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In the April number was given a full list of contents with copious extracts of the regulations governing the administration of the income tax law, in the preliminary form in which they were at first issued. The treasury department has since published, under T. D. 2831, a revised edition of these regulations, known as regulations 45. The new edition is in one compact volume (in place of the two preliminary instalments) and, in addition to the arrangement of the table of contents by which the articles are enumerated consecutively under their governing sections of the law, there is a valuable subject index at the end. Many amendments have been made in the regulations: new articles have been inserted, numerous topics re-named, others combined, regrouped or entirely eliminated. Consequently, the list of contents previously published being obsolete, we print herewith the revised table, for the purpose of giving a correct and comprehensive bird's-eye view of the rules now in force. We have indicated by asterisks articles which are wholly or partly new matter or have been materially altered; and we also give the text of certain articles, not previously published, which are of particularly timely interest (indicated in the list of contents in italic type).

An addition to article 23 supplies what had previously been lacking, the procedure to be followed when the basis of reporting is changed as between the cash and accrual methods. If the change is from the cash to the accrual basis, report the previous accruals, both debit and credit, not already reported, as well as those for the year for which the return is made; but if the change is from the accrual to the cash basis, exclude revenue receipts and disbursements already returned in previous years as accruals. In both cases mention the fact of the change, and state the amounts involved.

Three new articles (Nos. 52-54) amplify further the principles involved in determining when income is to be accounted for.

The rules on amortization of war plants or vessels (articles 181-188 herewith) have been entirely re-written and enlarged. The loss from this source as determined by sale, abandonment or, if continued in use, by reproduction cost in April, 1919, is to be spread over the period from January 1, 1918, to the date of abandonment or to April, 1919, as the case may be. Full proof of the supporting facts is required, and the allowance will be finally determined on re-examination within three years after the close of the war.

The subject of losses on inventories because of the sudden termination of hostilities is another question in regard to the working out of which much doubt has existed. This is now minimized by a new series of regulations (articles 261-268, also published herein). A mere shrinkage in value is not the kind of loss that is deductible; it must be an actual net loss

on sale in 1919 or on reinventory at the close of 1919 if the goods are then on hand. Although claims for refund may be filed once the inventoried goods are sold, claims for abatement on the ground of shrinkage in value of goods not sold will not be passed upon until after the close of 1919, when the taxpayer must in both cases file a detailed accounting for his 1918 inventories. The only advantage in filing a claim for abatement when the goods have not been sold is in saving the payment of an excess tax for the time being, and this benefit may be lost if the claim is not sustained and interest at 12 per cent. per annum is charged.

The preparation of consolidated returns is so much a matter of accounting that we give here the vital revised regulations on the subject, dealing with both the consolidation of income (articles 631-34, 636-37) and the consolidation of invested capital (articles 864-869).

Under T. D. 2836 have been enumerated the tax exemptions applicable to Liberty bonds and victory notes in effect from January 1, 1919. Besides the exemption of the new notes from normal tax and of the 3¾% series from surtaxes, an additional exemption from surtaxes on previous issues is granted on three times the amount of Victory notes subscribed for and kept, up to $20,000 of principal, and a further exemption, not dependent at all on subscriptions to the fifth loan, of $30,000.00 of principal.

REGULATIONS RELATING TO THE INCOME TAX AND WAR PROFITS AND EXCESS PROFITS TAXES

UNDER TITLES II AND III OF THE REVENUE ACT OF 1918

Table of contents

Part I. Income tax on individuals (sections 210-228)
II. Income tax and war profits and excess profits tax on corporations:
A. Income tax (sections 230-241)
B. War profits and excess profits tax (sections 300-337)
III. Administrative provisions (sections 250-261)
IV. Definitions and general provisions (sections 1-206; 1301-1408)
Index

PART I.

INCOME TAX ON INDIVIDUALS.

[The section numbers refer to the statute and the article numbers to the regulations.]

Section 210. Normal tax
Article 1. Income tax on individuals
2. Normal tax
3. Persons liable to tax
4. Who is a citizen
Section 211. Surtax
Article 11. Surtax
12. Computation of surtax
13. Surtax on sale of mineral deposits
Section 212. Net income defined
Article 21. Meaning of net income (See April number—page 283)
22. Computation of net income (See April number—page 284)
23. **Bases of computation* (See also April number—page 284)
24. Methods of accounting (See April number—page 284)
25. Accounting period
26. Change in accounting period

Section 213 (a). Gross income defined: inclusions
Article 31. *What included in gross income
32. Compensation for personal services
33. *Compensation paid other than in cash
34. *Compensation paid in notes
35. *Gross income from business
36. Long term contracts (See April number—page 285, Art. 33)
37. State contracts
38. Gross income of farmers
39. Sale of stock and rights (See April number—page 285, Art. 36)
40. Sale of patents and copyrights
41. Sale of goodwill
42. Sale of personal property on instalment plan (See April number—page 285, Art. 39)
43. Sale of real estate in lots (See April number—page 285, Art. 40)
44. Sale of real estate involving deferred payments
45. Sale of real estate on instalment plan
46. Deferred payment sales of real estate not on instalment plan
47. Annuities and insurance policies
48. Rent and royalties
49. Compensation for loss
50. Replacement fund for losses
51. *Forgiveness of indebtedness
52. **When included in gross income*
53. **Income not reduced to possession*
54. **Examples of constructive receipt*

