which is applicable to the tentative carry-back adjustment must be with respect to the same taxable year as that of the expected net operating loss or unused excess profits credit. In determining whether an amount has been so satisfied, however, the net effect of the carry-back, including any resulting deficiencies, must be taken into account. Interest upon any amount not so satisfied will be payable at the rate of 6 percent per annum.

(d) If an extension of time under section 3779 is terminated either by action of the taxpayer (by paying an amount the time for payment of which had been extended or by filing a new statement extending the time for payment of a lesser amount and their writ, issued in a prior statement) or by the Commissioner (because he believes the statement filed was erroneous or unreasonable in a ma-

terial respect or because he believes that the extension would be carried back in jeopardy) interest is payable on the amount to which such termination relates at the rate of 6 percent per annum to the date of payment of the amount extended. Where the taxpayer fails to file an application for a tentative carry-back adjustment prior to the last day of the month in which falls the last date prescribed by law (including any exten-

sion of time granted to the taxpayer) for filing the return for the taxable year of the expected net operating loss or unused excess profits credit, interest is payable on the amount to which such extension relates at the rate of 6 percent per annum to the date of payment of the amount extended. Where the application is filed after the last day of the month in which the application is due, the application shall be verified in the manner prescribed by section 81 or section 82 in the case of a return of such taxpayer, and shall be filed, on or after the date of filing of the return for the taxable year of the net operating loss or unused excess profits credit. The application shall be verified in the manner prescribed by regulations prescribed by the Commissioner with the approval of the Court of the United States.

The application shall be verified in the manner prescribed by section 81 or section 82 in the case of a return of such taxpayer, and shall be filed, on or after the date of filing of the return for the taxable year of the net operating loss or unused excess profits credit. The application shall be verified in the manner prescribed by regulations prescribed by the Commissioner with the approval of the Court of the United States.

The application shall be verified in the manner prescribed by regulations prescribed by the Commissioner with the approval of the Court of the United States.

Example. Corporation D, which came into existence in 1952, and which keeps its books and makes its tax returns on the calendar year basis, extended the time for payment of its §55 of its income tax for 1952 on the basis of an expected net operating loss carry-back from 1953. The corporation in fact operating loss carry-back from 1953, and on March 31, 1953, it filed an application under section 3780 (a) for a tentative carry-back adjustment with respect to the net operating loss carry-back from 1953. The application showed that the corporation's income tax for 1952 was decreased by $455 as a result of the carry-back from 1952. The Commissioner allowed the application in full on June 29, 1954. The $455 decrease in the corporation's income tax was applied against the §355 of its 1952 income tax for 1952. The time for payment of which had been extended pursuant to the statement filed under section 3779. Since the decrease in the corporation's income tax for 1952 was only $455, the corporation paid the remaining $540 for 1952 within ten days after notice and demand. The reduc-

tion in the corporation's income tax as pre-

ceded is attributable to the net operating loss carry-back from 1953, which is extended under section 3779, and on the second payment of the $400 interest paid. The $160 will run until the date such $160 is paid. The penalty and interest on any such extension are to be determined in respect of an application for a tentative carry-back adjustment under section 3779.

(d) If an extension of time under section 3779 is terminated either by action of the taxpayer (by paying an amount the time for payment of which had been extended or by filing a new statement extending the time for payment of a lesser amount and their writ, issued in a prior statement) or by the Commissioner (because he believes the statement filed was erroneous or unreasonable in a ma-

terial respect or because he believes that the extension would be carried back in jeopardy) interest is payable on the amount to which such termination relates at the rate of 6 percent per annum to the date of payment of the amount extended. Where the taxpayer fails to file an application for a tentative carry-back adjustment prior to the last day of the month in which falls the last date prescribed by law (including any exten-

sion of time granted to the taxpayer) for filing the return for the taxable year of the expected net operating loss or unused excess profits credit, interest is payable on the amount to which such extension relates at the rate of 6 percent per annum to the date of payment of the amount extended. Where the application is filed after the last day of the month in which the application is due, the application shall be verified in the manner prescribed by regulations prescribed by the Commissioner with the approval of the Court of the United States.

The application shall be verified in the manner prescribed by regulations prescribed by the Commissioner with the approval of the Court of the United States.
§ 39.3780-1 Tentative carry-back adjustments—(a) In general. Any taxpayer who claims a net operating loss or unused excess profits credit may file an application under section 3780 for a tentative carry-back adjustment of the tax previously determined, as amended by the tax previously determined for the taxable year of the loss or unused credit which are affected by the net operating loss carry-back or the unused excess profits credit carry-back resulting from such loss or unused credit. The right to file an application for a tentative carry-back adjustment is not limited to corporations, but is available to any taxpayer who has a carry-back adjustment in respect of both the net operating loss carry-back and the unused excess profits credit carry-back resulting from such loss and unused credit.

(b) Contents of application. (1) The application for a tentative carry-back adjustment in the case of a corporation is to be filed on Form 1139, and in the case of taxpayers other than corporations on Form 1045. The applications shall conform or be in accordance with the instructions accompanying such forms, and all information required by the forms and the instructions must be furnished by the taxpayer. The application shall contain or be in a corpora-

written declaration that it is made under penalties of perjury.

(2) An application for a tentative carry-back adjustment does not constitute a claim for credit or refund. If such application is disallowed by the Commissioner, in whole or in part, no suit may be maintained in any court for the recovery of any tax, and no suit may be maintained under section 3779. If a claim has both a net operating loss and an unused excess profits credit, it may file an application for a tentative carry-back adjustment in respect of both the net operating loss carry-back and the unused excess profits credit carry-back, which decrease shall be applied against any unpaid amount of the tax decreased (including any amount of such tax as to which an extension of time for payment under section 3779 is in effect) and any remainder shall be credited—

(1) Against the deficiencies (and additions to the tax) assessed under this sub-
section,

(2) Against any unsatisfied amount of any tax for the taxable year immediately precede-
ning the taxable year of the net operating loss or unused excess profits credit the time for payment of which such tax is extended under section 3779, and

any remainder shall, within such ninety-


day period, be either credited against any income, war profits, or excess profits tax or installment thereof and shall be returned to the taxpayer, or refunded to the taxpayer. The application, credit or refund of a decrease determined under this subsection shall be deemed a credit or refund of an overpayment within the meaning of sections 781 (b) and 3807 (b) (1).

(3) Assessment of erroneous allowances. If the Commissioner determines that the amount applied, credited or refunded under subsection (b) is not a proper allowance attributable to the carry-back with respect to which such amount was applied, credited or refunded, he may assess the amount of such erroneous allowance as a deficiency if it were due to a mathematical error appearing on the face of the return, as provided in section 372 (2). Upon making such assessment, the Commissioner shall immediately give the taxpayers notice of the overassessment the decrease in any other tax resulting from the adjustments reflected in the computation of the deficiency.

§ 39.3780-2 Computation of increase or decrease in prior years' taxes affected by the carry-back. (a) The taxpayer is to determine the amount of increase or decrease, attributable to the carry-back, in each tax previously determined, which is affected by such carry-back, for each taxable year before the taxable year of the net operating loss or unused excess profits credit tax decreased (including any amount of such tax as to which an extension of time for payment under section 3779 is in effect) and any remainder shall be credited—

(1) Against the deficiencies (and additions to the tax) assessed under this sub-
section,

(2) Against any unsatisfied amount of any tax for the taxable year immediately preceded the taxable year of the net operating loss or unused excess profits credit the time for payment of which such tax is extended under section 3779, and

any remainder shall, within such ninety-


day period, be either credited against any income, war profits, or excess profits tax or installment thereof and shall be returned to the taxpayer, or refunded to the taxpayer. The application, credit or refund of a decrease determined under this subsection shall be deemed a credit or refund of an overpayment within the meaning of sections 781 (b) and 3807 (b) (1).

(3) Assessment of erroneous allowances. If the Commissioner determines that the amount applied, credited or refunded under subsection (b) is not a proper allowance attributable to the carry-back with respect to which such amount was applied, credited or refunded, he may assess the amount of such erroneous allowance as a deficiency if it were due to a mathematical error appearing on the face of the return, as provided in section 372 (2). Upon making such assessment, the Commissioner shall immediately give the taxpayers notice of the overassessment the decrease in any other tax resulting from the adjustments reflected in the computation of the deficiency.

[Sec. 3780 as added by sec. 4 (a), Tax Adjust-
ment Act; amended by sec. 304 (b), Excess Profits Tax Act 1949]
§ 39.3780-3 Allowance of adjustments. (a) The Commissioner is to act upon any application for a tentative carry-back adjustment. In determining the increase or decrease in any tax previously determined, any items which are affected by the carry-back must be adjusted to reflect such carry-back. Thus, any deduction limited, for example, by net income or adjusted gross income, such as the deduction for charitable contributions, is to be recomputed on the basis of the net income or adjusted gross income as affected by the carry-back. Similarly, in any case where one tax is allowed as a deduction in computing a second tax, or where the income subject to one tax is a credit in computing the income subject to the second tax, such deduction or credit must be adjusted to reflect such carry-back. In computing the net operating loss deduction for purposes of determining any such increase or decrease, proper adjustments as required by section 122 (e) and 433 (a) (1) (2) are to be made.

(b) Within the 90-day period described in section 3780 (a) within a period of 90 days from whichever of the following two dates is the later:

(1) The date the application is filed;

(2) The last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss or unused excess profits credit from which the carry-back results.

(c) If the Commissioner finds that an application for a tentative carry-back adjustment contains material omissions or errors of computation, he may disallow such application in whole or in part without furnishing the application to the taxpayer. If, however, he deems that any error of computation can be corrected by him within the 90-day period, he may do so and allow the application in whole or in part. The Commissioner’s determination as to whether he can correct any error of computation within the 90-day period shall be conclusive. Similarly, his action in disallowing, in whole or in part, any application for a tentative carry-back adjustment, which he knows the taxpayer has claimed an excessive amount; likewise, he will not include in gross income any amount not so included by the taxpayer even though the Commissioner believes that such amount is subject to tax and properly should be included in gross income.

(d) If the Commissioner finds that an application for a tentative carry-back adjustment contains material omissions or errors of computation, he may disallow such application in whole or in part without furnishing the application to the taxpayer. If, however, he deems that any error of computation can be corrected by him within the 90-day period, he may do so and allow the application in whole or in part. The Commissioner’s determination as to whether he can correct any error of computation within the 90-day period shall be conclusive. Similarly, his action in disallowing, in whole or in part, any application for a tentative carry-back adjustment, which he knows the taxpayer has claimed an excessive amount; likewise, he will not include in gross income any amount not so included by the taxpayer even though the Commissioner believes that such amount is subject to tax and properly should be included in gross income.

