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REVENUE BILL OF 1938

JANUARY 5 (calendar day, APRIL 5), 1938.—Ordered to be printed

Mr. HARRISON, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 9682]

The Committee on Finance, to whom was referred the bill (H. R. 9682) to provide revenue, equalize taxation, and for other purposes, having had the same under consideration, report favorably thereon with certain amendments and as amended recommend that the bill do pass.

As to the objectives of the House bill, the following significant statement is found in the report of the Committee on Ways and Means:

> The purpose of the bill, as reported, is to improve our existing revenue system, to remove inequities, to equalize the tax burden, and to stimulate business activities, and to accomplish this without reducing the revenue which would be obtained by existing law under present conditions. According to the best information the committee has been able to secure, from the Treasury Department and other sources, it appears reasonably certain that the revenues of the Government will be as great under the bill as under existing law. In any event, it is certain that the changes proposed will tend to stabilize the revenue. Finally, and most important, it is believed that there will be a very substantial stimulation to business by the enactment of the bill into law which will bring into being a well-balanced tax system, improved with respect to certainty and equity.

The Committee on Finance concurs in these objectives. In fact, the major amendments proposed by the committee have been adopted with the view of going even further than the House bill in an effort to stimulate and encourage business. Under present conditions it seems of the utmost importance to bring about greater business activity and a freer flow of capital into productive enterprises. If this can be done, the number of unemployed will rapidly decrease. Moreover, such a result is vital to the revenue. High rates of income tax are ineffective in producing revenue when there is very little income to tax. If business goes ahead, and there is no reason why it should not go ahead under the provisions of the bill as reported, then

there will result more taxable net income, with a consequent increase in the revenue. In making its recommendations, the committee has also given special attention to changes which will simplify the law and increase its certainty. This, also, is important to business. Finally, every effort has been made to adopt measures which will free frozen capital and allow it again to be productively employed.

Under business conditions, such as are estimated for the calendar year 1938, the bill as reported will produce about 20 million dollars in revenue more than the House bill, if it is assumed that all the changes proposed have come into full operation. But this estimate leaves out of account any added revenue which your committee is certain will result from increased business activity.

Summary of Major Changes Proposed

CORPORATE TAXES

The House bill proposes a complete revision of the corporate income taxes imposed by existing law, and, in the opinion of the committee, represents a vast improvement over that law. The House bill eliminates the burdensome undistributed-profits tax, with rates graduated from 7 to 27 percent, and substitutes therefor a flat corporate tax of 20 percent, with a credit of 4 percent for dividends paid out. This plan produces the result that if the entire net income of a corporation is distributed, the effective tax rate becomes 16 percent. In other words, the House bill is substantially equivalent to a flat 16 percent tax rate, with a 4 percent surtax on undistributed profits. Thus, the House bill retains the principle of the undistributed-profits tax, although it reduces the total maximum effective rate of income tax on corporate income from 32.4 to 20 percent.

The committee believes that the principle of the undistributed profits tax should be entirely abandoned and that the plan of taxing corporations at a flat rate should be adopted. Such a plan is simple and gives certainty to the taxpayer and certainty with respect to the revenue. The committee recommends a flat rate of 18 percent. This rate will produce considerably more revenue under present conditions than the so-called 20–16 plan contained in the House bill.

The difference in tax between the House bill and the proposal of the Committee on Finance may be seen from the following simple table:

TABLE I.—*Comparison between tax imposed by House bill and Finance Committee proposal in the case of larger corporations*

Net income	Dividends paid	Tax House bill	Tax Finance Committee proposal	Percent increase (+) decrease (−)
$100,000	0	$20,000	$18,000	−10.0
$100,000	$10,000	19,600	18,000	−8.2
$100,000	20,000	19,200	18,000	−6.2
$100,000	30,000	18,800	18,000	−4.3
$100,000	40,000	18,400	18,000	−2.2
$100,000	50,000	18,000	18,000	0.0
$100,000	60,000	17,600	18,000	+2.5
$100,000	70,000	17,200	18,000	+4.7
$100,000	80,000	16,800	18,000	+7.1
$100,000	83,333	16,667	18,000	+8.0
$100,000	90,000	16,400	18,000	+9.8
$100,000	100,000	16,000	18,000	+12.5

The above table applies to the larger corporations with net incomes of more than $25,000. Both the House bill and the proposal of the committee give special treatment to corporations with net incomes of $25,000 or less. It should be noted that the percentage of increase or decrease in tax is the same for the larger corporations whether their net incomes are $100,000, $200,000, or $1,000,000.

Several points should be observed from the figures given in table I. First, a corporation which finds itself unable to distribute more than 50 percent of its net income obtains considerable relief under the committee proposal, this relief amounting to a tax reduction of as much as 10 percent. Second, a corporation which is able to distribute more than 50 percent of its net income but not more than its net income after providing for its tax, pays more under the committee proposal, the increase in tax amounting to as much as 8 percent. Finally, a corporation with a liquid surplus is benefited by the House bill, since it can pay its tax out of past accumulations of earnings. In this case, the committee proposal increases the tax by as much as 12½ percent. This result your committee considers equitable, for in the long run dividends declared must not be greater than the net income, less tax.

It should be noted that the committee's proposal does away with much of the complexity of the House bill. Section 13 of the reported bill comprises less than one page and replaces sections 13 and 14 of the House bill, comprising 6 pages. The corporations in this class are relieved from the complicated so-called "notch" provisions of the House bill, applying to corporations with net income slightly over $25,000. This is not all; sections 27 and 28 of the House bill, dealing with the dividends-paid credit and the consent-dividends credit, which comprise 10 pages, are also eliminated with respect to this general class of corporations. Your committee believes that in the average case less hardship will be created by their proposal than by the plan incorporated in the House bill.