Section 213 (b). Gross income defined: exclusions
Article 71. *What excluded from gross income
72. Proceeds of insurance
73. *Gifts and bequests
74. Interest upon state obligations
75. Dividends and interest from federal land bank and national farm loan association
76. Dividends from federal reserve bank
77. Interest upon United States obligations
78. *Liberty bond exemption from normal tax in 1918
79. *Liberty bond exemption from surtax and war profits and excess profits tax in 1918
80. *Liberty bond exemption after December 31, 1918
81. Liberty bond exemption in the case of trusts
82. Liberty bond exemption in the case of partnerships and personal service corporations
83. Income of foreign governments
84. *Income of states
85. *Compensation of state officers
86. *Compensation of soldiers and sailors
87. *Income accruing prior to March 1, 1913
88. *Subtraction for redemption of trading stamps

Section 213 (c). Gross income defined: nonresident alien individual
Article 91. Gross income of nonresident alien individuals
92. Income of nonresident alien individuals not subject to tax
93. *Income of nonresident aliens from United States bonds

Section 214 (a) (1). Deductions allowed: business expenses
Article 101. Business expenses
102. Cost of materials
103. Repairs

104. *Professional expenses
105. Compensation for personal services (See April number—page 285)
106. Treatment of excessive compensation
107. Bonuses to employees (See April number—page 286)
108. Pensions (See April number—page 286)
109. Rentals (See April number—page 286)
110. Expenses of farmers
111. When charges deductible (See April number—page 286)

Section 214 (a) (2). Deductions allowed: interest
Article 121. Interest (See April number—page 287)
122. Interest on capital (See April number—page 287)

Section 214 (a) (3). Deductions allowed: taxes
Article 131. Taxes
132. Federal duties and excise taxes
133. Taxes for local benefits
134. Inheritance taxes

Section 214 (a) (4), (5) and (6). Deductions allowed: losses
Article 141. Losses
142. Voluntary removal of buildings
143. Loss of useful value (See April number—page 287)
144. Shrinkage in securities and stocks (See April number—page 287)
145. Losses of farmers

Section 214 (a) (7). Deductions allowed: bad debts
Article 151. Bad debts (See April number—page 288)
152. Examples of bad debts
153. Worthless mortgage debt (See April number—page 288)
154. Worthless securities (See April number—page 288)

Section 214 (a) (8). Deductions allowed: depreciation
Article 161. Depreciation (See April number—page 288)
162. Depreciable property
163. Depreciation of intangible property
164. Capital sum returnable through depreciation allowance
165. Method of computing depreciation allowance (See April number—page 288, Art. 166)
166. Modification of method of computing depreciation (See April number—page 288, Art. 167)
167. *Depreciation of patent or copyright
168. Depreciation of drawings and models
169. Charging off depreciation (See April number—page 289, Art. 170)
170. Closing depreciation account
171. Depreciation in the case of farmers

Section 214 (a) (9). Deductions allowed: amortization
Article 181. **Scope of provision for amortization*
182. **Property cost of which may be amortized*
183. **Cost recoverable through amortization*
184. **Cost which may be amortized*
185. **Method of amortization*
186. *Additional requirements for amortization*
187. *Redetermination of amortization allowance*
188. *Information to be furnished by taxpayer*

Section 214 (a) (10). Deductions allowed: depletion
Article 201. Depletion of mines, oil and gas wells (See April number—page 290)
202. Capital recoverable through depletion allowance in the case of owner

203. Capital recoverable through depletion allowance in the case of lessee
204. Apportionment of deductions between lessor and lessee
205. Determination of cost of deposits
206. Determination of fair market value of deposits
207. Revaluation of deposits not allowed
208. Determination of quantity of ore in mine
209. Determination of quantity of oil in ground
210. Computation of allowance for depletion of mines and oil wells
211. Computation of allowance for depletion of gas wells
212. Gas well pressure records to be kept
213. Computation of allowance where quantity of oil or gas uncertain
214. Computation of depletion allowance for combined holdings of oil and gas wells
215. Depletion of mine based on advance royalties
216. Depletion and depreciation accounts on books
217. Statement to be attached to return where depletion of mine claimed
218. Statement to be attached to return where depletion of oil or gas claimed
219. Discovery of mine
220. Discovery of oil and gas wells
221. Proof of discovery of oil and gas wells
222. Charges to capital and to expense in the case of mine
223. *Charges to capital and to expense in the case of oil and gas wells
224. Depreciation of improvements in the case of mine
225. Depreciation of improvements in the case of oil and gas wells
226. Depletion and depreciation of oil and gas wells in years before 1916
227. Depletion of timber (See April number—page 290)
228. Capital recoverable through depletion allowance in the case of timber
229. Computation of allowance for depletion of timber
230. Revaluation of stumpage not allowed
231. Charges to capital and to expense in the case of timber
232. Depreciation of improvements in the case of timber
233. Statement to be attached to return where depletion of timber claimed