(e) If the Commissioner finds that an application for a tentative carry-back adjustment contains material omissions or errors of computation, he may disallow such application in whole or in part without furnishing the application to the taxpayer. If, however, he deems that any error of computation can be corrected by him within the 90-day period, he may do so and allow the application in whole or in part. The Commissioner’s determination as to whether he can correct any error of computation within the 90-day period shall be conclusive. Similarly, his action in disallowing, in whole or in part, any application for a tentative carry-back adjustment, which he knows the taxpayer has claimed an excessive amount; likewise, he will not include in gross income any amount not so included by the taxpayer even though the Commissioner believes that such amount is subject to tax and properly should be included in gross income.
§ 39.3780-4 Assessment of erroneous allowances, credits, etc.

(a) Disallowance of credits because of decrease in the amount of deficiency. If the Commissioner, in his discretion, determines that any amount applied, credited, or refunded under section 3780 (b) with respect to an application for a tentative carry-back adjustment is in excess of the overpayment of tax attributable to the carry-back upon which such application was based, he may assess the amount of the excess as a deficiency if such deficiency were due to a mathematical error appearing in the face of the return. That is, the Commissioner may assess an amount equal to the excess, and such amount may be disallowed only in accordance with the restrictions on assessment and collection imposed by section 272. Thus, the Commissioner, for example, may assess such amount without regard to whether he has previously made a prior assessment of a deficiency. Either before or after assessing such an amount, the Commissioner will notify the taxpayer that he has made, or will make, such assessment. Such notice will not constitute a notice of deficiency, and the taxpayer may not file a petition with The Tax Court of the United States based on such notice. The taxpayer, however, within the applicable period of limitation may file a regular claim for credit or refund under section 252 based on the carry-back, if he has not already filed such a claim, and may maintain a suit based on such claim if it is disallowed or if it is not acted upon by the Commissioner within six months from the date the claim was filed.

(b) Upon assessing any deficiency under section 3780 (c) the Commissioner will schedule an assessment of the deficiency at an interest rate equal to the rate of interest applicable to the carry-back for the taxable year within which the net operating loss or the unused excess profit credit arises or within which the election is made to terminate the amortization period, or for a preceding taxable year affected by such loss, credit, or election, the Commissioner, in his discretion, will make all such regulations as may be necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same, in cases where such expenses are not otherwise provided for by law.

(2) Any reduction of the decrease after such application and credits may, within the 90-day period, in the discretion of the Commissioner, be refunded to the taxpayer, with interest, if the corporation seeking an extension of time under section 3779, a tentative carry-back adjustment under section 3780, or a tentative carry-back adjustment with respect to an amortization deduction under section 124 (1) and (2), made or was required to make such adjustment, elects to terminate such carry-back, election, or adjustment, before the taxable year within which the net operating loss or the unused excess profit credit arises or within which the election is made to terminate the amortization period, or for a preceding taxable year affected by such loss, credit, or election, the Commissioner, in his discretion, will make all such regulations as may be necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same, in cases where such expenses are not otherwise provided for by law.
risings under the laws relating to Internal revenue, and such debt shall have been paid, together with the interest thereon, at the rate of 4 per centum per month, to the United States, within two years from the date of the acquisition of such real estate, it shall be lawful for the Secretary of the Treasury, with the approval of the Secretary, to release by deed, or otherwise convey such real estate to the debtor or to his heirs or other legal representatives.

§ 39.3797 Statutory provisions; definitions.

Sec. 39.3797. Definitions. (a) When used in this title, where not otherwise distinctly expressed 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 a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation or "partnership" which is not domestic.

(3) Corporation. The term "corporation" includes associations, joint-stock companies, and insurance companies.

(4) Domestic. The term "domestic" when applied to a corporation or a partnership means created, organized, or incorporated in any State or Territory of the United States or under the law of the United States or of any State or Territory.

(5) Foreign. The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(6) Fiduciary. The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(7) Stock. The term "stock" includes the share in an association, joint-stock company, or insurance company.

(8) Shareholder. The term "shareholder" includes a member, owner, or participant of any corporation, joint-stock company, or insurance company.

(9) United States. The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(10) State. The word "State" shall be construed to include the Territories and the District of Columbia, when such construction is necessary to conform to provisions of this title.

(11) Secretary. The term "Secretary" means the Secretary of the Treasury.

(12) Commissioner. The term "Commissioner" means the Commissioner of Internal Revenue.

(13) Collector. The term "collector" means collector of internal revenue.

(14) Taxpayer. The term "taxpayer" means any person subject to a tax imposed by this title.

(15) 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 Nurse Corps, Female, the Women's Army Auxiliary Corps; the Navy Nurse Corps, Female, and the Women's Reserve branch of the Naval Reserve.

(16) Withholding agent. The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of this title.

(17) Husband and wife. As used in sections 25 (k), 26 (u), and 17, and the last clause of section 161 (b), the term "husband and wife" therein referred to are divorced, wherever appropriate to the meaning of such terms, the term "former husband" and "former wife" and the term "husband" shall be read "former husband" and, if the payee described in subsection (a) is a husband or a wife therein, referred to as divorced wife, wherever appropriate to the meaning of such terms, the term "husband" shall be read "wife" and the term "wife" shall be read "husband".

(18) International organization. The term "international organization" means a public international organization entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act.

(19) Domestic building and loan association. The term "domestic building and loan association" includes a domestic building and loan association, a savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members.

(b) Includes and including. The terms "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

(c) Cross references. For other definitions, see the following:

§ 39.3797-2. 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 and for the purpose for which it is organized, that, 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, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an intersurance exchange, or a corporation, or a partnership. An "investment" trust of the type commonly known as a management trust is an association, and, if the tax imposed by this title is payable with respect to such trust, a trust agreement to vary the investment of the income or principal shall be treated as a declaration of trust, a statute, or otherwise. It includes any organization, created for the transaction of designated and for the purpose for which it is organized, that, 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, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an intersurance exchange, or a corporation, or a partnership. An "investment" trust of the type commonly known as a management trust is an association, and, if the tax imposed by this title is payable with respect to such trust, a trust agreement to vary the investment of the income or principal shall be treated as a declaration of trust, a statute, or otherwise.

§ 39.3797-3. Association distinguished from trust. (a) The term "trust," as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the income or principal, and are not the voluntary planners or creators of the trust arrangement. Even though the beneficia
ficials' do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

(b) 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 beneficiaries, or to conserve the property, and business of the enterprise, and 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) A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, 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 conducted by one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a partnership is not to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

(b) The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

§ 39.3797-6 Partnership associations.

A partnership association of the type authorized by the statutes of several States, such as those of the State of Pennsylvania (Purdon's Penna. Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the statutory 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.

(a) Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. 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.

(b) Though its name, charter powers, and subject to State insurance laws are significant in determining the business which a corporation is authorized and intended to carry on, the characteristics of the business actually done in the taxable year determines whether it is taxable as an insurance company under the
has been created in the estate controlled by the agent and attorney, the liability to which the trust fund is subject, or any such tax which shall have become due during the time within which the same may be refunded subject to the statute of limitations, or any such tax which shall have become due during the time within which the same may be refunded subject to the statute of limitations shall be refunded subject to the statute of limitations, or any such tax which shall have become due during the time within which the same may be refunded subject to the statute of limitations.
intended to assist depositors of a bank which had ceased to do business by reason of insolvency to recover their deposits, by the section only to the extent necessary to provide funds by the trustee or agent to whom assets of the bank have been transferred; that the bank be wholly or partially released from liability for repayment of deposits as and when due and have claims against the separated assets. Any excess of separated assets over the amount necessary for payment of such deposits will be available for tax collection after full payment of depositors' claims under the agreement against such assets. But see § 39.3798-9 (a)

(b) Corporate transferees. Where the segregated assets are transferred to a separate corporate trustee or corporate agent, the assets and earnings therefrom are within the protection of the section, until full payment of depositors' claims against such assets as earnings, no matter by whom the stock of such corporation is held, and no matter whether the assets be liquidated or operated or held for benefit of the depositors.

§ 39.3798-4 Unsegregated assets—(a) Depositors' claims. (1) Claims of depositors, to the extent that they are to be satisfied out of segregated assets, will not be considered in determining the availability of unsegregated assets for tax collection. Depositors have agreed to accept payment out of segregated assets only, collection of tax from unsegregated assets will not diminish the assets available and necessary for payment of the depositors' claims. Thus, it may be possible to collect taxes from the unsegregated assets of a bank, although the segregated assets are immune under the section.

(2) If the unsegregated assets of the bank are subject to any portion of the depositors' claims, such unsegregated assets will be within the immunity of the section only to the extent necessary to satisfy the claims to which such assets are subject. Taxes will still be collectible from the unsegregated assets to the extent of the amount by which the total liability of the bank, both available and necessary for payment of depositors' claims, will be diminished therefrom. Therefore, if, for example, in the case of a bank having a tax liability not previously immune under the section, of $50,000, the deposit claims against such bank are in the amount of $75,000, and the assets available for satisfaction of deposit claims amount to $100,000, the $50,000 tax is collectible to the extent of the $25,000 excess of assets over deposit claims. Collection is not to be postponed until the full amount of the tax is collected.