Both the House bill and the reported bill give relief to corporations with net incomes of less than $25,000. The House bill entirely relieves corporations with net incomes of $25,000 or less from the undistributed-profits tax, and imposes upon their net income rates graduated as follows: 12½ percent on the first $5,000 of net income, 14 percent on the next $15,000 of net income, 16 percent on the next $5,000 of net income.

The committee proposes to allow a deduction from income in the case of corporations with net income of less than $25,000, in an amount equal to 10 percent of the amount by which $25,000 exceeds

such net income. The differencein tax under the House bill and the committee's proposal may be seen from the following table:

TABLE II.—*Comparison of treatment of corporations with net incomes of $25,000 or less, House bill and Finance Committee plan*

Net income	Tax, House bill	Tax, Finance Committee plan	Increase (+) or decrease (−)	Increase (+) or decrease (−)	Effective rate on net income, House bill	Effective rate on net income, Finance Committee plan	Approximate number of taxable returns filed (1936)
				Percent	*Percent*	*Percent*	
$500	$62.50	0	−$62.50	−100.0	12.5	0	
$1,000	125.00	0	−125.00	−100.0	12.5	0	
$1,500	187.50	0	−187.50	−100.0	12.5	0	
$2,000	250.00	0	−250.00	−100.0	12.5	0	
$2,275	284.38	$0.45	−283.93	−99.8	12.5	0.02	
$2,500	312.50	45.00	−267.50	−85.6	12.5	1.8	130,607
$3,000	375.00	144.00	−231.00	−61.6	12.5	4.8	
$3,500	437.50	243.00	−194.50	−44.5	12.5	6.9	
$4,000	500.00	342.00	−158.00	−31.6	12.5	8.6	
$4,500	562.50	441.00	−121.50	−21.6	12.5	9.8	
$5,000	625.00	540.00	−85.00	−13.6	12.5	10.8	
$6,000	765.00	738.00	−27.00	−3.6	12.8	12.3	
$7,000	905.00	936.00	+31.00	+3.4	12.9	13.4	
$8,000	1,045.00	1,134.00	+89.00	+8.5	13.1	14.2	19,736
$9,000	1,185.00	1,332.00	+147.00	+12.4	13.2	14.8	
$10,000	1,325.00	1,530.00	+205.00	+15.5	13.3	15.3	
$12,000	1,605.00	1,926.00	+321.00	+20.0	13.4	16.1	9,968
$15,000	2,025.00	2,520.00	+495.00	+24.4	13.5	16.8	
$18,000	2,445.00	3,114.00	+669.00	+27.3	13.6	17.3	5,772
$20,000	2,725.00	3,510.00	+785.00	+28.8	13.6	17.5	
$22,000	3,045.00	3,906.00	+861.00	+28.2	13.8	17.7	3,956
$25,000	3,525.00	4,500.00	+975.00	+27.6	14.1	18.0	

NOTE.—Approximate number of corporations showing net incomes of over $25,000, 23,180.

It can be seen from the above table that more than 130,607 corporations filing taxable returns in 1936, out of an approximate total of 193,219, will receive more relief under the committee's proposal than under the House bill. The corporations with net incomes of less than $6,500 will be substantially benefited and the corporations with net incomes of $6,500 or more will pay a somewhat greater tax. If the size of the corporate net income is a test of ability to pay, then the committee's proposal appears the more reasonable. Moreover, it is to be noted that the proposed plan avoids any complicated "notch" provision for corporations with net incomes slightly in excess of $25,000.

Under the House bill, special rates of tax were provided in the case of banks, insurance companies, joint-stock land banks, rental housing corporations, foreign corporations engaged in a trade or business within the United States, mutual-investment corporations, and corporations in bankruptcy or receivership. These distinctions in rate are all done away with under the committee's plan and all corporations are taxed under the uniform flat rate of 18 percent, with relief to corporations with net incomes of less than $25,000. This results in a great deal of simplification.

It has long been recognized that much tax avoidance occurs through the unreasonable accumulation of corporate earnings and profits. As far as personal holding companies, or "incorporated pocket books", are concerned, this has been taken care of since 1934 by a special surtax on personal holding companies which retain such earnings. However, this evil still exists to a considerable extent in the case of operating companies. In the House bill, as originally reported, an

attempt to cure this evil was made in title IB, aimed at closely held operating companies. The House failed to approve of this drastic remedy.

Your committee is dealing with this problem where it should be dealt with—namely, in section 102, relating to corporations improperly accumulating surplus. The proposal is to strengthen this section by requiring the taxpayer by a clear preponderance of the evidence to prove the absence of any purpose to avoid surtaxes upon shareholders after it has been determined that the earnings and profits have been unreasonably accumulated. This will clearly shift the burden of proof to the taxpayer in such cases. The committee believes that substantial revenue will result from this change although no exact estimate of such revenue has been made by the Treasury Department. A reasonable enforcement of this revised section will reduce tax avoidance to a minimum and increase the revenues from sources where there is ability to pay.

Finally, the committee has approved a number of meritorious changes made in the House bill with respect to the equitable taxation of section 102 corporations, personal holding companies, and foreign personal holding companies.