Section 214 (a) (11). Deductions allowed: charitable contributions
Article 251. Charitable contributions
Section 214 (a) (12). Deductions allowed: loss in inventory
Article 261. **Losses in inventory and from rebates*
262. **Loss from rebates*
263. **Loss in inventory*
264. **Loss where goods have been sold*
265. **Loss where goods have not been sold*
266. **Claims*
267. **Disposition of claims*
268. **Effect of claim in abatement*
Section 214 (b). Deductions allowed: nonresident alien individual
Article 271. Deductions allowed nonresident alien individuals
Section 215. Items not deductible
Article 291. *Personal and family expenses
292. *Traveling expenses
293. *Capital expenditures
294. *Premiums on business insurance

Section 216. Credits allowed
Article 301. *Credits against net income
302. Personal exemption of head of family
303. Personal exemption of married person
304. Credit for dependents
305. *Date determining exemption
306. *Credits to nonresident alien individuals
307. *When nonresident alien individual entitled to personal exemption
Section 217. Nonresident aliens—Allowance of deductions and credits
Article 311. Allowance of deductions and credits to nonresident alien individual
312. Who is a nonresident alien individual
313. Proof of residence of alien
314. *Loss of residence by alien
315. Duty of employer to determine status of alien employee
316. *Allowance of personal exemption to nonresident alien employee
Section 218. Partnerships and personal service corporations
Article 321. Partnerships
322. Distributive shares of partners
323. Credits allowed partners
324. Taxation of partners in partnership with fiscal year ending in 1918
325. Application of different tax rates in the case of fiscal year of partnership ending in 1918
326. Taxation of partners in partnership with fiscal year ending in 1919
327. Application of different tax rates in the case of fiscal year of partnership ending in 1919
328. Personal service corporations
329. Personal service corporation with fiscal year ending in 1918
330. Distributive shares of stockholders in personal service corporation
331. Credits allowed stockholders of personal service corporation
332. Taxation of stockholders of personal service corporation with fiscal year ending in 1918
333. Application of different tax rates in the case of fiscal year of personal service corporation ending in 1918
334. Taxation of stockholders of personal service corporation with fiscal year ending in 1919
335. Application of different tax rates in the case of fiscal year of personal service corporation ending in 1919
Section 219. Estates and trusts
Article 341. *Estates and trusts
342. Estates and trusts taxed to fiduciary
343. Decedent's estate during administration
344. Incidence of tax on estate or trust
345. Estates and trusts taxed to beneficiaries
346. *Credits to trust or beneficiary
Section 220. Profits of corporations taxable to stockholders
Article 351. Profits of corporation taxable to stockholders
352. *Purpose to escape surtax
353. *Unreasonable accumulation of profits
Section 221. Payment of tax at source
Article 361. Withholding tax at source
362. *Fixed or determinable annual or periodical income
363. Exemption from withholding

364. Ownership certificates for interest coupons
365. Form of certificate where withholding required
366. Form of certificate where no withholding required
367. Use of substitute certificates
368. *Interest coupons without ownership certificates
369. *Interest on registered bonds
370. Return of tax withheld
371. Withholding in 1918
372. Release of excess tax withheld
373. *Use of information return where no actual withholding
374. Ownership certificates in the case of fiduciaries and joint owners
375. Withholding in the case of enemies
376. *Return of income from which tax withheld
Section 222. Credit for taxes
Article 381. Analysis of credit for taxes
382. Meaning of terms
383. Conditions of allowance of credit
384. Redetermination of tax when credit proves incorrect
Section 223. Individual returns
Article 401. *Individual returns
402. Form of return
403. Return of income of minor
404. Return of income of nonresident alien
405. Return of corporate dividends
406. Verification of returns
407. Use of prescribed forms
Section 224. Partnership returns
Article 411. Partnership returns
412. Contents of partnership return
Section 225. Fiduciary returns
Article 421. Fiduciary returns
422. Return by guardian or committee
423. Returns where two trusts
424. Return by receiver
425. Return for nonresident alien beneficiary
Section 226. Returns where accounting period changed
Article 431. Returns where accounting period changed (See April number—page 291)
Section 227. Time and place for filing return
Article 441. Time for filing return (See April number—page 291)
442. *Time for filing return upon death or termination of trust
443. *Extension of time by collector
444. Extension of time by commissioner
445. Extension of time in the case of persons abroad
446. Extension of time in the case of enemies
447. Last due date
448. Place for filing return
Section 228. Understatement in returns
Article 451. Understatement of income

PART II.

