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Income-tax Department

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In the October issue of this magazine attention was drawn to the advisability of recomputing the interest allowances on claims for refund. An erroneous statement was made to the effect that the collector computed the interest on claims for refund. Our attention has been drawn to this error, and we are glad to acknowledge it and make the correction. We are informed that the commissioner's office calculates the interest on refunds and credits. It is a source of satisfaction to learn, even in such a manner, that the *Income-tax Department* is read carefully.

To the September issue of *Internal Revenue News* Elmer C. Wood of the claims-control section has contributed an article entitled "Interest on overpayment of income tax" which throws light upon the method of computing interest on these claims.

A summary of the contents of this article follows:

The act of 1921 was the first to contain a provision for the payment of interest on refunds or credits.

According to the provisions of that act, interest is payable only upon the basis of a claim. The interest period begins:

(a) In case of an original tax not paid under protest, six months from the date claim was filed;

(b) In case of an additional tax, the date the tax was paid;

(c) In case of a tax paid under specific protest, the date the tax was paid.

The interest period ends on the date of the allowance of the claim.

Under the acts of 1924 and 1926 taxpayers are granted the right to interest on overpayments from the date the taxes were overpaid to date of allowance, whether or not a claim for refund or credit was made.

The supreme court ruled (in the case of the *Girard Trust Company, et al.* v. *The United States*) that the date of allowance was the date of final approval by the commissioner, which is the date he ordered the refund, and not the date of his approval of the schedule forwarded to the collector. This court decision applies to refunds and credits under the acts of 1921 and 1924.

Under the revenue act of 1926, the date of allowance of refund is the first date on which the commissioner signs the schedule of overassessment.

Thus does Mr. Wood's article clear up the question of the method of computation of the interest on overpayments of income tax in the commissioner's office.

As it has happened in a number of instances, at least, that the first information the taxpayer receives is a cheque from the treasury department, the questions for the taxpayer to solve are: under which revenue act his overpayment falls; the date the commissioner finally approved the allowance of the refund (under the acts of 1921 and 1924), and the first date on which the commissioner signed the schedule of overassessment (under the act of 1926).

There is one point, however, that is not cleared up by Mr. Wood's statement. It is probably best stated in the form of the following question:

> Why should not the interest on a refund or credit granted after the enactment of the law of 1926, though the refund be for overpayment of taxes under the 1921 and 1924 laws, be computed under the provisions of section 1116 (c) of the act of 1926?

Section 1116 (c) reads as follows:

> "This section shall be applicable to any refund paid, and to any credit taken, on or after the date of the enactment of this act, even though such refund or credit was allowed prior to such date."

Under the quoted provision it would appear that interest on an overpayment of tax refunded or credited since the enactment of the 1926 act should begin on the date such tax or penalty was paid and accrue until the date the refund or credit was "allowed", whether or not the overpayment was made after the 1926 law became effective.

That the date interest should begin is a matter not clear to those computing taxes on refunds allowed since the enactment of the 1926 law is evidenced by several instances that have come to our attention wherein the interest allowance apparently was for some shorter period than that covered from the date of the overpayment to the date of the allowance.

In view of our experience, we again direct attention to the advisability of carefully verifying the allowances of interest on overpayment of income taxes.

A special advisory committee has been established in the bureau of internal revenue, the general purpose of which is stated to be examination into the reasons for the accumulation of pending income-tax cases in the bureau.

This committee will act, subject to the approval of the commissioner, upon cases waiting in the bureau for advice as to the bureau policy; cases arising out of mailing of deficiency letters under the act of 1926, and such others as may be submitted to it by the commissioner.

The committee consists of nine members, and the personnel comprehends men well versed in the matters of income taxation. As pointed out by Thomas M. Wilkins, one of the members, in the October issue of *Internal Revenue News*, ". . . the opposing views as to facts in issue before an independent tribunal is wholly absent. . . ." This committee, being of the bureau, must of necessity regard controverted cases from the viewpoint of the commissioner, and as it is presumed to be conversant with the very latest ideas of the commissioner on any given subject, a taxpayer, when conferring with it, will at least know the particular point of fact or law wherein his difference with the bureau lies.

The committee, in an effort to reduce the accumulation of income-tax cases pending in the bureau, encourages the making of proposals by the taxpayers for settlement where such a result is possible.

The decentralization that became effective some months ago makes it possible for taxpayers to settle their differences with the commissioner in the offices of the "revenue agents in charge" scattered throughout the country, and this has been found to be a satisfactory method to most taxpayers. The advantages accruing to taxpayers arise from the familiarity with the problems at issue of agents in their own part of the country, and from avoiding the expendi-

ture of the time, as well as the expense, of going to Washington to clear up questions that could be more intelligently solved by those residing nearer the taxpayers' own communities.