CAPITAL GAINS AND LOSSES

The House bill makes several changes with respect to the treatment of capital gains and losses. Under existing law, the amount of gain or loss taken into account in computing net income depends upon the length of time the asset has been held by the taxpayer. If the asset has been held for 1 year or less, 100 percent of the gain or loss is taken into account; if the asset has been held for more than 1 year but not more than 2 years, 80 percent of the gain or loss is taken into account; if the asset has been held for more than 2 years but not more than 5 years, 60 percent is taken into account; if the asset has been held for more than 5 years, but not more than 10 years, 40 percent is taken into account; and if the asset has been held more than 10 years, 30 percent of the gain or loss is taken into account. However, if the losses taken into account exceed the gains, such excess of losses can be charged against net income only to the extent of $2,000.

The House bill, while retaining the principle of reducing the amount of gain or loss taken into account according to the length of time for which the asset has been held, makes substantial improvements in the existing law.

First, capital gains and losses are divided into two categories by the House bill—short-term capital gains and losses and long-term capital gains and losses. Short-term losses can only be charged against short-term gains, and, likewise, long-term losses can only be charged against long-term gains. A carry-over for 1 year is provided for in case the losses in either category exceed the gains in such category. A short-term gain or loss arises from the sale of an asset held for 1 year or less, and a long-term gain or loss from the sale of an asset held over 1 year.

Second, the House bill provides a new schedule of percentage brackets which reduces the amount of long-term gain or loss taken into account, monthly, from 100 percent in the case of an asset held more than 1 year and not more than 13 months, to 40 percent in the case of an asset held more than 5 years. It is to be observed that the 30-percent bracket of existing law is eliminated.

Finally, the House bill provides that, in the case of a long-term capital net gain, in no case shall the tax on the net gain taken into account exceed 40 percent of such gain. Thus, if an asset has been held more than 5 years, 40 percent of the gain is taken into account on which amount the tax may not exceed 40 percent. Therefore, in such a case, the tax on the actual gain is 16 percent.

While it may be recognized that the House provision is a considerable improvement over existing law, the committee believes that the plan proposed in the House bill is excessively complicated and will not permit of a free flow of capital into productive enterprises. The committee is convinced that at the present time transactions are prevented by the capital-gains tax and that the result has been a material hindrance to business and a considerable loss of revenue.

There is an essential difference between income derived from salaries, wages, interest, and rents and income derived from capital gains. It is always to the advantage of the taxpayer to receive the first class of income, no matter what the rate of tax as long as it is less than 100 percent. On the other hand, the tax in respect of capital gains is optional—the taxpayer is not obliged to pay any tax unless he realizes a gain by the sale of the asset. There is no tax under existing law if a taxpayer transfers his money from one bank to another, but there may be a very heavy tax if he wishes to transfer his investment from a bond in one company to a bond in another company. Thus, an excessive tax on capital gains freezes transactions and prevents the free flow of capital into productive investments. The effect of the present system of taxing capital gains is to prevent any individual with substantial capital from investing in new enterprises. This is most unfortunate, because it adversely affects the employment situation.

The proposal made by your committee may be briefly described as follows:

First, short-term capital gains and losses are defined as those arising from the sale of assets held for 18 months or less. Short-term capital losses can only be charged off against short-term capital gains, but if such short-term capital losses exceed the gains, the excess may be carried forward 1 year and applied against the short-term capital gains of such subsequent year.

Second, long-term capital gains and losses are defined as those arising from the sale of assets held for more than 18 months. A net long-term capital gain is taxable at a rate not in excess of 15 percent. In order to give consistent relief to taxpayers in the lower income brackets, it is also proposed that, if the tax is less, the taxpayer may include in his income only one-half of the net long-term capital gain. If there is a net long-term capital loss, the taxpayer is not allowed to receive a reduction in tax of more than 15 percent of such net loss, nor is he allowed to pay a lesser tax than would have been payable if he had deducted only one-half of his capital net loss from his ordinary income. Thus, the deduction for losses is made consistent with the taxation in the case of gains.

The above plan is simple and practically identical with the system of taxing capital gains and allowing credit for capital losses which was in force from 1924 to 1932. The principal exception is in respect to net short-term losses. These cannot be charged against ordinary income but must be carried forward one year against the short-term gains of such subsequent year.

The above plan affects individuals only. Corporations are taxed as under existing law with respect to their capital gains and are treated with respect to capital losses as under existing law. However, there is one exception to this rule. The definition of capital assets has been changed, so that depreciable assets are no longer included in the category of capital assets. This change made in the House bill allows a corporation to receive the full benefit of a deduction for losses on the sale of depreciable assets from its ordinary income. The change does not, of course, affect the deduction for obsolescence allowed by section 23 (l) of the bill and corresponding provisions of prior acts.

The committee believes that this treatment of capital gains and losses will stimulate transactions, facilitate the flow of capital into new enterprises, release frozen capital, and increase the revenues of the Government.

LIQUIDATION OF CORPORATIONS

The testimony presented to the committee in its hearings reveals that many corporate structures are excessively complicated, that the assets of many personal holding companies and foreign personal holding companies are frozen, and that the utility companies are faced with a death sentence and in addition, with a heavy tax penalty for carrying out the orders of the Federal Government.

It is true that the House bill provides that, on a showing of undue hardship, the Commissioner may allow the shareholders of a personal holding company to have 5 years in which to pay the tax due with respect to the liquidation of such a company. This, in the opinion of your committee, is not sufficient, although such a change is approved.

The committee believes that any corporation should be allowed 3 years in which to consummate a complete liquidation. The fact that a corporation takes 3 years in which to liquidate should not be deemed to be an attempt to avoid taxes and should not be regarded as impeaching the bona fides of the liquidation. In many cases, on account of assets not having a ready market, it is impossible to liquidate rapidly. Furthermore, even in the case of liquid securities, a large block of such securities cannot be dumped on the market at one time without seriously affecting the market price of such securities.