Income Tax and War Profits and Excess Profits Tax on Corporations

A. Income Tax

Section 230. Tax on corporations
Article 501. Income tax on corporations
502. Rates of tax
503. Corporations liable to tax
504. Tax on transportation corporations

Section 231. Conditional and other exemptions
Article 511. Proof of exemption
512. Agricultural and horticultural organizations
513. Mutual savings banks
514. Fraternal beneficiary societies
515. Building and loan associations
516. Cemetery companies
517. Religious, charitable, scientific and educational corporations
518. Business leagues
519. Civic leagues
520. Social clubs
521. Mutual insurance companies and like organizations
522. Cooperative associations

Section 232. Net income defined
Article 531. Net income (See April number—page 291)

Section 233. Gross income defined
Article 541. Gross income
542. Sale of capital stock (See April number—page 291)
543. Contributions by stockholders (See April number—page 291)
544. *Sale and retirement of corporate bonds
545. Sale of capital assets (See April number—page 292, Art. 544)
546. Income from leased property
547. *Gross income of corporation in liquidation
548. Gross income of insurance companies
549. *Gross income of life insurance companies
550. Gross income of foreign corporations

Section 234. Deductions allowed
Article 561. Allowable deductions (See April number—page 292)
562. Donations (See April number—page 292)
563. *Sale of capital stock, bonds and capital assets
564. Interest
565. Effect of tax-free covenant in bond (See April number—page 292, Art. 564)
566. Tax on bank stock
567. Depositors' guaranty fund
568. *Deductions allowed insurance companies
569. Required addition to reserve funds of insurance companies
570. *Special deductions allowed in the case of combined life, health and accident policies
571. *Special deductions allowed mutual marine insurance companies
572. *Special deductions allowed mutual insurance companies
573. Deductions allowed foreign corporations

Section 235. Items not deductible
Article 581. Items not deductible
582. *Capital expenditures

Section 236. Credits allowed
Article 591. Credits allowed

Section 237. Payment of tax at source
Article 601. Withholding in the case of nonresident foreign corporations

Section 238. Credit for taxes
Article 611. Credit for foreign taxes

Section 239. Corporation returns
Article 621. Corporation returns (See April number—page 293)
622. Returns by receivers
623. Returns of insurance companies

624. Returns of personal service corporations (See April number—page 293)
625. Returns of foreign corporations (See April number—page 293)
626. *Returns for fractional part of year
Section 240. Consolidated returns
Article 631. *Affiliated corporations*
632. *Consolidated returns*
633. **When corporations are affiliated*
634. Change in ownership during taxable year
635. Corporation deriving chief income from government contracts
636. *Domestic corporation affiliated with foreign corporation*
637. *Consolidated net income of affiliated corporations*
638. Different fiscal years of affiliated corporations
Section 241. Time and place for filing returns
Article 651. Time and place for filing returns

B. War Profits and Excess Profits Tax

Section 300. General definitions
Article 701. War profits and excess profits tax
Section 301. Imposition of tax
Article 711. Imposition of tax
712. Computation of tax for 1918
713. Computation of tax for years after 1918
714. Computation of tax on income from government contracts
715. Allocation of net income to particular source
716. Illustration of computation of tax
717. Illustration of computation where no tax under third bracket
718. Illustration of computation where excess profits credit not exhausted under first bracket
719. Illustration of computation where net income derived from government contract
720. *Illustration of computation where return for period of less than 12 months
Section 302. Limitation of tax
Article 731 Short form of computation of limitation
732. *Limitation when return for fractional part of year
733. *Illustration of computation of limitation
Section 303. Tax when partly personal service business
Article 741. Apportionment of invested capital and net income
742. Computation of tax upon net income
743. Illustration of computation of tax where partly personal service business
Section 304. Exemptions
Article 751. Corporations exempt from tax
752. Net income exempt from tax
753. Illustration of computation of tax where net income from gold mining
Section 305. Apportionment of specific exemption
Article 761. Apportionment of specific exemption
Section 310. Pre-war period
Article 771. Pre-war period
Section 311. War profits credit
Article 781. War profits credit
782. War profits credit where meager pre-war net income

783. War profits credit where no pre-war period
784. War profits credit where no pre-war period in special circumstances
785. War profits credit in the case of affiliated corporations

Section 312. Excess profits credit
Article 791. Excess profits credit

Section 320. Net income
Article 801. Net income
802. Pre-war net income of affiliated corporations

Section 325. Terms relating to invested capital
Article 811. Intangible and tangible property (See April number—page 294)
812. Borrowed capital: securities (See April number—page 294)
813. Borrowed capital: amounts left in business (See April number—page 294)
814. Borrowed capital: other illustrations (See April number—page 294)
815. Inadmissible assets (See April number—page 294)
816. Inadmissible assets: government bonds
817. Inadmissible assets: partial exception
818. Admissible assets (See April number—page 295)

Section 326. Invested capital
Article 831. Meaning of invested capital (See April number—page 295)
832. Cash paid in: bonus stock
833. Tangible property paid in: evidences of indebtedness
834. Tangible property paid in: inadmissible assets
835. Tangible property paid in: mixture of tangible and intangible property
836. Tangible property paid in: value in excess of par value of stock (See April number—page 295)
837. Surplus and undivided profits: paid-in surplus (See April number—page 295)
838. Surplus and undivided profits: earned surplus (See April number—page 296)
839. Surplus and undivided profits: allowance for depletion and depreciation
840. Surplus and undivided profits: additions to surplus account
841. Surplus and undivided profits: limitation of additions to surplus account
842. Surplus and undivided profits: property paid in and subsequently written off
843. Surplus and undivided profits: patents
844. Surplus and undivided profits: reserve for depreciation or depletion
845. Surplus and undivided profits: reserve for income and excess profits taxes (See April number—page 296)
846. Surplus and undivided profits: insurance on officers
847. Surplus and undivided profits: property taken for debt or in exchange
848. Surplus and undivided profits: discount on sale of bonds
849. Surplus and undivided profits: miscellaneous
850. Surplus and undivided profits: current profits (See April number—page 296)
851. Intangible property paid in (See April number—page 296)
852. Percentage of inadmissible assets (See April number—page 297)
853. Changes in invested capital during year (See April number—page 297)
854. Computation of average invested capital