(b) Depositors' claims against earnings. Even though under a bona fide agreement a bank has been released from depositors' claims as to segregated assets, if all or a portion of its earnings are subject to depositors' claims, all assets, including the earnings from which, in whole or part, are charged with the payment of depositors' claims, will be immune from tax collection. But see § 39.3798-5 (a)

§ 39.3798-5 Earnings—(a) Availability for tax collection. Earnings of a bank with section 3798 (b), whether from segregated or unsegregated assets, which are necessary for, applicable to, and not available for, payment of depositors' claims under an agreement, are within the immunity of the section. It only a portion or percentage of income from segregated or unsegregated assets is necessary for, applicable to, and not available for, payment of depositors' claims, the remaining income is available for tax collection. Earnings of the bank's first fiscal year ending after the date of the agreement, if it is possible to collect taxes from the assets available and necessary for payment of depositors' claims will be assumed to be applicable for collection of any tax due prior or subsequent to execution of the agreement. Earnings of subsequent fiscal periods from unsegregated assets not applicable to depositors' claims will be assumed to be applicable to payment of taxes as to which immunity under the section has not previously attached. Earnings from segregated assets are available for collection of tax, whether previously uncollectible under the section or not, after depositors' claims against segregated assets have been paid in full. See §§ 39.3798-3 (a) and 39.3798-9 (a)

(b) Tax computation. The fact that earnings of a given year may be wholly or partially immune under the section, does not exempt the bank from tax liability. The tax is determined on the earnings produced for the purpose of section 3798 in computing the portion of the earnings to be paid to depositors. The bank has an outstanding tax liability for prior years of $7,000. The income tax liability of the bank for the calendar year 1952 is $10,000, $9,000 produced by the segregated, and $6,000 produced by the unsegregated assets. Such amount shall be considered as unsegregated for the purpose of section 3798 in computing the portion of the earnings to be paid to depositors.
full. No part of the $6,000 from collection of taxes in 1953 may be collected thereafter from unsegregated assets of the bank or earnings therefrom, so that except for payments of $6,000 from unsegregated assets, as in 1952, the return filed shows income of $5,000 and a tax liability of $1,500. An investigation shows the true income to be $10,000, on which the tax is $3,000. The full $2,500 will be assumed to be collectible. The $500 differs from $6,000 as earnings from unsegregated assets over the amount going to the depositors, and the $3,000 tax will be available for collection of the tax for prior years, which became immune as described above, but may be available for collection of tax for subsequent years.

(c) No significance attaches to the selection of the years 1952 and 1953 in the example set forth in paragraph (b) of this section. The rules indicated by the example are equally applicable to subsequent or prior years not excluded by limitations.

§ 39.3798-5 Abatement and refund.
(a) An assessment or collection, no matter when made, if contrary to section 3798, is subject to abatement or refund within the applicable statutory period of limitations.

(b) Collection from a bank within section 3798 (b) which diminished assets necessary for payment of depositors, if made prior to agreement with depositors, is not contrary to the section, and affords no ground for refund.

(c) Any abatement or refund is subject to existing statutory periods of limitation, which periods are not suspended or extended by section 3798. In order to secure refund of any taxes paid for any taxable year during the period of immunity the bank must file claim therefor.

§ 39.3798-7 Establishment of immunity. (a) The mere allegation of insolvency, or that depositors have claims against segregated or other assets or earnings from unsegregated assets in their own interest, is not sufficient for immunity from tax collection. It must be affirmatively established to the satisfaction of the Commissioner that collection of tax will be contrary to section 3798. See also § 39.3798-5.

(b) Any claim, by a bank, of immunity under section 3798 (b) shall be supported by a statement, under oath or confirmation, which shall fully set forth: (i) the total of depositors' claims outstanding, and (ii) separately and in detail, the amount of each of the following, and the amount of depositors' claims properly chargeable against each: (1) Segregated or transferred assets; (ii) segregated assets; (iii) estimated future average annual earnings and profits; (iv) amount collectible from shareholders; and (v) any other resources available for payment of depositors' claims. The detail shall show the full amount of depositors' claims chargeable against each of the items in subdivisions (1) to (v), inclusive, of this paragraph even though part or all of the amount chargeable against a particular item is also chargeable against some other item or items. There shall also be filed a copy of any agreement between the bank and its depositors, or other agreement or document bearing on the claim of immunity. The statement shall show the basis, as "book," "market," etc., of valuation of the assets.

§ 39.3798-8 Procedure during immunity—(a) Statutory provisions: A bank, long as complete or partial immunity is claimed, a bank within section 3798 (b) shall file with income tax returns a statement as required by § 39.3798-6, in duplicate, and each additional statements as the Commissioner may require. Whether or not additional statements shall be required, and the frequency thereof, will depend on the circumstances, including the financial status and apparent prospects of the bank, and the time which is available for assessment and collection. If a copy of an agreement or document has once been filed, a copy of the same agreement or document need not again be filed with a subsequent statement, if it is shown by the subsequent statement where and when and with what return the copy was filed. In case of amendment a copy of the amendment must be filed with the return for the taxable year in which the amendment is made.

(b) Failure to file. Failure of a bank to file any required statement will be treated as indicating that the bank is not entitled to immunity.

§ 39.3798-9 Termination of immunity—(a) If general creditors, or depositors of a bank within section 3798 (a) on the basis, as "book," "market," etc., of valuation of the assets, by the Commissioner of Internal Revenue, the bank will be treated as having not been immune for the period of immunity. Any collection within the applicable statutory period of limitations, for collection of tax due at any time.

§ 39.3799-10 Collection of tax after termination of immunity.

(b) Set-aside assets. Deposit insurance payable to depositors shall not be treated as an asset of the bank and shall be disregarded in determining the sufficiency of the assets to meet the claims of depositors.

(c) Notice by bank. A bank within section 3798 (b) upon termination of immunity with respect to (1) earnings, (2) segregated or transferred assets, or (3) unsegregated assets, the notice to notify the district director of internal revenue for the internal revenue district in which the taxpayer's returns were filed of such termination of immunity.

§ 39.3799-11 Social security taxes. The regulations under section 3799 do not relate to social security taxes, since the immunity granted by the section does not apply to taxes imposed by the Social Security Act.

§ 39.3799-3300 Statutory provisions; income from obligations and mortgages issued by joint-stock land banks; jurisdiction of district courts to issue orders, processes, and judgments.

§ 39.3799-3302 Income from obligations and mortgages issued by joint-stock land banks; jurisdiction of district courts to issue orders, processes, and judgments.

§ 39.3799-10 Collection of tax after termination of immunity. W. In the case of a bank within section 3793 (b) segregated assets (including earnings therefrom) in excess of those necessary for payment of outstanding deposits become available, such excess of segregated assets shall be applied toward satisfaction of accumulated outstanding taxes previously immune under the section, and not barred by the statute of limitations. But see § 39.3799-5 (c).

§ 39.3799-11 Social security taxes. The regulations under section 3799 do not relate to social security taxes, since the immunity granted by the section does not apply to taxes imposed by the Social Security Act.

§ 39.3799-2000 Jurisdiction of district courts to issue orders, processes, and judgments. The district courts of the United States at the
§ 39.3801 (a) (1) [Statutory provisions; mitigation of effect of limitation and other provisions in income tax cases; definition of determination.]

Sect. 3801. Mitigation of effect of limitation and other provisions in income tax cases—
(a) Definitions. For the purpose of this section—

(1) Determination. The term "determination under the income tax laws" means—

(A) A closing agreement made under section 3760;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court with respect to which the error was made; or

(C) A final disposition by the Commissioner.

For the purpose of this section a claim for refund shall be deemed finally disposed of by the Commissioner if—

(I) As to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(II) As to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Commissioner in reduction of tax, the date of expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which becomes final, or claim for refund finally disposed of, prior to August 27, 1938.

§ 39.3801 (a) (1)–1 Purpose and scope of section 3801. Section 3801 provides for correction of the effect of certain types of errors specified in section 3801 (b) and §§ 39.3801 (b)–1 to 39.3801 (b)–5. 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 only when 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, has maintained a position inconsistent with the error. No correction is permitted unless that inconsistent position is adopted by a determination made on or after August 27, 1938. The provisions of section 3801 and of the regulations promulgated under such section shall not apply to any tax as would be treated under chapter 9, relating to employment taxes.

§ 39.3801 (a) (1)–2 Closing agreement as a determination. For the purposes of section 3801, a determination 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 periods of tax liability. If it becomes necessary or desirable to effect a determination in order to obtain or accelerate an adjustment of a closing agreement, a closing agreement may be used for such purpose whenever a taxpayer and the Government have concurred in the disposition of an item or items. A closing agreement becomes effective as of the date of its approval by the Secretary, the Under Secretary, or an Assistant Secretary, except that a closing agreement with respect to a final determination of tax liability for past years becomes final on the date of its approval by the Commissioner.

§ 39.3801 (a) (1)–3 Decision by Tax Court or court as a determination. (a) A determination may take the form of a decision by the United States Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final. (b) The date upon which a decision by the Tax Court becomes final is prescribed in section 1140.

(c) The date upon which a judgment of a court becomes final must be determined upon the basis of the facts in the particular case. Ordinarily a judgment of a United States district court becomes final upon the expiration of the time allowed 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.

§ 39.3801 (a) (1)–4 Final disposition of claim for refund as a determination. (a) A determination may take the form of a final disposition of a claim for refund. Such disposition may result in a final determination with respect to two classes of items, i.e., items included in the taxpayer's claim for refund with respect to which the taxpayer's contention is sustained and items applied by the Commissioner to offset the alleged overpayment. The time at which such claim becomes final may depend not only upon what action is taken with respect to such items but also upon the date of filing claim for refund, and the consequent overpayment is only deductible loss, if at all, if the overpayment is only disallowed in part. For example, if a taxpayer claims a deductible loss of $10,000 but the Commissioner's computation of the consequent overpayment is only $2,000, the disposition of the claim for refund with respect to both the allowance of the $5,000 and the disallowance of the remaining $8,000, or the allowance of the $2,000 overpayment and the denial of the $5,000, 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.

(d) Items applied by the Commissioner in reduction of the refund or credit. If the Commissioner applies an item in reduction of the overpayment disallowed in the claim for refund, and the net result is an allowance of refund or credit, the disposition with respect to such item is 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 acceleration of tax liability, such action does not constitute a final disposition by the Commissioner of a claim for refund within the meaning of section 3801 (a) (1) (A), (B), or (C).

(e) The necessity of waiting for the expiration of the 2-year period of limitations provided in section 3772 may be avoided in such cases as are described under paragraph (e) or (d) of this sec-
tion by the use of a closing agreement to effect a determination.

§ 39.3801 (a) (2)–(3) Statutory provisions; mitigation of effect of limitation and other provisions in income tax cases; definitions of taxpayer and related taxpayer

Sec. 3801. Mitigation of effect of limitation and other provisions in income tax cases; definitions of taxpayer and related taxpayer

(a) Definitions. For the purpose of this section * * *

(2) Taxpayer. Notwithstanding the provisions of subsection (c), the term "taxpayer" means any person subject to a tax under the applicable Revenue Act.

(3) Related taxpayer. The term "related taxpayer" means a taxpayer who, with respect to whom the determination is made with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor, assignor, or donee, as the case may be, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Relative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or disallowed, or allowable, as the case may be, in respect of the related taxpayer; or

(5) Determination relates to such rents determined under section 3801 although the determination is made with respect to a different taxpayer, provided that such taxpayers stand in one of the relationships specified in section 3801 (a) (3). The concept of "related taxpayer" has application only to section 3801 (b) (1), (2), (3), or (4) and does not apply to section 3801 (b) (6).