Your committee proposes to give all corporations 3 years in which to consummate a complete liquidation instead of the 2 years provided for under existing law. Thus, a shareholder may be able to report his profits from liquidation in four taxable periods, if the corporation begins liquidation during one of his taxable years. For example, suppose a taxpayer reports on the calendar-year basis and suppose he owns all the stock of a corporation, which stock cost him $2,000,000 on its organization over 18 months ago. Now, suppose that the corporation assets are worth $10,000,000, and that the corporation begins to liquidate in accordance with a plan of complete liquidation.

Assume that on July 1, 1938 the corporation distributes assets to a shareholder with a fair market value of $2,500,000. There is no tax on the corporation, but on March 15, 1939, the shareholder will be obliged to pay a tax of $75,000 to the Government, only 15 percent of $500,000, which is his profit above his basis at that date.

Assume that on July 1, 1939 the corporation distributes assets to the the shareholder with a fair market value of $2,500,000. On March 15, 1940, the shareholder will be obliged to pay a tax of $375,000 to the Government.

Assume that on July 1, 1940 the corporation distributes assets to the shareholder with a fair market value of $2,500,000. On March 15, 1941, the shareholder will be obliged to pay a tax of $375,000 to the Government.

Finally, assume that on July 1, 1941, the corporation distributes the remainder of its assets to the shareholder, having a fair market value of $2,500,000. On March 15, 1942, the shareholder will be obliged to pay a tax of $375,000 to the Government.

It can be seen from the above example that the total tax payable in the shareholder's four taxable periods amounts to $1,200,000. This is 15 percent of his $8,000,000 profit. Therefore, there has been no reduction in the total amount of tax which would have been payable if the liquidation had all been consummated in the first year. However, the fact that the shareholder can realize his profits over a period of 4 years is a great convenience to him. In the first place, it enables him to sell the assets received gradually without disturbing market conditions and thus provide for the payment of his taxes. In the second place, this system protects the shareholder from fluctuations in the market. If the market for the assets received on liquidation declines, his tax will be correspondingly reduced. It is true that if the fair market value of the assets increases his tax will increase, but he should not complain at this as his net profit after tax will also increase. Finally, if the taxpayer is in difficulty with respect to making payments for any year, the provision of the House bill allowing the Commissioner to extend the time for the payment of tax in cases of undue hardship will still be applicable. While this system is proposed for all corporations, it will undoubtedly be very helpful in the case of personal holding companies with frozen assets. The committee believes that many corporations will take advantage of this method of orderly liquidation and as a result a large amount of capital will be released for investment in industry.

In respect of foreign personal holding companies, existing law provides that these companies must be liquidated before January 1, 1938, in order that their shareholders may receive the benefits of the capital-gains provisions, unless an extension was granted by the Commissioner. Such an extension could only be granted up to June 30, 1938. Shareholders of foreign personal holding companies which did not liquidate within the above period or secure the permission of the Commissioner for an extension of time, pay a tax on 100 percent of their gains. The committee believes that many foreign personal holding companies did not have sufficient time in which to liquidate and as a result will stay in existence. The committee proposes, therefore, in the case of these companies, to allow their liquidation on or before June 30, 1939 under the capital-gains provisions of the bill. The committee believes it will be of advantage to allow this capital which is now frozen in the foreign personal holding companies to be brought back into the United States and put to work.

TRANSACTIONS UNDER ORDERS OF SECURITIES AND EXCHANGE COMMISSION

The committee has also provided in the bill (secs. 112 (b) (7) and 113 (a) (17) and Supplement R) for nonrecognition of gain or loss in the case of the disposition of property upon certain exchanges and the receipt of property upon certain distributions ordered by the Securities and Exchange Commission in furtherance of the policies of section 11 of the Public Utility Holding Company Act of 1935. By the terms of that section the Commission is directed to effect the simplification and geographical integration of public utility holding-company systems. In the course of such simplification and geographical integration many properties will have to be regrouped, corporations completely or partially liquidated, and stock or securities shifted. Since the exchanges and distributions by means of which these results will be achieved will be compulsory transactions, whether initiated by the Commission, or in the form of a plan initiated by the corporations affected and submitted to the Commission for its approval, the committee believes that recognition of gain or loss should, wherever possible, be postponed until a voluntary realization occurs. Since the present provisions of law relative to the nonrecognition of gain or loss in the case of disposition of property in certain types of exchanges are not broad enough to cover many of the involuntary exchanges or distributions which will be typical, it has been thought advisable to provide special provisions relative to such transactions. This course was strongly recommended by the chairman of the Securities and Exchange Commission.

Briefly stated, Supplement R covers (1) cases in which a holder of stock or securities in a registered holding company or a majority-owned subsidiary disposes of his stock or securities by transferring them to such company or to another registered holding company or majority-owned subsidiary which is in the same holding-company system in exchange for other stock or securities, (2) the disposition of property by a member of a holding-company system in exchange for other property, (3) distributions of stock or securities by registered holding companies or majority-owned subsidiaries to their shareholders, and (4) a disposition of property in a transaction solely between members of a limited class of closely related corporations.

In none of the above transactions except (4) is cash or other "nonexempt" property receivable without the recognition of gain. Nonexempt property includes, in addition to cash, short-term obligations, Government bonds, cancelation or assumption of indebtedness, certain rights to receive money, and stock or securities acquired after February 28, 1938, except those acquired pursuant to an order of the Securities and Exchange Commission.