855. Invested capital for full year or less
856. Illustration of return for fractional part of year
857. Method of determining available net income (See April number—page 297)
858. Effect of ordinary dividend (See April number—page 298)
859. Effect of stock dividend (See April number—page 298)
860. Impairment of capital (See April number—page 298)
861. Surrender of stock (See April number—page 298)
862. Purchase of stock (See April number—page 298)
863. Invested capital and other measures of capital (See April number—page 299)
864. *Affiliated corporations: invested capital*
865. *Affiliated corporations: intangible property paid in*
866. *Affiliated corporations: inadmissible assets*
867. *Affiliated corporations: stock of subsidiary acquired for cash*
868. *Affiliated corporations: stock of subsidiary acquired for stock*
869. *Affiliated corporations: invested capital for pre-war period*
870. *Insurance companies
871. *Foreign corporations

Section 327. Special cases
Article 901. Treatment of special cases

Section 328. Computation of tax in special cases
Article 911. Computation of tax in special cases
912. Determination of first instalment of tax in special cases
913. *Determination of first instalment of tax in the case of foreign corporation
914. *Payment of tax in special cases

Section 330. Reorganizations
Article 931. Scope of reorganizations
932. Net income and invested capital of predecessor partnership or individual
933. Election to be taxed as corporation
934. Adjustment for asset differently valued in pre-war invested capital

Section 331. Valuation of assets upon reorganization
Article 941. Valuation of asset upon change of ownership (See April number—page 299)

Section 335. Fiscal years ending in 1918 or 1919
Article 951. Fiscal year with different rates
952. Fiscal year of corporation ending in 1918
953. Deductions and credits in the case of fiscal year ending in 1918
954. Fiscal year of corporation ending in 1919
955. Illustration of computation of tax for fiscal year

Section 336. Returns
Article 961. Returns
962. *Returns in special cases

Section 337. Sale of mineral deposits
Article 971. Tax on sale of mineral deposits
972. Illustration of computation of tax where sale of mineral deposits

PART III

Administrative provisions

Section 250. Payment of taxes
Article 1001. Time for payment of tax
1002. Payment of tax when no proper return

1003. Interest on tax
1004. Penalty for failure to file return
1005. Penalty for understated return
1006. Penalty for nonpayment of tax
1007. Notice and demand of payment
1008. Collection of tax by suit
1009. Collection of tax by distraint
1010. Enforcement of tax lien by bill in equity
1011. Compromise of tax cases
1012. Assessment of tax
1013. Declaration of termination of taxable period

Section 251. Receipts for taxes
Article 1021. Receipts for tax payments

Section 252. Refunds
Article 1031. Authority for abatement, credit and refund of taxes
1032. Claims for abatement of taxes erroneously assessed
1033. Claims for abatement of uncollectible taxes
1034. *Claims for credit of taxes erroneously collected
1035. *Action on claims for credit
1036. Claims for refund of taxes erroneously collected
1037. Suits for recovery of taxes erroneously collected
1038. Claims for refund of sums recovered by suit

Section 253. Penalties
Article 1041. Specific penalties

Section 254. Returns of payments of dividends
Article 1051. Return of information as to payments of dividends

Section 255. Returns of brokers
Article 1061. Return of information by brokers

Section 256. Information at source
Article 1071. Return of information as to payments of $1,000
1072. Return of information as to payments to employees
1073. *Return of information by partnerships, personal service corporations and fiduciaries
1074. Cases where no return of information required
1075. Return of information as to interest on corporate bonds
1076. Return of information as to payments to nonresident aliens
1077. Source of information as to foreign items
1078. Ownership certificates for foreign items
1079. Return of information as to foreign items
1080. Information as to actual owner

Section 257. Returns to be public records
Article 1091. Inspection of returns
1092. Inspection of returns by state
1093. Inspection of returns by stockholder
1094. Penalties for disclosure of returns

Section 258. Publication of statistics
Article 1101. Statistics of income

Section 259. Collection of foreign items
Article 1111. License to collect foreign items

Section 260. Citizens of United States possessions
Article 1121. Status of citizen of United States possession

Section 261. Porto Rico and Philippine Islands
Article 1131. Income tax in Porto Rico and Philippine Islands
1132. Taxation of individuals beetween United States and Porto Rico and Philippine Islands
1133. Taxation of corporations between United States and Porto Rico and Philippine Islands

PART IV

Definitions and general provisions

Section 1. General definitions

Article 1501. Person
1502. Association
1503. Association distinguished from partnership
1504. *Association distinguished from trust
1505. Limited partnership as partnership
1506. Limited partnership as corporation
1507. Joint ownership and joint adventure
1508. *Insurance company
1509. Domestic and foreign persons
1510. *Government contract