(b) (1) An adjustment is made only as to the tax imposed for the taxable year with respect to which the error was made which corresponds to the tax imposed for the year or another taxable year of a related taxpayer for which the error is made.

(c) Section 3801 is not applicable if, on the date of the determination, correction of the effect of the error is permissible without recourse to sections 3761 and corresponding provisions of 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, and such determination may be made only after the expiration of the period of limitation applicable to the year with respect to which the error was made; if the determination relates to the tax imposed by chapter 1 of the Internal Revenue Code, the adjustment may be only with respect to the tax imposed by such chapter or by the corresponding provisions of the Revenue Acts relating to such year or of a related taxpayer for the same or another taxable year.

§ 39.3801 (b)–(2)–(1) Double inclusion of item of gross income. A. § 39.3801 (b) (1) If the determination requires the inclusion, in a taxpayer's gross income, of an item which was erroneously included in the gross income of another taxpayer, the taxpayer may apply to the Board of Tax Appeals for the year with respect to which the erroneous inclusion was made, or, if such application is not made, then at the time of the determination, correction of the effect of the error is prevented by the operation of any provision of the internal revenue laws other than section 3761 of the Internal Revenue Code and the corresponding provisions of prior revenue acts (relating to periods of limitation).

§ 39.3801 (b)–(1)–18 Federal Reg. 6189 1953

HeinOnline -- 18 Fed. Reg. 6189 1953
the Commissioner discovers that the taxpayer received this rent in 1949 and asserts a deficiency for the year 1948, which is main-
tained by The Tax Court of the United States in 1953. An adjustment is authorized with respect thereto. If the commis-
payer had returned the rent for both 1948 and 1949 and by a determination was denied a refund claimed for 1949 on account of the rent item, an adjus-
tment is authorized. 

Example (2). A husband assigned to his wife salary to be earned by him in the year 1950. The 1946 income included such salary in her separate return for that year and the hus-
bread omitted it. The Commissioner as-
serted a deficiency against the wife for 1950 with respect to a different item and she contested that deficiency before the Tax Court in 1952. An adjust-
ment is authorized with respect to the wife's tax for 1950.

§ 38301 (b)–2 Double allowance of a deduction or credit. (a) Section 3801 (b) (2) applies if the determine-
lows the taxpayer a deduction or credit which was erroneously allowed the same taxpayer for another taxable year or a related taxpayer for the same or another taxable year.

(b) The application of section 3801 (b) (3) may be illustrated by the following examples:

Example (1). A taxpayer in his return for 1947 claimed and was allowed a deduc-
tion for destruction of timber by a forest fire. Subsequently it was discovered that the forest fire occurred in 1946 rather than in 1947. After the expiration of the period of limitations for the assessment of a defi-
cency for 1947, the taxpayer files a claim for refund for 1948 based upon a deduction for the fire loss in that year. The Commissioner in 1952 allows the claim for refund. An adjust-
ment is authorized with respect to the year 1947.

Example (2). The beneficiary of a testa-
mentary trust received in 1946 a distribution of income, which is erroneously allowed to the beneficiary, and was allowed, a deduction for depreci-
ation of the trust property. The Commis-
sioner asserts the deficiency against the beneficiary for 1946 with respect to the different item and final decision of The Tax Court of the United States was rendered in 1948, so that the Commissioner was thereafter barred by section 270 (b) of the Internal Revenue Code from asserting a further deficiency against the beneficiary for 1946. The trustee thereafter filed a timely refund claim con-
tending that, under the terms of the will, the trust, and not the beneficiary, was entitled to the allowance for depreciation. The court in 1952 sustains the refund claim. An adjust-
ment is authorized with respect to the year 1946.

Example (3). The application of section 3801 (b) (3) may be illustrated by the following examples:

Example (1). The application of section 3801 (b) (3) may be illustrated by the following example:

Example. For the taxable year 1946, a trustee, directed by the trust instrument to distribute the trust income to the beneficiary and returned the entire net income as taxable to the trust. After the expiration of the period of limitations on deficiency assessments against the beneficiary, the trustee in his return for the year 1946 included the entire net income of the trust in his return for the year 1946. In 1948, a State court held invalid the determination made by the court in 1950, and that, as the payments had accrued in 1948, they were properly taxable in that year. An adjustment is authorized with respect to the year 1948. If the taxpayer had not included the payments in any return and the Commis-
sioner had asserted a deficiency for 1949 with respect to the payments, and the defi-
cency was not sustained by The Tax Court of the United States in its final decision in 1953, no adjustment is authorized with re-
to the year 1948. Although the deter-
mation requires the exclusion of the Item from gross income, no tax had been paid with respect thereto. If the taxpayer, however, had paid the deficiency and thereafter successfully sued for refund in court, an adjustment is authorized.

Example. A husband and son conducted a partnership, each being entitled to one-half of the net profits. The father included the entire net income of the partner-
ship in his return. The son included no portion of this Income in his return for that year. Shortly before the expiration of the period of limitations with respect to deficiency assessments and refund claims for both father and son for 1946, the father died. The beneficiary of a distribution of income, The court sustains the claim for refund in 1952. An adjust-
ment is authorized with respect to the son's tax for 1946.

§ 38301 (b)–4 Correlative deduc-
tions and exclusions specified in section 162 (b) and (c) and corresponding provi-
sions of prior revenue acts. (a) Section 3801 (b) (4) applies if the determina-
tion relates to the additional deduction of section 162 (b) and (c) of the Internal Revenue Code, or the corresponding provisions of a prior revenue act, for amounts distribut-
able to the beneficiaries, heirs, or lega-
tees of an estate or trust, and such determination requires:

(1) The allowance to the estate or trust of such additional deduction when such amounts have been erroneously omitted or included from the income of the beneficiaries, heirs, or legatees;

(2) The exclusion of such amounts in the income of the beneficiaries, heirs, or legatees when such additional deduction has been erroneously allowed to or omitted by the estate or trust;

(3) The disallowance to an estate or trust of such additional deduction when such amounts have been erroneously included in the income of the beneficiaries, heirs, or legatees; or

(4) The exclusion of such amounts from the income of the beneficiaries, heirs, or legatees when such additional deduction has been erroneously allowed to the estate or trust.

(b) The application of section 3801 (b) (1) of this section may be illustrated by the following example:

Example. The claim for refund is allowed in 1950. The wife would therefore be barred from filing a claim for refund on behalf of the trust for the year 1949. The remaining period of limitations for filing claim, the Commissioner, relying upon the exemp-
tion in paragraph (b) of this section, except that, instead of the trustor's filing a re-
fund claim, the Commissioner, relying upon the exemp-
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tion in paragraph (b) of this section, except that, instead of the trustor's filing a re-
refund claim, the Commissioner, relying upon the exemp-
tion in paragraph (b) of this section, except that, instea
made mediately or immediately derived title from such person subsequent to such transaction. Section 3801 (b) (5) applies with respect to the person who acquires and holds as consequent transferees or donees who have a substituted basis ascertained by reference to the basis in the hands of such person. No adjustment is authorized with respect to the property which had cost him $5,000 to the X Corporation in exchange for an original issue of shares of its stock having a fair market value of $10,000. In his return for 1946 taxpayer A treated the exchange as one in which gain or loss was not recognized.

(i) In 1952 the X Corporation claims that gain should have been recognized on the exchange in 1946 and therefore the property is not acquired at the cost of $5,000. Its contention is confirmed by a closing agreement. No adjustment is authorized with respect to the property which taxpayer A acquired in the exchange in 1946, but, rather, to the property which he transferred in such exchange.

Example (1). In 1946 taxpayer A transferred property which had cost him $5,000 to the X Corporation in exchange for an original issue of shares of its stock having a fair market value of $10,000. In his return for 1946 taxpayer A treated the exchange as one in which gain or loss was not recognized.

(ii) In 1952 the X Corporation transfers the property to the Y Corporation in a tax-free exchange. In 1953 the Y Corporation sells the property and computes its profit on the basis of $10,000, which basis is sustained by The Tax Court of the United States. No adjustment is authorized with respect to the property which taxpayer A acquired in the exchange in 1946, but, rather, to the property which he transferred in such exchange.

Example (2). In 1947, taxpayer A sold property acquired at a cost of $5,000 to taxpayer B for $0.00. In his return for 1947 taxpayer A failed to include the profit on such sale. In 1952 taxpayer B sells the property for $100,000 and in 1953 taxpayer B reports a gain of $5,000 upon the sale, which is confirmed in a closing agreement. No adjustment is authorized with respect to the tax to the taxpayer A for 1947, as taxpayer A is not the taxpayer with respect to whom the determination is made. It is the determination that relate to property which taxpayer A acquired in the transaction in 1947 but rather to property which he transferred in such transaction.

Example (3). In 1946 a taxpayer received as additional compensation shares of stock in a corporation because he had contributed $5,000 in his return for 1946 as profit on the sale. A deficiency is asserted by the Commissioner on the theory that the basis is zero and the recognized gain is $15,000. The Tax Court sustains the taxpayer's contention that the transaction was erroneously treated in 1946 in that the property had a fair market value of $10,000. Adjustment is authorized with respect to the year 1946.

Example (4). In 1943 a taxpayer received 100 shares of the X Corporation for a consideration of $5,000. In 1944 the X Corporation having a fair market value of $5,000, in exchange for shares of stock in the Y Corporation for a consideration of $12,000. In 1945 his return for 1943 the taxpayer treated the exchange as one in which gain or loss was not recognized. The taxpayer sold 50 shares of the X Corporation stock in 1944 and in his return for that year treated such shares as having a $5,000 basis. In 1950 the taxpayer sells the remaining 50 shares of stock of the X Corporation for $7,500 and reports $4,500 gain in his return for 1949. After the expiration of the period of limitations on deficiency assessments for 1946, the Commissioner instituted a deficiency proceeding for the year 1949. The taxpayer filed a claim for refund for the year 1948 based upon the allowance of a deduction for the loss in that year, and the claim was allowed. The Commissioner, on the other hand, contended that the taxpayer thus has maintained a position inconsistent with the allowance of the deduction for 1947 by filing a claim for refund for 1948 based upon the same deduction. As the determination—the allowance by the Commissioner of the claim for refund—adopts such inconsistent position, an adjustment is authorized for the year 1947.

(2) An adjustment which would result in an additional assessment is not authorized if the Commissioner, and not the taxpayer, has maintained such inconsistent position.