Supplement R also provides, generally, for a continuation of the basis, either in the form of applying the basis of the property transferred to the property received, or, in the case of closely related companies, by requiring the basis of the property in the hands of the transferor to go with the property. Such a continuation of the basis will insure that the gains which are deferred as a result of the operation of the provisions of section 371 will be taxable whenever any realization occurs with respect to the property received, if such realization is not itself within the exceptions provided by section 112.

It is believed that the above provisions will greatly facilitate the simplification and integration of public-utility holding-company systems. By such provisions the public-utility systems will be encouraged to cooperate with the Securities and Exchange Commission and will effect results which will carry out the purposes of simplification and integration without undue burden on the companies and their shareholders, resulting from forced reorganizations, liquidations, and transfers. The effect of these provisions will not be to exempt gains from tax but merely to postpone their taxation until subsequent voluntary realization.

ESTATE AND GIFT TAXES

The House bill proposes a consolidation of the two Federal estate taxes now in force. One of these is imposed by the Revenue Act of 1926, as amended, with an 80 percent credit for State death taxes paid; the other is imposed by the Revenue Act of 1932, as amended, with no credit for State death taxes paid. The House bill provides for a credit for State death taxes paid of 16⅔ percent with respect to the combined estate taxes. While in the aggregate this is estimated to result in the same total credit as given under existing law, it appears to have unequal results with respect to different States. The State tax commissioners of a number of the States have protested against this result, stating that it will have a bad effect on their budgets. Moreover, because of the fact that many of the States have enacted estate taxes by reference to the Federal estate tax law of 1926, the change proposed by the House bill would force a large number of the States to enact new laws with respect to estate taxes.

Your committee realizes the desirability of simplifying our estate tax laws, but believes that this action should be deferred until such time as an effective plan can be devised for coordinating Federal, State, and local taxes. It should be observed that only about 15,000 estate tax returns are filed annually, and that simplification is not such a necessity in this case as in the case of the income tax where over 4,500,000 returns are filed annually. Accordingly your committee recommends that the present Federal laws dealing with estate taxes be retained in their present form.

The House bill provides for a reduction in the specific exemption of $40,000 allowed an estate in an amount equal to the amount of the specific exemption used up with respect to the gift tax. The House bill also proposes to reduce from $5,000 to $3,000 the annual exemption allowed as to gifts to any one individual. The committee does not concur in either of these recommendations, because it believes that it will prevent the reasonable distribution of wealth and reduce spending.

EXCISE TAXES

The committee has concurred in the majority of the provisions of the House bill which eliminate certain "nuisance taxes" as of June 30, 1938. Some exceptions, however, should be noted.

The House bill eliminated entirely the 2-cent-per-thousand tax on wooden matches and the ½-cent-per-thousand tax on paper matches, retaining only the 5-cent-per-thousand tax on wooden matches with a fancy or colored stem. This action would cost about $6,000,000. The

great majority of match manufacturers did not ask to have this tax removed, but they did advocate a 2-cent rate on both wooden and paper matches. The committee can find no grounds on a volume basis or on a value basis for the differential in the rate of tax contained in existing law. Matches are extremely cheap and the tax is not believed to be a burden on the consumer. Accordingly, your committee recommends that the tax on matches be retained as in existing law except that the rate on paper matches be made 2 cents per thousand as is the case of wooden matches. This change should increase the present revenue from this tax by $1,200,000.

The House bill does not propose any change in the existing excise taxes on tires and inner tubes. The present tax on tires is 2¼ cents per pound and on inner tubes 4 cents per pound. It appears that these taxes are equivalent to from 8 to 12 percent of the manufacturers' sales price. These rates are several times greater than are imposed on other automobile accessories. Moreover, there is great duplication of taxes on the automobile user, such as gasoline taxes, lubricating oil taxes, automobile taxes, etc. The committee believes that a moderate reduction in the rates of tax on tires and inner tubes is amply justified. It recommends, therefore, that the tax on tires be reduced to 1½ cents per pound and on inner tubes to 2½ cents per pound.

The tax on brewers' wort and malt sirup is not disturbed by the House bill. The revenue from this tax is only about $800,000, and it is an administrative nuisance. The committee recommends eliminating this tax effective June 30, 1938. The repeal of the eighteenth amendment to a great extent obviated the primary utility of this tax.

The House bill contains a provision modifying to some extent the definition of filled cheese. The committee does not concur in the modification of this definition, being fearful that it will open the door to the evasion of the tax on filled cheese.

The excise tax on the importation of lumber is changed by the House bill so as not to apply to Northern white pine, Norway pine, Englemann's spruce, and Western white spruce. Your committee concurs in this change with one exception. It recommends that Englemann's spruce still be left subject to tax. The reason for this action lies in the fact that large stands of this timber still exist within the borders of the United States.

The House bill provides for an excise tax with respect to the importation of pork and certain pork products. The rate of tax proposed is 6 cents per pound except in the case of pork joints, in which case the rate proposed is 3 cents per pound.

The Secretary of Agriculture appeared before the committee and made the two following principal points with respect to this tax:

> First. That the proposed taxes would yield little, if any, additional revenue; and
>
> Second. That the imposition of these taxes was against the interest of the American hog producer for the reason that our hog industry is on a substantial export basis and is, therefore, not in a position to be "protected" against foreign competition through high import taxes. On the other hand, the imposition of such taxes would jeopardize the prospects of expanding foreign outlets for our surplus pork and lard production.

The Secretary of State also testified before the committee and presented the most convincing facts and arguments in opposition to this tax.