SUMMARY OF RECENT RULINGS

Decedent bequeathed his wife absolutely without mention of the other half, one half of the proceeds of an insurance policy on his life taken out in 1897, and payable to his wife in trust; held that his gross estate should include the proceeds of the policy undisposed of by will, but not the half disposed of by will which, under the laws of the state of Pennsylvania, is not subject to the payment of charges against the decedent's estate. (United States district court, E. D. Pennsylvania, *Executors for Richard G. Parks, Jr.*, v. *Blakely D. McCaughn, collector.*)

Suit for recovery of tax will lie when based upon a question which was considered and rejected by the commissioner in his notice of a rejection of a claim for refund, even though not specifically set forth in the claim for refund. (United States district court, E. D. Pennsylvania, *Executors for Richard G. Parks, Jr.*, v. *Blakely D. McCaughn.*)

Liberty bonds constituting part of the trust estate of a non-resident alien decedent, who had not been engaged in business in the United States, should not be included in his gross estate under the revenue act of 1918. (United States district court, S. D. New York, *Trustee of estate of William Waldorf Astor*, v. *Frank Bowers, collector.*)

A mine "facility" within the meaning of sec. 234 (a) (9), act of 1918, and the cost of opening and developing mines for production of coal for sale to factories, railroads and steamships is amortizable. (United States district court, N. D. Alabama, *Corona Coal Company*, v. *United States of America.*)

An allottee of Choctaw Indian tax-exempt bonds may recover income taxes paid by him on oil royalties derived from such lands, allotted to a member, even though claim for refund was filed after statutory period. (United States district court, N. D. Oklahoma, *Clifton L. Richards*, v. *United States of America.*)

Interest at 6% per annum from expiration of one year after the decedent's death should be computed under the 1918 act, on a deficiency in estate tax as finally determined. (United States district court, E. D. Pennsylvania, *United States of America* v. *Elmer E. Rodenbough, executor.*)

An action against the executor of an estate in his capacity as such, for collection of a deficiency in estate tax is not barred by sec. 407, act of 1921, which provides for discharge of the executor from personal liability for additional tax, under the conditions specified therein. (United States district court, E. D. Pennsylvania, *United States of America* v. *Elmer E. Rodenbough, executor.*)

Income bonds claimed to have been issued for goodwill of a predecessor corporation, payable only from the net earnings of the corporation, the books of account showing neither the bonds as a liability nor goodwill as an asset, redeemed prior to 1917, may not be included in invested capital. (United States district court, S. D. New York, *The Baker & Taylor Company* v. *United States of America.*)

Certain instruments executed in the form required under the laws of the state (New York) for the grant of interests in real estate, providing for the

payment of an annuity to the grantor for a period, were held not to have created an interest in the properties or a rent charge, the income derived from the properties being taxable to the grantor. (United States district court, S. D. New York, *Louis S. Bing* v. *Frank K. Bowers, collector.*)

A taxpayer is not limited in a suit for recovering of taxes to the reasons for relief sought advanced in the claim for refund before the commissioner. (United States district court, Connecticut, *Eva F. Warner* v. *James J. Walsh, collector.*)

An action for recovery of internal-revenue taxes against the collector, no longer in office, to whom the tax was paid, may be maintained under the 1921 act in a district court. (United States district court, Connecticut, *Eva F. Warner* v. *James J. Walsh, collector.*)

An action for taxes erroneously paid may be maintained under the 1924 act against a collector regardless of protest. (United States district court, Connecticut, *Eva F. Warner* v. *James J. Walsh, collector.*)

The filing of a proof in a bankruptcy court is a proceeding in a court for the collection of the tax, and is subject to the statutory period of limitation. (United States district court, N. D. Georgia, *In re McClure Company, bankrupt.*)

The government is allowed six years after assessment of tax, though assessment made prior to act of 1924. (United States district court, N. D. Georgia, *In re McClure Company, bankrupt.*)

Two corporations, all the stock of which was in the complete control of the same persons may not be consolidated for the year 1917 for income-tax purposes, where they were not engaged in the same or closely related lines of business and one was not the subsidiary of the other. (United States district court, Minnesota, third division, *Bowe-Burk Mining Company and Bowe-Burk Company* v. *Levi M. Willcuts, collector.*)

A corporation formed to carry on operations under a mining lease—tangible property which it acquired in 1917 in exchange for its stock—did not have for 1917 more than a nominal capital within the meaning of sec. 209 of the act of 1917. (United States district court, Minnesota, third division, *Bowe-Burk Mining Company and Bowe-Burk Company* v. *Levi Willcuts, collector.*)

TREASURY DECISIONS

(Treasury decision 4025, June 18, 1927)

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells.

Under the provisions of article 223, *Regulations* 69, such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in the exploration of oil and gas property, drilling of wells, building of pipe lines, and development of such property, may at the option of the taxpayer be deducted as a development expense or charged to capital account. The regulations promulgated under the revenue acts of 1918, 1921, and 1924 provide for the same option.