Example. In the example in subparagraph (1) of this paragraph, assume that the taxpayer B did not file a claim for refund for 1948 but the Commissioner issued a notice of deficiency for 1948 based upon other items. The taxpayer filed a petition with The Tax Court of the United States. The Commissioner in his answer voluntarily proposed the allowance of a deduction for the loss provided for in his claim for refund. The Tax Court took the deduction into account in its re-determination in 1953 of the tax for the year 1948. In such cases it would be authorized for the year 1947 as the Commissioner, and not the taxpayer, has maintained a position inconsistent with the allowance of a deduction for the loss in that year.

§ 39.3801 (b)-6 Loss attributable to determination of tax. The question whether there was an erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition is determined by the provisions of the Internal Revenue Law applicable with respect to the year as to which the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, was in pursuance of an Interpretation, a decision, a ruling, a judicial opinion, or an administrative regulation. The fact that the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, was in pursuance of an Interpretation, a decision, a ruling, a judicial opinion, or an administrative regulation, is not determinative of this question. For example, if a later judicial opinion is authoritative in such an Interpretation so that such action was contrary to such provisions of the Internal Revenue Law as later interpreted, the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, is erroneous within the meaning of section 3801 (b) (6).

§ 39.3801 (b)-7 Operation dependent upon maintenance of inconsistent position. (a) Adjustments resulting in additional assessments. (1) An adjustment which would result in an additional assessment is authorized only if (i) the taxpayer with respect to whom the determination is made, has, in connection therewith, maintained a position which is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, and (ii) such inconsistent position is adopted in the determination.

Example. A taxpayer in his return for 1947 claimed and was allowed a deduction for a loss arising from a casualty. After the taxpayer had filed his return for 1948 and maintained a position inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, and (ii) such inconsistent position is adopted in the determination.

Example. In the example in subparagraph (1) of this paragraph, assume that the taxpayer B did not file a claim for refund for 1948 but the Commissioner issued a notice of deficiency for 1948 based upon other items. The taxpayer filed a petition with The Tax Court of the United States. The Commissioner in his answer voluntarily proposed the allowance of a deduction for the loss provided for in his claim for refund. The Tax Court took the deduction into account in its re-determination in 1953 of the tax for the year 1948. In such cases it would be authorized for the year 1947 as the Commissioner, and not the taxpayer, has maintained a position inconsistent with the allowance of a deduction for the loss in that year.

(b) Adjustments resulting in refund or credit. (1) An adjustment which would result in the allowance of a refund or credit is authorized only if the Commissioner, in connection with a determination, has maintained a position which is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, and (ii) such inconsistent position is adopted in the determination.

Example. A taxpayer who keeps books on the cash basis computed in his return for 1946 an item of accrued interest. After the period of limitations on refund claims for 1946 had expired, it was discovered that the loss actually occurred in 1946. The taxpayer filed a claim for refund for the year 1948 based upon the allowance of a deduction for the loss in that year, and the claim was allowed. The Commissioner, on the other hand, contended that the taxpayer thus has maintained a position inconsistent with the allowance of the deduction for 1947 by filing a claim for refund for 1948 based upon the same deduction. As the determination—the allowance by the Commissioner of the claim for refund—adopts such inconsistent position, an adjustment is authorized for the year 1947.

(2) An adjustment which would result in an additional assessment is not authorized if the Commissioner, and not the taxpayer, has maintained such inconsistent position.

Example. In the example in subparagraph (1) of this paragraph, assume that the taxpayer B did not file a claim for refund for 1948 but the Commissioner issued a notice of deficiency for 1948 based upon other items. The taxpayer filed a petition with The Tax Court of the United States. The Commissioner in his answer voluntarily proposed the allowance of a deduction for the loss provided for in his claim for refund. The Tax Court took the deduction into account in its re-determination in 1953 of the tax for the year 1948. In such cases it would be authorized for the year 1947 as the Commissioner, and not the taxpayer, has maintained a position inconsistent with the allowance of a deduction for the loss in that year.
received in 1947, and, therefore, was prop-
erly includable in gross income for that year.
The taxpayer appealed to the Tax Court, which
in 1955 sustained the deficiency. By
asserting a deficiency for 1947 based upon
the inclusion of the item of interest in that
year, the Commissioner maintained a posi-
tion inconsistent with the inclusion of the
interest item in 1946. As the deter-
mination—the determination of the Tax Court
in 1952 included the item of interest
sustained that the interest item should be
ascertained as provided in subsection (d), in
manner as if it were a deficiency deter-
mined by the Commissioner with respect to
the taxpayer as to whom the error was
made or an overpayment claimed by such
taxpayer as to whom the error was made, and as if on the date of the determi-
nation deficiency and later filing claim for
refund for such taxable year.
§ 39.3801 (c) Method of adjustment. The adjust-
ment authorized in subsection (b) shall be
made or an overpayment claimed by such
taxpayer as to whom the error was made, and as if on the date of the determi-
nation deficiency and later filing claim for
refund for such taxable year.

(1) Method of adjustment. The adjust-
ment authorized in subsection (b) shall be
made or an overpayment claimed by such
taxpayer as to whom the error was made, and as if on the date of the determi-
nation deficiency and later filing claim for
refund for such taxable year.

(2) An adjustment which would result
in the allowance of a refund or credit is
not authorized if the taxpayer with re-
spect to whom the determination is
made, and not the Commissioner, has
maintained such inconsistent position.

Example. In the example in subpara-
graph (1) of this paragraph, assume that the
Commissioner asserted a deficiency for 1947
based upon other items for that year, but
in computing the net income upon which
such deficiency was based did not include
the item of interest. The taxpayer appealed
to the Tax Court and in his position as-
serted that the interest item should be
included in gross income for 1947. The Tax
Court in 1953 included the item of interest
in its redetermination of the tax for the
taxable year 1947. In such case no adjust-
ment would be authorized for 1946 as the
taxpayer, and not the Commissioner, has
maintained a position inconsistent with the
 erroneous inclusion of the item of interest
in the gross income of the taxpayer for that
year.

§ 39.3801 (b)–8 Existence of status of
taxpayer at time of the first
maintenance of an inconsistent position.

(a) No adjustment by way of a defi-
ciency assessment shall be made with
respect to a return or credit taxpayer unless
the relationship existed both in the taxable
year with respect to which the error was
made and at the time the taxpayer with
respect to whom the determination is
made first maintained, in the manner
-described in this section, the inconsistent
position with respect to the taxable year
with which the determination relates.

(b) If that 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 de-
termination is made, the requisite rela-
tionship must exist on the date of filing
such document. If the inconsistent posi-
tion is maintained in more than one of
such documents, the requisite date is the
date of filing of the document in which
it was first maintained. If the inconsist-
ent position was not thus maintained then
the relationship must exist on the date of
the return, or petition, for example, where at the instance of the tax-
payer a deduction is allowed, the right
to which was not asserted in a return,
claim for refund, or petition to The Tax
Court, and a determination is effected by
means of a closing agreement.

§ 39.3801 (c) Statutory provisions;
maintenance of effect of limitation
and other provisions in income tax cases; method of adjustment. Sec.
39.3801. Mitigation of effect of limitation and other provisions in income tax cases; method of adjustment.

(1) If the amount of the adjust-
ment ascertained pursuant to section
3801 (d) represents an increase in tax, it
is to be treated as if it were a deficiency
determined by the Commissioner with
respect to the taxpayer as to whom the
error was made and for the taxable year
with respect to which the error was
made. The amount of the adjustment
represented by item (a) of the
section ascertained pursuant to section
3801 (e) No deficiency, unless the
amount so ascertained (together with
the interest item) shall be issued with respect to such amount
and the taxpayer may contest the defi-
cency before The Tax Court of the
United States or, if he chooses, may pay
such amount and at the time the taxpayer
with respect to whom the determination
is made. Such amount may be re-
covered under the law and regulations
applicable to overpayments of tax,
subject, however, to the limita-
tions imposed by section
3801 (e) No deficiency, unless the
amount so ascertained (together with
the interest item) shall be issued with respect to such amount
and the taxpayer may contest the defi-
cency before The Tax Court of the
United States or, if he chooses, may pay
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amount so ascertained (together with
the interest item) shall be issued with respect to such amount
and the taxpayer may contest the defi-
cency before The Tax Court of the
United States or, if he chooses, may pay
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with respect to whom the determination
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tions imposed by section
3801 (e) No deficiency, unless the
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United States or, if he chooses, may pay
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applicable to overpayments of tax,
subject, however, to the limita-
tions imposed by section
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amount so ascertained (together with
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cency before the Tax Court of the
United States or, if he chooses, may pay
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is made. Such amount may be re-
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tions imposed by section
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the interest item) shall be issued with respect to such amount
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cency before the Tax Court of the
United States or, if he chooses, may pay
such amount and at the time the taxpayer
with respect to whom the determination
is made. Such amount may be re-
covered under the law and regulations
applicable to overpayments of tax,
subject, however, to the limita-
tions imposed by section
3801 (e) No deficiency, unless the
amount so ascertained (together with
the interest item) shall be issued with respect to such amount
and the taxpayer may contest the defi-
cency before the Tax Court of the
United States or, if he chooses, may pay
such amount and at the time the taxpayer
with respect to whom the determination
is made. Such amount may be re-
covered under the law and regulations
applicable to overpayments of tax,
subject, however, to the limita-
tions imposed by section
3801 (e) No deficiency, unless the
amount so ascertained (together with
the interest item) shall be issued with respect to such amount
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cency before the Tax Court of the
United States or, if he chooses, may pay
such amount and at the time the taxpayer
with respect to whom the determination
is made. Such amount may be re-
covered under the law and regulations
applicable to overpayments of tax,
subject, however, to the limita-
tions imposed by section
3801 (e) No deficiency, unless the
amount so ascertained (together with
the interest item) shall be issued with respect to such amount
and the taxpayer may contest the defi-
cency before the Tax Court of the
United States or, if he chooses, may pay
such amount and at the time the taxpayer
with respect to whom the determination
is made. Such amount may be re-
covered under the law and regulations
applicable to overpayments of tax,
account. In such cases, the tax previously determined will be as follows:

(1) For taxable years beginning before January 1, 1943, the tax previously determined will be the tax shown on the return, increased by any amounts previously assessed or collected without assessment as deficiencies, and decreased by any amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. If no amount was shown as the tax upon the return, or as the amount of any tax previously determined will be the sum of the amounts previously assessed, or collected without assessment, as deficiencies, decreased by any amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

(2) For taxable years beginning after December 31, 1942, the tax previously determined will be the sum of the amount shown as the tax by the taxpayer upon his return and the amounts previously assessed (or collected without assessment) as deficiencies, reduced by the amount of any rebate or other items. The amount shown as the tax by the taxpayer upon his return and the amount of any rebates shall be determined in accordance with the regulations thereunder.