The committee accordingly recommends the elimination of this tax from the House bill.

An increase in the tax on distilled spirits from $2 to $2.25 per gallon is provided for by the House bill. This increase is estimated to produce 19 million dollars in revenue annually. While it is admitted that liquor is a good object of taxation, your committee has taken into account in considering the matter the heavy State and local taxes imposed on liquor and also the bootlegging problem. Several State liquor administrators are much opposed to this increase in tax. Finally, the Treasury Department does not recommend this increase. Your committee, therefore, recommends that no increase in liquor taxes be made at this time.

The House bill provides for a reduction in the rate of the stamp tax on sales of produce for future delivery from 3 cents to 1 cent per $100. The bill also provides that so-called "scratch sales" shall be taxed, although such sales have not been taxed in recent years.

The Assistant Chief, Commodity Exchange Administration, Department of Agriculture, appeared before the committee and gave the committee detailed information in respect to this tax. He also placed in the record a letter from the Chief of this Administration containing the following significant statement:

> It would be of value to the commodity markets if this tax could be eliminated entirely. It places a particularly heavy burden on the scalpers who give flexibility to the market. In fact, without the presence of scalpers a futures market cannot function efficiently in that hedgers desiring to sell a future as a protection against loss would be compelled to sell at a lower price and hedgers desiring to buy a future as a protection against the sale of flour would be compelled to pay a higher price than justified. In the former case the result would be a lower price to producers and in the latter case a higher price to consumers.

In view of the above, your committee recommends that this tax be entirely eliminated after June 30, 1938.

The House bill makes no change in the stamp taxes on transfers of stocks and bonds. Your committee recommends that certain transfers be made exempt where double or triple taxes occur with no change in beneficial title. This change is in the interest of justice and equity, and affects mainly the transfers of stocks or bonds into the hands of nominees or custodians. The result sought is somewhat similar to that arrived at under the New York State law governing the tax on these transfers.

A detailed explanation of the major technical changes in the bill follows. Clerical changes such as those making necessary cross references and transposing provisions for clarity and purely technical changes are not discussed.

DETAILED EXPLANATION OF THE CHANGES IN THE HOUSE BILL PROPOSED IN THE BILL AS REPORTED

Section 13. Tax on Corporations

In place of the taxes imposed by sections 13 and 14 of the House bill, the reported bill imposes a flat tax of 18 percent on corporations. The tax is levied on "normal-tax net income." "Normal-tax net income" is defined as "adjusted net income" minus the credits for dividends received and minus 10 percent of the amount by which $25,000 exceeds net income. The definition of "adjusted net income" is the same as "adjusted net income" in section 13 (a) of the House bill, namely, net income minus the credit for interest on obligations of the

United States and its instrumentalities. The credit for dividends received, provided in section 26 (b), is unchanged from the House bill. That subsection provides that the credit for dividends received shall be 85 percent of the amount received as dividends from a domestic corporation, but shall not be in excess of 85 percent of the adjusted net income. The credit of 10 percent of the amount by which $25,000 exceeds the net income is a new credit not found in the House bill and will serve to exempt entirely from the tax imposed by section 13, corporations having a net income of less than about $2,272. The application of this 10-percent credit may be illustrated by the following example:

Suppose a corporation has a net income of $15,000, of which amount $2,000 is derived from interest on United States obligations and $1,000 from dividends received from domestic corporations. The computation of tax in such a case is now shown.

Net income	$15, 000
Subtract interest on United States obligations	2, 000
Adjusted net income	13, 000
Subtract credit for dividends received (85 percent of $1,000)	850
Balance	12, 150
Subtract 10 percent of ($25,000 less $15,000)	1, 000
Normal tax net income	11, 150
Tax at 18 percent	2, 007

It should be noted from the above that the fact that the corporation has income from United States Government obligations or from dividends from other corporations does not increase the tax relief afforded to corporations with net income of less than $25,000. In all cases, a corporation with a net income of $15,000 will receive a special 10-percent credit of $1,000. This amounts to a reduction in tax of $180.

Mutual investment companies, corporations in bankruptcy and receivership, joint-stock land banks, rental housing corporations, banks and trust companies, China Trade Act corporations, corporations having the benefit of section 251, and foreign corporations having an office or place of business in the United States, are all subject to the flat 18-percent tax on their normal-tax net income, provided by section 13 in lieu of the special treatment accorded them by sections 13 and 14 of the House bill. The treatment of nonresident foreign corporations provided for in the House bill remains unchanged.

Section 23 (g) (1). Limitation on Capital Losses

For discussion of this provision, see discussion of section 117—Capital Gains and Losses.

Section 23 (g) (2) and (k). Bad Debts and Worthless Securities

The House bill provides in section 23 (g) that when certain securities (shares of stock or rights to subscribe for or receive such shares) become worthless, the loss resulting therefrom shall not be fully deductible but shall be subject to the treatment accorded capital losses provided in section 117. The House bill in section 23 (k) prescribes similar treatment for the loss resulting where securities of another type (including bonds, debentures, notes, and similar evi-

dences of indebtedness issued by any corporation) are ascertained to be worthless and are charged off within the taxable year.