In view of the change in the basis for depletion provided by the revenue act of 1926, in the case of oil and gas wells, taxpayers may make a new election as to the treatment of the expenditures above mentioned for taxable periods ending on or after January 1, 1925, but not later than six months after the date of this decision. Taxpayers desiring to make a new election are required to file amended returns for the taxable periods involved within six months from the date of this decision.

(Treasury decision 4027, June 22, 1927)

ARTICLE 1561: Basis for determining gain or loss from sale.

1. STOCK DIVIDEND—INCOME—BASIS IN DETERMINING GAIN FROM SALE.

Income resulting from the sale of stock received as a stock dividend is not the receipt of a dividend but gain or profit derived from the sale of stock.

In determining the gain from a sale of original common stock in respect of which dividend stock of the same character, except that it has no voting rights, was issued, and also the gain from a sale of the dividend stock, the cost of each share of each kind of stock sold is computed by dividing the total cost of the old shares by the total number of the old and the new shares.

The following decision of the United States Court of Claims in the case of *John D. Chapman* v. *United States* is published for the information of internal revenue officers and others concerned.

COURT OF CLAIMS OF THE UNITED STATES
John D. Chapman v. *The United States*
[February 14, 1927]
OPINION

MOSS, judge, delivered the opinion of the court.

Plaintiff, John D. Chapman, is seeking by this action to recover the sum of $132,089.99 additional income taxes collected from him for the years 1917 and 1918, $103,371.58 of which was collected for the year 1917 and $28,697.41 for the year 1918. The history of the transaction out of which this controversy arose is as follows:

Throughout the year 1917 plaintiff was the owner of 1,800 shares of the common capital stock of the Bethlehem Steel Corporation, which were acquired at a cost of $48 per share, or $86,400. On January 23, 1917, the directors voted to increase the capitalization of the said corporation, and in this connection declared a stock dividend of 200 per cent. upon the common stock; and on February 17, 1917, plaintiff received from the corporation 3,600 shares of the new stock as his proportion of the stock dividend. In his tax return for the year 1917 plaintiff reported said stock dividend as dividend. In the same year, and prior to December 31, 1917, plaintiff sold the 3,600 shares received as a stock dividend for the sum of $371,928.

It is the plaintiff's contention that the income resulting from the sale in 1917 of the stock received as a stock dividend in that year was taxable at the rates for prior years under the provisions of section 31 of the revenue act of 1916, as amended by section 1211 of the revenue act of 1917 (40 Stat., 300, 336–337), in which it is provided that in any distribution made by a corporation, whether represented by cash or by stock of the corporation, such distribution shall be considered income to the amount of the earnings or profits so distributed.

The government contends, on the other hand, that the income resulting from the sale of the stock received as a stock dividend was not the receipt of dividend but was gain or profit derived from the sale of the stock, and that section 31 of the act of 1916 as amended has no application. The commissioner of internal revenue assessed the tax on this basis, computing the tax on the difference between the cost of the stock and the amount realized from its sale, properly applying the 1917 rates.

The theory upon which the commissioner proceeded was correct as determined by the United States supreme court in the case of *Towne* v. *Eisner* (245 U. S., 418), in *Eisner* v. *Macomber* (252 U. S., 189), and in other cases, in which it was distinctly held that a stock dividend does not constitute taxable income.

In April, 1918, plaintiff sold his original 1,800 shares of stock, and his income-tax return for the year 1918 included the sale price with other sales of stocks

and bonds during that year. In computing the profit from the sale of the 1,800 shares plaintiff reported the cost of said shares at $48 per share, or a total of $86,400. The commissioner, however, in computing the cost of the 1,800 shares properly considered the original cost of $86,400, paid by plaintiff for the 1,800 shares, as representing the total cost of both the 1,800 shares and the 3,600 shares distributed as a stock dividend; and on this basis the commissioner fixed the cost of the 1,800 shares at $16 per share and assessed the additional tax accordingly. The plan adopted by the commissioner in ascertaining the profit was correct. To state the question simply, by the payment of the sum of $86,400 plaintiff acquired a capital interest in the corporation, and he received as evidence of this interest 1,800 shares of the original common stock, and without further cost he also received an additional 3,600 shares, or a total of 5,400 shares. His interest in the corporation was neither increased nor diminished by the later acquisition of the 3,600 shares. It remained precisely the same.

The same question applies to the sale of the 3,600 shares, and the same procedure was followed by the commissioner in arriving at the profit on that sale.

The contention of the plaintiff that the government is barred by the statute of limitations is not tenable. It is the opinion of the court that plaintiff is not entitled to recover. It is therefore the judgment of the court that plaintiff's petition should be dismissed. And it is so ordered.