(b) Any overpayment of tax shall not be considered as a refund for any taxable year as to which the error was made.

(c) Any interest or additions to the tax previously determined will be as follows:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Amount Calculated</th>
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</thead>
<tbody>
<tr>
<td>No return, or if no return was made, the tax for which a claim or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error would be allowed.</td>
<td></td>
</tr>
<tr>
<td>A deficiency or the allowance of a refund for any taxable year as to which the error was made.</td>
<td></td>
</tr>
<tr>
<td>A deficiency for the year 1947 and asserted a deficiency for that year as to which the error was made.</td>
<td></td>
</tr>
<tr>
<td>An amount shown as the tax by the taxpayer upon his return and the amount of any rebates shall be determined in accordance with the regulations thereunder.</td>
<td></td>
</tr>
</tbody>
</table>

(d) If the Commissioner has refunded the amount of an adjustment, no part thereof may be recovered by the taxpayer in any suit for refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered in a suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered in a suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered in a suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error.
(c) If 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.

§ 39.3801 (f)-(g) Statutory provisions; mitigation of effect of limitation and other provisions in income tax cases; no adjustment for years prior to 1932; not applicable to taxes imposed by chapter 9.

Sec. 3801. Mitigation of effect of limitation and other provisions in income tax cases; no adjustment for years prior to 1932; not applicable to taxes imposed by chapter 9.

(f) 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.

(g) Taxes imposed by chapter 9. The provisions of this section shall not be construed to apply to any tax imposed by chapter 9.

[Sec. 3801 (g) as added by sec. 208 (a), Social Security Act Amendments, 1950.]

§ 39.3804 Statutory provisions; time for performing certain acts postponed by reason of war.

Sec. 3804. Time for performing certain acts postponed by reason of war—(a) Individual. The period of time prescribed by sections 3801 and 3802 for the performance of any act required or permitted to be performed by or on behalf of the United States in connection therewith, may be made, taken, begun, or prosecuted in accordance with law, without regard to the time prescribed therefor, in any other case in which the taxpayer of income tax imposed by, or gift tax (except income tax withheld at source) is disregard of, under the internal revenue laws, the time prescribed therefor, in respect of any tax liability (including any interest, penalty, additional amount, or addition to the tax) affected by the failure to perform such act within such time, and in determining the amount of any credit or refund (including interest) affected by such failure, there shall be disregarded such period after December 6, 1941, as may be prescribed by such regulations.

(b) Limitation on time to be disregarded. The period of time disregarded under this section shall not extend beyond the date specified in clause (1) or clause (2) of this subsection, whichever is the earlier:

(1) December 6, 1947, as the date of enactment of this section; or
(2) March 1, 1948, of one or more of the circumstances specified in paragraph (1), (2), or (3) of subsection (a).

(c) Limitation on time to be disregarded. The period of time disregarded under this section, the fifteenth day of the third month following the month in which an executor, administrator, or a conservator of the estate of such individual qualifies.

(d) Exception. The provisions of this section do not apply to the enforcement of any estate tax, gift tax, or any other tax law, including any deficiency, penalty, additional amount, or addition to the tax.

(e) Notice and assessment. Notice of deficiency, penalty, additional amount, or addition to the tax, shall be posted by the Commissioner, and shall be deemed to be the month in which such notice is served upon the person or persons to whom it is addressed.

§ 39.3804 (f-g)
statutory provisions须incorporated amendments to the laws of the Unites States, effective on February 19, 1942; amended by sec. 509 (a), Pub. L. 894 (60th Cong.) Pub. L. 908 (81st Cong.)

§ 39.3805 Statutory provisions; income tax due dates postponed in case of China Trade Act corporations.

Sec. 305. Income tax due dates postponed in case of China Trade Act corporations. In the case of any taxable year beginning after December 31, 1948, and ending before October 1, 1953, no Federal income tax return of, or payment on account of, Federal income tax due by, any corporation organized under the China Trade Act of 1922 (22 Stat. 495, U. S. C., title 53, § 3906), as such corporation shall become due until December 31, 1953, but only with respect to any such corporation and on such tax year as the Secretary may determine reasonable under the circumstances in China pursuant to such regulations as he may prescribe. Such due date shall be the date of the power of the Secretary to extend the time for filing such return or paying such tax, as in other cases.

Sec. 305 as added by sec. 507 (a), Rev. Act 1942; sec. 19, Pub. L. 904 (60th Cong.) sec. 19, Rev. Act 1951

§ 39.3805-1 China Trade Act corporations. (a) with respect to a taxable year ending before October 1, 1953, the Federal income tax return of, or the payment on account of, Federal income tax due by, a corporation organized under the China Trade Act of 1922 (15 U. S. C., 4) shall not become due until December 31, 1953, if, in the case of any such taxable year, no such corporation shall have any such application of such postponed due date is determined by the Secretary under regulations to be reasonable in view of the circumstances in China.

(b) The due date thus prescribed is expressly subject to the power of the Commissioner to extend, as in other cases, the time for filing the income tax return or paying the income tax. See sections 53 (a) (2) and 56 (a) (1) and the regulations thereunder. See also section 5904 and the regulations thereunder.

(c) The postponement of the due date to December 31, 1953, permitted by section 3805 shall apply with respect to—

(1) A taxable year ending before October 1, 1953, of any corporation organized under the China Trade Act of 1922 if such corporation shall have been so unsettled as to militate against the normal commercial operations and corporation activities of such corporation, except that—

(i) In the case of any such taxable year of any such corporation in respect to which the situation is such that, despite such unsettled conditions, the books of account and business records are available so as to permit the filing of a proper return and the corporation has otherwise been in a position to carry on its commercial operations and corporate activities and to make a proper distribution of its earnings or profits, if any, so as to permit the certification required by section 262 (b), or

(ii) In the case of any such taxable year of any such corporation during which all of the commercial operations and corporate activities of such corporation have been carried on in Hong Kong, Macao, or Taiwan;

(2) Any such taxable year of any such corporation excepted under subparagraph (1) of this paragraph in respect of which the corporation satisfies the Commissioner that special circumstances exist, related to the unsettled conditions in China, which warrant such postpone ment.

§ 39.3806 Statutory provisions; mitigation of effect of renegotiation of war contracts or disallowance of reimbursement.

Sec. 3806. Mitigation of effect of renegotiation of war contracts or disallowance of reimbursement—(a) Reduction for prior taxable year. (1) Excessive profits eliminated for prior taxable year. If a contract with the United States or any agency thereof, or any subcontract thereunder, that is a contract the renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as “prior taxable year”) is disallowed (under section 271 for the prior taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount disallowed for such year provided for under such method, which for the purposes of section 271 (b) shall be considered a prior taxable year.

(b) Credit against repayment on account of renegotiation of war contracts or subcontracts. There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (1) of subsection (a) therein. The amount so credited shall be credited against the amount disallowed for such year provided for under such method, which for the purposes of section 271 (b) shall be considered a prior taxable year.

(c) Special rules as to individuals for 1942 and 1943. * * * [Not applicable]

§ 39.3806-1 Mitigation of effect of renegotiation of war contracts or disallowance of reimbursement—(a) Reduction for prior taxable year. (1) Excessive profits eliminated for prior taxable year. If a contract with the United States or any agency thereof, or any subcontract thereunder, that is a contract the renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as “prior taxable year”) is disallowed (under section 271 for the prior taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount disallowed for such year provided for under such method, which for the purposes of section 271 (b) shall be considered a prior taxable year.

(b) Credit against repayment on account of renegotiation of war contracts or subcontracts. There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (1) or paragraph (2) of subsection (a) therein. The amount so credited shall be considered a deduction for the year in which the tax is determined for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (2) of subsection (a).

(c) Special rules as to individuals for 1942 and 1943. * * * [Not applicable]

§ 39.3806-1 Mitigation of effect of renegotiation of war contracts or disallowance of reimbursement—(a) Reduction for prior taxable year. (1) Excessive profits eliminated for prior taxable year. If a contract with the United States or any agency thereof, or any subcontract thereunder, that is a contract the renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as “prior taxable year”) is disallowed (under section 271 for the prior taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount disallowed for such year provided for under such method, which for the purposes of section 271 (b) shall be considered a prior taxable year.

(b) Credit against repayment on account of renegotiation of war contracts or subcontracts. There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (1) of subsection (a) therein. The amount so credited shall be considered a deduction for the year in which the tax is determined for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (2) of subsection (a).

(c) Special rules as to individuals for 1942 and 1943. * * * [Not applicable]

§ 39.3806-1 Mitigation of effect of renegotiation of war contracts or disallowance of reimbursement—(a) Reduction for prior taxable year. (1) Excessive profits eliminated for prior taxable year. If a contract with the United States or any agency thereof, or any subcontract thereunder, that is a contract the renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as “prior taxable year”) is disallowed (under section 271 for the prior taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount disallowed for such year provided for under such method, which for the purposes of section 271 (b) shall be considered a prior taxable year.

(b) Credit against repayment on account of renegotiation of war contracts or subcontracts. There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (1) of subsection (a) therein. The amount so credited shall be considered a deduction for the year in which the tax is determined for the prior taxable year under Chapter 2, Chapter 3, or Chapter 2A, Chapter 2B, Chapter 2C, and Chapter 2E, is decreased by reason of the application of paragraph (2) of subsection (a).
the prior taxable year shall be the amount by which such tax is decreased.

(4) Interest. In determining the amount of credit under this subsection no interest shall be allowed with respect to the amount ascertained under paragraph (1) or paragraph (2); except that if interest is charged by the United States Internal Revenue Service, or by any State on account of the disallowance for any period before the date of the payment, repayment, or offset, or if any interest is charged by an amount equal to interest on the amount ascertained under either such paragraph as aforesaid for the period (prior to the date of the payment, repayment, or offset) as interest is so charged.

(c) Credit in lieu of other credit or refund. If a credit is allowed under subsection (b) with respect to a prior taxable year no other credit or refund under the internal-revenue laws founded on the application of subsection (a) shall be made on account of the amount allowed with respect to such taxable year. If the amount allowable as a credit under subsection (b) exceeds the amount allowed under subsection (a), the excess shall, for the purposes of the internal-revenue laws relating to credit or refund under such subsection (a) shall be made on account of the time the payment, repayment, or offset was made.