The committee believes that the policy of treating such losses as capital losses is sound as applied to taxpayers other than corporations. This is particularly true in view of the fact that section 117 in the reported bill provides much more liberal treatment to capital losses in the case of taxpayers other than corporations than did the House bill. The committee does not believe, however, that this change should apply with respect to such losses incurred by corporations. Losses of this type incurred by corporations are customarily a part of their ordinary business expense and should be treated as such. Furthermore, the more favorable treatment allowed with respect to the losses of individuals under section 117 is not extended to corporations; corporation losses may be deducted only to the extent of capital gains, plus $2,000. In addition there are certain groups of corporate taxpayers, such as banks and trust companies, which are required by regulatory governmental agencies to deduct in full losses of the kinds referred to in computing their income for the purposes of such agencies. It is desirable to permit such taxpayers similar deductions for income-tax purposes.

The effect of the amendments is to confine the operation of the provisions to taxpayers other than corporations.

Under the House bill the loss from the worthlessness of the security was considered to have been sustained on the first day of the taxpayer's taxable year. By reason of the committee amendments relating to capital losses, this date has been changed to the last day of the taxable year. In some cases, if the first day is determinative, the effect would be to make the loss a short-term capital loss and thus deductible only against short-term gains. Fixing the date as the last day of the taxable year will, in many cases, make the loss a long-term capital loss and thus permit the application of the more favorable treatment accorded to such losses.

SECTIONS 23 (O) AND (Q). AMOUNT DEDUCTIBLE AS CHARITABLE CONTRIBUTION IF MADE IN PROPERTY OTHER THAN MONEY

Under the House bill if a gift is made in kind to a charity the amount deductible as a charitable gift is the fair market value or the adjusted basis of the property in the taxpayer's hands, whichever is the lower. Thus if an individual gives to a charity a piece of real estate worth $5,000, which cost him $4,000, the amount deductible for income-tax purposes under the House provision is $4,000. Representations were made to the committee by officials of educational and charitable institutions that the effect of such a provision would be to discourage the making of charitable gifts in kind. The committee believes that charitable gifts generally ought to be encouraged and so has eliminated this provision of the House bill.

The House bill contained similar limitations in the case of charitable gifts by corporations (sec. 23 (q)), section 102 companies, foreign personal holding companies (sec. 336), and domestic personal holding companies (sec. 406). For the same reason these provisions of the House bill have been eliminated.

SECTION 26. CREDITS OF CORPORATIONS

Subsection (a) of section 26 of the House bill (relating to the credit of corporations for interest on obligations of the United States and its instrumentalities) and subsection (b) (relating to the credit for dividends received) are retained in the reported bill. These credits are necessary to determine normal-tax net income upon which the tax on corporations is imposed by section 13. However, this is not true as to the net operating loss carry-over credit provided in section 26 (c) of the House bill and the bank affiliate credit in section 26 (d) thereof. These credits are not required for corporations in general in the reported bill because they are applicable only to taxes upon undistributed profits. These provisions are still applicable, however, in computing the surtax imposed by section 102 on corporations improperly accumulating surplus and the surtax imposed by title IA on personal holding companies and in computing the undistributed income of foreign personal holding companies. They have, therefore, been shifted in the reported bill to supplement Q where they appear without substantial change in subsections 361 (d) and (e).

SECTIONS 27 AND 28 (HOUSE BILL). DIVIDENDS PAID CREDIT AND CONSENT DIVIDENDS CREDIT

Section 27 of the House bill (relating to the dividends-paid credit) and section 28 (relating to the consent-dividends credit) have been transferred to Supplement Q for the same reasons as those stated with respect to the transfer of sections 26 (c) and (d) of the House bill. Section 27 (a) of the House bill defining the dividends-paid credit appears in section 361 (a) of the reported bill. Section 27 (b) defining the basic surtax credit appears in section 361 (b). Section 27 (c) relating to the dividend carry-over has been placed in section 361 (c). Subsections (d) to (i) of section 27 of the House bill describing in various respects the treatment of dividends appear in section 362. Section 28 of the House bill relating to the consent dividends credit has been placed in section 363.

SECTIONS 51 AND 145. DISPENSING WITH OATH ON INDIVIDUAL RETURNS

Under existing law income returns filed by taxpayers or on their behalf must be made under oath. It has come to the attention of the committee that this requirement has caused inconvenience to a considerable number of individuals who reside in places where persons authorized to take oaths are not close at hand. Abolishing such a requirement will make more convenient for all individual taxpayers the filing of returns. Accordingly, section 51 of the reported bill provides that the return shall contain or be verified by a written declaration that such return is made under the full penalties of perjury and that if an individual's name is signed to a filed return, such fact shall for all purposes be prima facie evidence that the return was actually signed by such individual. Similar procedure for the making of State income returns has been found to be administratively satisfactory in Massachusetts.

Correspondingly, section 145 (c) of the reported bill provides that the willful making and signing of an income return false in any material matter is a felony, punishable under the penalties for perjury prescribed in section 125 of the Criminal Code. These penalties are in addition to the penalties provided in section 145 (b) for willful attempt to evade or defeat income tax.

A bill introduced by Senator Walsh containing the same principles has heretofore passed the Senate.

Section 56 (c) (2). Extension of Time for Payment on Liquidation of Personal Holding Companies

This subsection of the House bill, relating to extension of time for payment of tax on liquidation of personal holding companies, is retained in the reported bill, except that there is eliminated the requirement for the approval of the Secretary of the Treasury to every request for an extension under this subsection. This change is made in the interest of simplifying procedure and of relieving the Secretary of considerable administrative detail. It is to be noted, however, that extensions are to be granted only under rules and regulations prescribed by the Commissioner of Internal Revenue and approved by the Secretary. Consequently, such regulations may set forth appropriate rules indicating in what cases the extension may not be granted without the express approval of the Secretary.