Section 200. Definitions

Article 1521. Fiduciary
1522. Fiduciary distinguished from agent
1523. Personal service corporation
1524. *Personal service corporation: certain corporations excluded
1525. Personal services rendered by personal service corporation
1526. Personal services rendered by personal service corporation: more than one business
1527. Activities of stockholders of personal service corporation
1528. Activities of stockholders of personal service corporation: conduct of affairs
1529. Activities of stockholders of personal service corporation: stock interest required
1530. Activities of stockholders of personal service corporation: change in ownership
1531. Capital of personal service corporation
1532. Capital of personal service corporation: inference from use
1533. "Taxable year," "withholding agent," and "paid"

Section 201. Dividends

Article 1541. Dividends
1542. *Presumption as to source of distribution
1543. Distributions which are not dividends
1544. Dividends paid in property (See April number—page 299, Art. 1543)
1545. Stock dividends
1546. Stock dividends of 1918
1547. Sale of stock received as dividend
1548. Distribution in liquidation
1549. Distribution from depletion or depreciation reserve

Section 202. Basis for determining gain or loss

Article 1561. Basis for determining gain or loss from sale
1562. Sale of property acquired by gift or bequest
1563. Exchanges of property
1564. Determination of gain or loss from exchange of property
1565. Exchange of different kinds of property
1566. *Exchange of property and stock
1567. Exchange of stock for other stock of no greater par value
1568. *Determination of gain or loss from subsequent sale
1569. Exchange of stock for other stock of greater par value
1570. *Readjustment of partnership interests

Section 203. Inventories
Article 1581. Need of inventories
1582. *Valuation of inventories
1583. Inventories at cost (See April number—page 300)
1584. Inventories at market (See April number—page 300)
1585. Inventories by dealers in securities (See April number—page 300)
Section 204. Net losses
Article 1601. Scope of net losses
1602. *Claim for allowance of net loss
1603. Allowance of net loss
Section 205. Fiscal year with different rates
Article 1621. Fiscal year with different rates
1622. Fiscal year of corporation ending in 1918
1623. Deductions and credits in the case of corporation fiscal year ending in 1918
1624. Fiscal year of individual ending in 1918
1625. Fiscal year of corporation or individual ending in 1919
Section 206. Parts of income subject to rates for different years
Article 1641. Parts of income subject to rates for different years
1642. Stock dividend subject to rates for different years
Section 1301. Advisory tax board
Article 1701. Submission of questions to advisory tax board
1702. Procedure before advisory tax board
Section 1305. Extension of existing statutes
Article 1711. Aids to collection of tax
Section 1313. Fractional part of cent
Article 1721. When fractional part of cent may be disregarded
Section 1314. Medium of payment of tax
Article 1731. Payment of tax by certificates of indebtedness
1732. Procedure with respect to certificates of indebtedness
1733. Payment of tax by uncertified cheques
1734. Procedure with respect to dishonored cheques
Section 1318. Jurisdiction of district courts
Section 1320. Deposit of United States bonds as security
Section 1400. Repeal of former acts
Section 1402. Validating provision
Section 1405. Citation of act
Section 1408. Inspection of government contracts
Section 1409. Authority for regulations
Article 1800. Promulgation of regulations

Income

Art. 23. Bases of computation.—The return of income shall in every case be made on the basis clearly reflecting the income, including such items of income and deductions as properly would have been included in the return for the preceding taxable year had the present basis been used, but which were not so included, and excluding such items of income and deductions as would have been excluded from the return for the preceding taxable year had the present basis been used, but which were in fact included. A separate statement shall be attached to the return showing in detail all such items and the reasons why they were excluded or included in the return for the preceding taxable year. If in the opinion of the commissioner the net effect of such items upon the net income for the taxable year indicates that the returns for any previous years did not approximately reflect the true income for such years, amended returns for such years may be required.

Art. 52. When included in gross income.—Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. See articles 21-24. Lands which are received as compensation for services in one year, the title to which is disputed and in a later year adjudged to be valid, constitute income to the grantee in the former year. On the other hand, a person may sue in one year on a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in that year, assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. See articles 111 and 151. In view of the unusual conditions prevailing at the close of the year 1918 it is recognized that many items of gross income, such as claims for compensation under cancelled contracts, together with claims against contracting departments of the government for amortization and other matters, while properly constituting gross income for the taxable year 1918 were undecided and not sufficiently definite in amount to be reported in the original return for that year. In every such case the taxpayer should attach to his return a full statement of such pending claims and other matters, and when the correct amount of such items is ascertained an amended return for the taxable year 1918 should be filed.

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

Art. 54. Examples of constructive receipt.—Where interest coupons have matured, but have not been cashed, such interest payment, though not collected when due and payable, is nevertheless available to the taxpayer and should therefore be included in his gross income for the year during which the coupons matured. This is so if the coupons are exchanged for other property instead of eventually being cashed. Dividends on corporate stock are subject to tax when set apart for the stockholder, although not yet collected by him. See section 201 of the statute and articles 1541-1549. The distributive share of the profits of a partner in a partnership or of a stockholder in a personal service corporation is regarded as received. See section 218 of the statute and articles 321-335. Interest credited on savings bank deposits, even though the bank nominally have a rule, seldom or never enforced, that it may require so many days' notice in advance of cashing depositors' cheques, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit.