[Sec. 3806 as added by sec. 558, Rev. Act 1945; amended by sec. 701 (c) (1), (2), and (3), Rev. Act 1948; see. 14 (b), Individual Income Tax Act 1944; sec. 203 Pub. Law. 9 (62d Cong.).]

§ 39.3809 Statutory provisions; verification of returns; penalties of perjury.

§ 3810. Verification of returns; penalties of perjury. Any person who wilfully makes and subscribes any return, statement, or other document which contains any information, fact, or matter, or any signature thereto, shall be liable to a fine of not more than $1,000 or imprisonment not more than five years, or both.

(b) Signature presumed correct. The fact that an individual's name is signed to a return, statement, or other document shall be prima facie evidence for all purposes that the return, statement, or other document was signed by such individual.

(c) Verification in lieu of oath. The Commissioner, under regulations prescribed by him with the approval of the Secretary, may require that every return, statement, or other document required to be filed under any provision of the internal-revenue laws shall contain or be verified by a written declaration that it is made under the penalties of perjury, and such declaration shall be in lieu of any oath otherwise required.

[Sec. 3809 as added by sec. 4 (a), Pub. Law 271 (91st Cong.).]

§ 39.3809-1 Verification by declaration in lieu of oath. If the form officially prescribed for any internal-revenue return, return, statement, or other document contains therein provisions for verification by a written declaration that it is made under the penalties of perjury, such return, statement, or other document shall be verified by such a written declaration, and such declaration shall be in lieu of any oath otherwise required for verification by law or by regulations (including Treasury decisions) prescribed by the Commissioner with the approval of the Secretary.

§ 39.3810 Statutory provisions; effective date of self-employment tax in Puerto Rico.

§ 3810. Effective date in case of Puerto Rico. If the Governor of Puerto Rico certifies to the President of the United States that the Legislature of Puerto Rico has, by concurrent resolution, resolved that it desires the extension to Puerto Rico of the provisions of Title II of the Social Security Act, the effective date referred to in sections 1245 (e), 481 (a) (7), and 481 (b) shall be the day on which the calendar year which begins more than ninety days after the date on which the President receives such certification.

[Sec. 3810 as added by sec. 208 (b), Social Security Act Amendments 1950.]

§ 39.3810-1 Effective date of self-employment tax in Puerto Rico. Since the Governor of Puerto Rico has certified to the President of the United States that the Legislature of Puerto Rico has, by concurrent resolution, resolved that it desires the extension to Puerto Rico of the provisions of Title II of the Social Security Act, the certificate having been received by the President on September 23, 1950, the effective date specified in section 3810 is January 1, 1951. See § 3810-1 (c) (7)

§ 39.3811-3812 Statutory provisions; collection of taxes in Puerto Rico and Virgin Islands; mitigation of effect of statute of limitations and other provisions in case of related taxes under different chapters.

§ 3811. Collection of taxes in Puerto Rico and Virgin Islands—(a) Puerto Rico. For the purpose of the collection of laws respecting taxation in Puerto Rico, all taxes imposed by chapter 1, and by subchapters A and D of chapter 9, shall be collected under the direction of the Secretary and shall be paid into the Treasury of the United States as internal revenue collections. All provisions of the laws of the United States applicable to the administration, collection, and enforcement of any tax imposed upon the incomes of individuals, estates, and trusts by chapter 1 (including the provisions relating to The Tax Court of the United States), of title 9, of chapter A of subtitle D of chapter 9, shall, in respect to such tax, extend to and be applicable in Puerto Rico in the same manner and to the same extent as if such taxes were a State tax, and as if the term "United States" when used in a geographical sense included Puerto Rico.

(b) Virgin Islands. Notwithstanding any other provision of law respecting taxation in the Virgin Islands, all taxes imposed by subsection E of chapter 1, and by subchapter A of chapter 9, shall be collected under the direction of the Secretary and shall be paid into the Treasury of the United States as internal revenue collections. All provisions of the laws of the United States applicable to the administration, collection, and enforcement of the tax imposed by subchapter D of chapter 1 (including the provisions relating to The Tax Court of the United States), and of any tax imposed by subchapter A of chapter 9, shall, in respect to such tax, extend to and be applicable in the Virgin Islands in the same manner and to the same extent as if the Virgin Islands were a State, and as if the term "United States" when used in a geographical sense included the Virgin Islands.

(c) Definition. As used in this section, the term "tax" includes any penalty with respect to the tax, any additional amount with respect to the tax, provided for by any law of the United States.

[Sec. 3811 as added by sec. 208 (b), Social Security Act Amendments 1950; amended by sec. 231 (1) of the Internal Revenue Code of 1954.]

§ 3812. Mitigation of effect of statute of limitations and other provisions in case of related taxes under different chapters.

(1) (i) If an error is made in the computation or verification of any amount of self-employment income, or (ii) If an amount is erroneously treated as wages, and

(2) If the correction of the error would require an assessment of one such tax and the refund or credit of the other tax, and

(3) If at any time the correction of the error is authorized as to one such tax but is prevented as to the other tax by any law or rule of law (other than section 3701, relating to compromises), then, if the correction authorized is made, the amount of the assessment, or the amount of the credit or refund, as the case may be, which would be required with respect to such other tax for the correction of the error if the credit or refund, or such assessment, of such other tax were not prevented by any law or rule of law (other than section 3701, relating to compromises),

(b) Definitions. For the purposes of subsection (a) of this section, the terms "self-employment income" and "wages" shall have the same meaning as when used in section 461 (b).

[Sec. 3812 as added by sec. 208 (b), Social Security Act Amendments 1950.]

§ 39.3812-1 Application of section. (a) Section 3812 may be applied in the correction of a certain type of error involving both the tax on self-employment income and the employer tax under section 1401 of the correction of the error as to one tax is, on the date the correction is authorized, prevented in whole or in part by the operation of any law or rule of law other than section 3701, relating to compromises, or rules of law (other than section 3701) relating to compromises.

(b) Definitions. For the purposes of subsection (a) of this section, the term "wages" means the wages paid into the Treasury of the United States as internal revenue collections. All provisions of the laws of the United States applicable to the administration, collection, and enforcement of any tax imposed upon the income of individuals, estates, and trusts by chapter 1 (including the provisions relating to The Tax Court of the United States), of title 9, of chapter A of subtitle D of chapter 9, shall, in respect to such tax, extend to and be applicable in the Virgin Islands in the same manner and to the same extent as if such taxes were a State tax, and as if the term "United States" when used in a geographical sense included the Virgin Islands.

(c) Mitigation of effect of statute of limitations and other provisions in case of related taxes under different chapters.

[Sec. 3812-1 as added by sec. 208 (b), Social Security Act Amendments 1950.]

§ 39.3813 Statutory provisions; collection of taxes in Puerto Rico and Virgin Islands; mitigation of effect of statute of limitations and other provisions in case of related taxes under different chapters.
for the amount of the tax erroneously paid, and either the amount of such adjustment prevented by any law or rule of law (other than section 3761) the amount of the assessment of or the credit or refund authorized shall reflect the adjustment would be made in respect of the other tax (either the tax on self-employment income under section 1450 or the employee tax under section 480 or the employee tax under section 1452). But for the operation of such law or rule of law. For example, assume that during 1952 A paid $10 as tax on an amount erroneously treated as "wages"—when such amount was actually self-employment income, and that credit or refund of the $10 is not barred. A should have paid a self-employment tax of $15 on the amount. If the assessment of the correct tax, that is, $15, is not paid, the statute of limitations, no credit or refund of the $10 shall be made without offsetting against such $10 the $15 assessment of which is barred. Thus, no credit or refund in respect of the $10 can be made. 

(e) As another example, assume that during 1952 a taxpayer reports wages of $3,600 and net earnings from self-employment of $900. By reason of the limitations applicable under the Federal Insurance Contributions Act that $700 of the $3,600 reported as wages were not for employment as defined in section 1426, the amount of $700 of such wages is barred. The question of the amount of his wages, as defined in section 1426, was not in issue in the Tax Court litigation, but it is subsequently determined (when a protest of the report of earnings is filed under regulations applicable under the Federal Insurance Contributions Act) that $700 of the $3,600 reported as wages were not for employment as defined in section 1426 (b) and he is entitled to the allowance of a refund of the $10.50 tax paid on such remuneration under section 1400. The reduction of his wages from $3,600 to $3,000 would result in the determination of $700 self-employment income, the tax on which is $187.50 for the year. The overpayment of $10.50 would be offset under section 3812 by the barred determination of $700 of self-employment income, but the $25 of the refund not allowed otherwise. If the facts were changed so that the taxpayer erroneously paid tax on self-employment income of $700, having been taxed on only $2,900 of wages, and within the period of limitations applicable under the Federal Insurance Contributions Act, it is determined that his wages were $2,900. The tax on $2,900 under section 1400, whatever collectible, would be eliminated by offsetting under section 3812 the barred overpayment of $15.75.

(b) Another illustration of the operation of this section is the case of a taxpayer who, for 1952, is erroneously taxed on $2,900 of wages, the tax on which is $37.50, and who is entitled to self-employment income. After the statute of limitations has run on the refund of the tax under the Federal Insurance Contributions Act, it is determined that the amount treated as wages should have been reported as self-employment income. The taxpayer's self-employment income would then be $2,500 and the tax thereof would be $56.25. Assume that the period of limitations under chapter 1 has not expired, and that a notice of deficiency may properly be issued. If the amount of the deficiency of $56.25 must be reduced by the barred overpayment of $37.50.

§ 39.3812-2 Law applicable in determination of error. The question of whether there was an erroneous treatment of self-employment income or of the provisions of law and regulations applicable with respect to the year or other taxable period as to which the error was made. The effect of the error was in pursuance of an interpretation, either judicial or administrative, accorded such provisions of law and regulations at the time of such action is not necessarily determinative of this question. For example, if a later judicial decision authoritatively alters such interpretation so that such action was contrary to such provisions of law and regulations at a later date, the error is within the meaning of section 3812.

§ 39.3813 Statutory provisions; requirements for exemption of certain organizations under section 101 (6) and for deductibility of contributions made to such organizations for exemption. An organization exempt pursuant to the provisions of this section which has engaged in a prohibited transaction after July 1, 1950, shall be exempt from taxation for the taxable year in which such prohibited transaction occurred, and for any taxable year following the taxable year in which notice of such prohibited transaction was received by the Secretary, but shall be denied exemption from taxation under section 101 (g) by reason of such prohibited transaction.