Where the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share.

Amortization

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

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

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

Art. 184. Cost which may be amortized.—For the purpose of making returns in 1919 the total amount to be extinguished by amortization is the difference between the value of the property on the bases indicated below and the original cost of the property less any amounts otherwise deducted for depreciation, losses, etc., prior to January 1, 1918; or in the case of property acquired or completed after December 31, 1917, it is the difference between the value of the property on the bases indicated below and the cost of such property at the date of acquisition or completion.

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

(2) In the case of property still in use which will not be required for the future use of the business and which is certain to be permanently

discarded before the last instalment payment of the tax covered by the return, the basis is the salvage value as of the date when the property will be permanently discarded.

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

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

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

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

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

Art. 188. Information to be furnished by taxpayer.—To obtain the benefit of this provision of the statute the taxpayer must establish to the satisfaction of the commissioner that the entire deduction claimed and the proportion claimed for any particular year are reasonable. The taxpayer shall also submit a supplementary statement setting forth the following information: (a) a description of the property in reasonable detail; (b) the date or dates on which the property was acquired and from whom, or, if constructed, erected or installed by the taxpayer, the dates on which such construction, erection or installation was begun and completed; (c) evidence establishing the intention of the taxpayer on and after April 6, 1917, or on and after the date of acquisition or the date of beginning construction, erection or installation, to devote such property or vessels to the production of articles (or, in the case of vessels, the transportation of articles or men) contributing to the prosecution of the present war; (d) the cost of construction, erection, installation or acquisition; (e) the value of the property after termination of the amortization period; (f) a segregation of the property permanently discarded, or of the property which will be permanently discarded before the last instalment payment covered by the return; (g) all deductions from gross income otherwise taken or claimed with respect to such property; (h) the computation by which the total amount to be extinguished by amortization was determined; and (i) the computation by which the proportion of the amortization charge claimed as a deduction in the taxable year for which the return is being made was determined.

Losses in inventory

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

Art. 262. Loss from rebates.—Where after the close of the taxable year 1918 rebates have been bona fide paid in pursuance of contracts entered into during such year upon sales made during such year, the net income for that year may be reduced by the deduction of the amount of such rebates actually paid. No such deduction will be allowed unless the profits from such sales have been included in the income for the taxable year 1918.

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

Art. 264. Loss where goods have been sold.—Where goods included in the inventory at the end of the taxable year 1918 have been sold during

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

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

Art. 266. Claims.—Claims in abatement should be filed with the collector on form 47 when the return for the taxable year 1918 is made. Claims for refund should be filed on form 46 not later than 30 days after the close of the taxable year 1919. Each claim shall contain a concise statement of the amount of the loss sustained and the basis upon which it has been computed, together with all pertinent facts necessary to enable the commissioner to determine the allowability of the claim. The amount allowed by the commissioner in respect of any such claim shall be deducted from the net income for the taxable year 1918 and the taxes shall be recomputed accordingly. Any excess paid over the tax due shall be credited or refunded to the taxpayer. See section 252 of the statute and articles 1031-1038. In computing income for the taxable year 1919 the opening inventory must be properly adjusted by the taxpayer in respect of any claim allowed for the year 1918 under this article.

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

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

part of the tax covered by such a claim is denied, then such part shall be paid by the taxpayer with interest at the rate of 12 per cent. per annum from the original due date of the tax.

Consolidated returns—Income

Art. 631. Affiliated corporations.—The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. See articles 785, 791, 802 and 864-869.

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

Art. 633. When corporations are affiliated.—Corporations will be deemed to be affiliated (a) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (b) when substantially all the stock of two or more domestic corporations is owned or controlled by the same interests. The words "substantially all the stock" cannot be interpreted as meaning any particular percentage, but must be construed according to the facts of the particular case. The owning or controlling of 95 per cent. or more of the outstanding voting capital

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

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

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

Consolidated returns—Invested capital

Art. 864. Affiliated corporations: invested capital.—The invested capital of affiliated corporations, as defined in section 240 (b) of the statute and article 633, for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance-sheet should be prepared in accordance with standard accounting practices, which will reflect the

actual assets and liabilities of the affiliated group. In preparing such a balance-sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporation included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance-sheet will then show (a) the capital stock of the parent or principal company in the hands of the public; (b) the consolidated surplus belonging to the stockholders of the parent or principal company; and (c) the capital stock, if any, of subsidiary companies not owned by the parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b) and (c) above. This total must be increased or diminished by any adjustments required to be made under the provisions of sections 325, 326, 330 and 331 of the statute and articles 811-818, 831-869, 931-934 and 941 of the regulations, except as otherwise provided in articles 865-868.

Art. 865. Affiliated corporations: intangible property paid in.—(1) In respect of corporations whose affiliation is in the nature of parent and subsidiary companies: (a) in the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent. of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (a) and (c) in article 864), or in the aggregate 25 per cent. of the par value of the total stock or shares shown on the consolidated balance-sheet, being the amount of the capital stock included in items (a) and (c) in article 864 at the beginning of the taxable year, whichever is lowest; and (b) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent. of the par value of the total stock or shares shown by the consolidated balance-sheet, being the amount of the capital stock included in items (a) and (c) in article 864 outstanding at the beginning of the taxable year, whichever is lowest. (c) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per cent. of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance-sheet, being the amount of the capital stock included in items (a) and (c) in article 864.