(2) Taxable years affected. An organization shall be denied exemption from taxation under sections 101 (g) by reason of a prohibited transaction in any taxable year following the taxable year in which notice of such prohibited transaction was received by the Secretary, but shall be exempt from taxation under section 101 (g) by reason of such prohibited transaction in any taxable year following the taxable year in which such prohibited transaction was received, but such organization shall be denied exemption from taxation under section 101 (g) by reason of such prohibited transaction in any taxable year following the taxable year in which such prohibited transaction occurred, and for any taxable year following the taxable year in which such prohibited transaction occurred, such deduction shall be disallowed to the donee to such donee (if an individual) any member of the family (as defined in section 24 (b) (2) (D)) of an individual who is the creator of such trust which is deemed to make a contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all classes of stock entitled to vote or 50 per centum or more of the total value of shares of all classes of stock of the corporation.

(c) Denial of exemption to organizations engaged in prohibited transactions—(1) General rule. No organization subject to the provisions of this section which has engaged in a prohibited transaction after July 1, 1950, shall be exempt from taxation under section 101 (g).

§ 39.3814 Requirements for exemption of certain organizations under section 101 (g) and for deductibility of contributions made to such organizations—(a) General rule. An organization exempt pursuant to the provisions of this section which has engaged in a prohibited transaction after July 1, 1950, shall be exempt from taxation under section 101 (g) by reason of such prohibited transaction.

§ 39.3815 No gift or bequest for religious, etc., purposes. No gift or bequest for charitable, scientific, etc., purposes (including the encouragement of science and the prevention of art or the encouragement of knowledge) is permissible to a trust which results in a substantial diversion of its income or corpus to; the creator of such organization (as defined in section 24 (b) (2) (D)) of an individual who is the creator of such trust which is deemed to make a contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all classes of stock entitled to vote or 50 per centum or more of the total value of shares of all classes of stock of the corporation.

§ 39.3813 Statutory provisions; requirements for exemption of certain organizations under section 101 (6) and for deductibility of contributions made to such organizations—(a) General rule. An organization exempt pursuant to the provisions of this section which has engaged in a prohibited transaction after July 1, 1950, shall be exempt from taxation under section 101 (g).
§ 39.3813-1 Denial of exemption to organizations engaged in prohibited transactions. If any one or more of the prohibited transactions enumerated in section 3813 (b) are in addition to and not in limitation of the restrictions contained in section 101 (6), even though an organization has not engaged in any of the prohibited transactions referred to in section 3813 (b), it still may not qualify for tax exemption in view of the general provisions of section 101 (6). Thus, if the other fiduciary of the organization (whether or not he is also a creator of such organization) enters into a transaction with the organization, such transaction will be closely scrutinized in the light of the fiduciary principle requiring undivided loyalty, to ascertain whether the organization is in fact being operated for the stated exempt purposes.

Example (a). An organization authorized to make such affidavit, exemption shall be denied if it knowingly again engage in a prohibited transaction. See § 3810-1 for proof of exemption requirements in general.

Example (b). If the Commissioner is satisfied that such organization will not knowingly again engage in a prohibited transaction and that the organization also satisfies all other requirements under section 101 (6), he shall so notify the organization in writing. In such case the organization will be exempt (subject to the provisions of sections 101 (6), 3813, and 3814 (a) (2), with respect to the taxable years subsequent to the year in which such claim is filed. Section 3813 contemplates that an organization denied exemption because of the terms of such section will be subject to taxation for at least one full taxable year. For the purpose of this section, the term "taxable year" means the established annual accounting period of the organization; if the organization has no such established annual accounting period, the "taxable year" of the organization means the calendar year.

The application of section 3813 (b) may be illustrated by the following examples:

Example (1). A creates a foundation in 1946 ostensibly for educational purposes. B, as trustee, accumulates the foundation's income from 1952 until 1955 and then uses a substantial part of this accumulated income to send A's children to college. The foundation's income or corpus is so diverted to the organization's charitable purpose, the members of an individual donor's family include only his brothers and sisters, whether mother or father, spouse, ancestors, and lineal descendants.

Example (2). If, under the facts in example (1) such private benefit was the purpose of the foundation from the inception, such foundation is not exempt by reason of the general provisions of section 101 (6), without regard to the provisions of section 3813, for all years since its inception, that is, from 1949 through 1955 and subsequent taxable years, since under section 101 (6) the organization must be operated exclusively for exempt purposes. See § 3810-1 (1). Section 3813 also § 3810-1 for loss of exemption in the case of certain organizations accumulating income.

§ 39.3813-2 Future status of organization denied exemption. (a) Any organization denied exemption under section 101 (6) by reason of the provisions of section 3813 (c) may file, in any taxable year following the taxable year in which notice of denial of exemption was issued, a claim for exemption with respect to the organization's income or corpus for the internal revenue district in which is located the principal place of business or principal office of the organization. Form 3813, exemption application, a copy of which may be obtained from any district director of internal revenue, shall be used for this purpose. The claim must contain or have attached to it, in addition to the information generally required of an organization claiming exemption under section 101 (6) an affidavit, by a principal officer of such organization authorized to make such affidavit, that the organization will not knowingly again engage in a prohibited transaction. See § 3810-1 for proof of exemption requirements in general.

(b) If the Commissioner is satisfied that the organization does not have a substantial part of its income or corpus diverted to a prohibited transaction and that the organization also satisfies all other requirements under section 101 (6), he shall so notify the organization in writing. In such case the organization will be exempt (subject to the provisions of sections 101 (6), 3813, and 3814 (a) (2), with respect to the taxable years subsequent to the year in which such claim is filed. Section 3813 contemplates that an organization denied exemption because of the terms of such section will be subject to taxation for at least one full taxable year. For the purpose of this section, the term "taxable year" means the established annual accounting period of the organization; if the organization has no such established annual accounting period, the "taxable year" of the organization means the calendar year.

§ 39.3813-3 Disallowance of certain charitable, etc., deductions. (a) No gift or contribution otherwise be allowable as a charitable or other deduction under section 23 (o) (2) 102 (a) or 506 (a) shall be allowed as a deduction if made to an organization which at the time the gift or contribution is made is not exempt under section 101 (6) by reason of the provisions of section 3813.

(b) If an organization, which receives a gift or contribution, is not exempt under section 101 (6) because it engaged in a prohibited transaction involving a substantial part of its income or corpus with the purpose or function described in section 101 (6), the annual accounting period for the organization during which such gift or contribution is made is the same as or is prior to, the taxable year of the organization in which such transaction occurred, then a deduction with respect to the gift or contribution shall not be allowable under paragraph (a) of this section unless the donor or member of his family if the donor is an individual is a party to such prohibited transaction. For the purpose of the preceding sentence, the members of an individual donor's family include only his brothers and sisters, whether mother or father, spouse, ancestors, and lineal descendants.

(c) The application of section 3813 (e) may be illustrated by the following example:

Example. In 1953, corporation A, which files its income tax returns on the calendar year basis, creates a foundation purportedly for charitable purposes and deducts from its taxable income for 1953, a gift to the foundation. Corporation A makes additional gifts to this foundation in 1953, 1954, and 1955, and takes charitable deductions for such years. B, an individual, also contributes to the foundation in 1953, 1954, and 1955, and takes charitable deductions for such years. In 1953, the foundation commences purposely to divert its corpus to the benefit of corporation A, and a substantial amount of such corpus is so diverted by the close of the taxable year 1954. For 1953, corporation A deducts the gift and any other gifts it makes to the foundation under section 101 (6) is denied by reason of the provisions of section 3813 (e). Both corporation A and individual B may file for exemption for the contributions made during 1955 to the foundation. Moreover, the charitable contributions taken by corporation A as deductions to the foundation in the years 1953 and 1954 would also be disallowed since corporation A was a party to the prohibited transaction. If the facts and surrounding circumstances indicate that the contribution in 1953 by corporation A was for the purpose of the prohibited transaction, then the charitable deduction for the year 1952 shall then have commenced with the making of such contribution and the exemption allowed the foundation under section 101 (6) (b) would then be denied for 1955 by reason of the provisions of section 3813 (e).

§ 39.3814 Statutory provisions; denial of exemption under section 101 (6) in the case of certain organizations accumulating income.

Sec. 3814. Denial of exemption under section 101 (6) in the case of certain organizations accumulating income. In the case of any organization described in section 101 (6), to which section 3813 is applicable, if the amounts accumulated out of income during a taxable year are not actually paid out by the end of the taxable year—

(1) Are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101 (6); or

(2) Are used to a substantial degree for purposes or functions other than those constituting the basis for such organization's exemption under section 101 (6); or

(3) Are invested in such a manner as to jeopardize the carrying out of such organization's charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101 (6), exemption under section 101 (6) shall be denied for the taxable year.

[Sec. 3814 as added by sec. 331, Rev. Act 1950]

§ 39.3814-1 Denial of exemption under section 101 (6) in the case of certain organizations accumulating income.

The application of section 3814 are in addition to and not in
Thus, if a trustee or other fiduciary of property acquired and held proceeds of such sale or exchange is ableness of an accumulation out of incorporation. In determining the reason- principles applicable year-shall be determined under the prin-
ing the taxable year or any prior taxable 
ing the basis for the organization's ex-
a manner as to jeopardize the carrying 
for the -organization's exemption. Fur-
come unreasonable when more income 
amounts accumulated out of income 
transaction will be closely 
limitation of the restrictions contained 
Saturday, September 
(d) Whether the conditions specified in paragraphs (1) (2) and (3) of sec-
office or discharged from employment. The provisions of this paragraph shall apply to internal revenue agents as fully as to internal revenue 
(3) Income tax data. For penalty for dis-
closing income tax data, see section 55 (f) (4). 
§ 39.6000–1 Extension of time for making certain elections. (a) If the regulations in this part are on or before which an election or an appli-
cation for relief may be made by the tax-
payer and such time is not expressly pro-
vided in the law, the Commissioner in his 
discretion may, for good cause shown, ex-
cept as provided in the next paragraph, 
grant a reasonable extension of time for 
the making of such election or applica-
tion if request for such extension is filed 
with the Commissioner before the time 
fixed for making such election or appli-
cation or within such time thereafter as 
the Commissioner, in his discretion 
eminent under the circumstances and it is 
shown to the satisfaction of the Commissi-
oner that the granting of the extension 
will not jeopardize the interests of the 
G. M. HUMPHREY, 
Secretary of the Treasury.

§ 39.6000–1