(2) In respect of corporations affiliated by reason of ownership by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, so valued, shall be included in invested capital in the consolidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) shall in no case exceed 25 per cent. of the outstanding capital stock of such corporation at the beginning of the taxable year.

Art. 866. Affiliated corporations: inadmissible assets.—Where adjustment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) of section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance-sheet with due regard to the adjustments and eliminations set forth in articles 864 and 865 and to the provisions of articles 815-818.

Art. 867. Affiliated corporations: stock of subsidiary acquired for cash.—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired.

Art. 868. Affiliated corporations: stock of subsidiary acquired for stock.—Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to the provisions of article 837.

Art. 869. Affiliated corporations: invested capital for pre-war period.—The invested capital of affiliated corporations for the pre-war period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in existence during the pre-war period, but were not then affiliated as herein defined, then the average consolidated invested capital for the pre-war period shall be the average invested capital of the corporations which were affiliated in the pre-war period plus the aggregate of the average invested capital for each of the several corporations which were not affiliated during the pre-war period. Full recognition, however, must be given to the provisions of section 330 of the statute, particularly the last paragraph thereof, and of articles 931-934.

TREASURY DECISIONS

(T. D. 2836, May 7, 1919)

Tax exemptions of Liberty bonds and Victory notes

The appended circular, issued under date of April 23, 1919, with reference to the tax exemptions of Liberty bonds and Victory notes, is published for the information of internal-revenue officers and others concerned.

Tax exemptions of Liberty bonds and Victory notes

Liberty bonds and Victory notes issued under authority of the acts of congress approved April 24, 1917, September 24, 1917, April 4, 1918, July 9, 1918, September 24, 1918, and March 3, 1919, are entitled, respectively, to the exemptions from taxation set forth in said acts, from which the statements in this circular are summarized and to which they are subject.

I. *4 per cent. and 4¼ per cent. bonds* are exempt from all federal, state, and local taxation, except (a) estate or inheritance taxes and (b) federal income surtaxes and profits taxes, as follows:

1. First Liberty loan converted 4 per cent. bonds of 1932-1947 (first 4s).
2. First Liberty loan converted 4¼ per cent. bonds of 1932-1947 (first 4¼s, issue of May 9, 1918).
3. First Liberty loan second converted 4¼ per cent. bonds of 1932-1947 (first 4¼s, issue of October 24, 1918).
4. Second Liberty loan 4 per cent. bonds of 1927-1942 (second 4s),
5. Second Liberty loan converted 4¼ per cent. bonds of 1927-1942 (second 4¼s).
6. Third Liberty loan 4¼ per cent. bonds of 1928 (third 4¼s).
7. Fourth Liberty loan 4¼ per cent. bonds of 1933-1938 (fourth 4¼s).
8. Victory Liberty loan 4¾ per cent. convertible gold notes of 1922-1923 (4¾ per cent. Victory notes).

} Are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any state, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations or corporations.

II. *4 per cent. and 4¼ per cent. bonds* are entitled to limited exemptions from federal income surtaxes and profits taxes, as follows:

4 per cent. and 4¼ per cent. Liberty bonds (but not 4¾ per cent. Victory notes) are entitled to certain limited exemptions from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations or corporations, in respect to the interest on principal amounts thereof, as follows:

$5,000 in the aggregate of first 4s, first 4¼s (issues of May 9 and October 24, 1918), second 4s and 4¼s, third 4¼s, fourth 4¼s, treasury certificates, and war-savings certificates.

30,000 of first 4¼s (issue of October 24, 1918, only), until the expiration of two years after the termination of the war.

30,000 in the aggregate of first 4s, first 4¼s (issues of May 9 and October 24, 1918), second 4s and 4¼s, third 4¼s, and fourth 4¼s, as to the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war.

45,000 in the aggregate of first 4s, first 4¼s (issue of May 9, 1918, only), second 4s and 4¼s, and third 4¼s, as to the interest received after January 1, 1918, until the expiration of two years after the termination of the war; this exemption conditional on original subscription to, and continued holding at the date of the tax return of, two-thirds as many bonds of the fourth Liberty loan.

20,000 in the aggregate of first 4s, first 4¼s (issues of May 9 and October 24, 1918), second 4s and 4¼s, third 4¼s, and fourth 4¼s, as to the interest received on and after January 1, 1919; this exemption conditional upon original subscription to, and continued holding at the date of the tax return of, one-third as many notes of the Victory Liberty loan, and extending through the life of such notes of the Victory Liberty loan.

160,000 total possible exemptions from federal income surtaxes and profits taxes, subject to conditions above summarized.

III. *3½ per cent. bonds and 3¾ per cent. notes* are exempt from all federal, state, and local taxation, except estate or inheritance taxes, as follows:

1. First Liberty loan 3½ per cent. bonds of 1932-1947.
2. Victory Liberty loan 3¾ per cent. convertible gold notes of 1922-1923.

Are exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any state or any of the possessions of the United States or by any local taxing authority.