Similar appropriate changes have been made in connection with extensions of time for payment of deficiencies (sections 272 (j) and 815), and execution of closing agreements (section 802) and compromises (section 814).

Section 102 (c). Evidence Determinative of Purpose

This subsection of the bill provides that the fact that the earnings or profits are accumulated beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary. Under existing law, an unreasonable accumulation is merely prima facie evidence of purpose to avoid surtax upon shareholders. Consequently, it has been argued that the only effect of an unreasonable accumulation is to shift to the taxpayer the burden of going forward with the evidence relating to purpose. Under the amendment, however, it is clear that an unreasonable accumulation puts upon the taxpayer the burden of proving by the clear preponderance of all the evidence submitted that it did not have the purpose of avoidance.

Section 103. Rates of Tax on Citizens and Corporations of Certain Foreign Countries

The changes made in the bill with respect to the normal tax on corporations and to the taxation of mutual investment companies require that corresponding changes be made in the references in section 103 to sections imposing tax. Other than making such changes, the bill leaves section 103 as it is in the House bill.

SECTION 104. (HOUSE BILL). BANKS AND TRUST COMPANIES

The House bill taxed banks and trust companies in section 104. Since the reported bill taxes banks and trust companies like other corporations, no special taxing section for them is necessary and consequently section 104 of the House bill is omitted. The definition of banks and trust companies has been transferred to section 169 which deals with common trust funds since the definition is of importance in that section.

SECTION 112 (B) (7). EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF THE SECURITIES AND EXCHANGE COMMISSION

This amendment provides for the nonrecognition of gain or loss in certain cases where exchanges or distributions are made in obedience to orders of the Securities and Exchange Commission. The kind of cases covered and the extent to which there will be no recognition of gain or loss are described in detail in Supplement R.

SECTION 113 (A) (6). TAX-FREE EXCHANGES GENERALLY

In view of the addition by the reported bill of section 372, relating to property received in pursuance of certain orders of the Securities and Exchange Commission, your committee has made a necessary revision in section 113 (a) (6) of the House bill in order to make clear that its provisions, relating to basis of property acquired in tax-free exchanges generally, are not applicable to property acquired in any manner described in section 372 of the reported bill.

SECTION 113 (A) (15) AND SECTION 808. BASIS OF PROPERTY ACQUIRED IN CONNECTION WITH LIQUIDATION

It has been brought to the attention of the committee that the retroactive effect of section 112 (b) (6) of the Revenue Act of 1936 has resulted in hardship to certain corporations arising out of distributions in complete liquidation of other corporations where the distributions occurred prior to the enactment of the 1936 act. Section 110 of the Revenue Act of 1935 amended the Revenue Act of 1934 so as to provide that on certain complete liquidations of a subsidiary by a parent corporation no gain or loss was to be recognized to the parent. In such cases the basis of the property transferred to the parent was, in its hands, the basis of the stock which the parent gave up for the property. The 1936 act superseded the 1935 act amendment as to distributions in taxable years beginning after December 31, 1935, and provided that the basis, in the hands of the parent, of the property transferred should be the basis, in the hands of the liquidating corporation, of the property transferred.

The effect of the amendment in section 808 of the bill is to permit such a parent corporation to elect to have the basis provisions of the 1934 act (those which would have governed had the 1935 amendment not been superseded) apply to property received. The election may be made only with respect to property received before June 23, 1936 (the day following the enactment of the 1936 act) in a taxable year of the parent beginning after December 31, 1935. The election

applies only if the liquidation was completed before June 23, 1936. The election applies to all the property received in such period and may not be made with respect to particular pieces or to particular distributions. Distributions made after the date of the enactment of the 1935 act (August 27, 1935) and prior to a taxable year of the parent beginning after December 31, 1935, were not, under the 1935 amendment or the 1936 act, tax-free. The amendment in section 808 does not affect these distributions or the basis of property so received, but the fact that there were distributions during that period does not affect the recognition of gain or loss on the transfer of property or the basis thereof if received by the parent after that time in a liquidation completed prior to June 23, 1936. The parent corporation, in order to have the 1934 act basis, must affirmatively elect to have such basis apply to the property. This must be done within 180 days after the date of the enactment of the bill. Failure to elect is not an election and an election once made is irrevocable.

Section 113 (a) (15) of the bill preserves the applicability of the 1934 act basis provisions elected by the parent for years to which the new bill applies. This section gives no new election for taxable years 1938 and following. Once having elected under the amendment in section 808, the election stands not only for 1936 and 1937 but also for 1938 and subsequent years.

SECTION 113 (A) (17). PROPERTY ACQUIRED IN CONNECTION WITH EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO CERTAIN ORDERS OF SECURITIES AND EXCHANGE COMMISSION

This amendment provides a continuation of the basis with respect to property acquired in connection with exchanges and distributions made in obedience to orders of the Securities and Exchange Commission. The basis in such cases is described in detail in Supplement R.

SECTION 115 (c). DISTRIBUTIONS IN LIQUIDATION

The reported bill endeavors to encourage the liquidation of both domestic and foreign personal holding companies by expanding the time within which complete liquidation must occur to have any resulting gain to shareholders subject only to the capital-gains rate. In the case of corporations, other than foreign personal holding companies, such time has been extended from 2 years to 3 years in the case of liquidations begun in a taxable year beginning after December 31, 1937. In order not to discriminate in favor of personal holding companies, this provision is made applicable to all companies except foreign personal holding companies.

In the case of foreign personal holding companies, the time for complete liquidation in order for the shareholders to receive the benefits of the capital-gains provisions has been extended to July 1, 1939.

The changes in the fifth sentence of this subsection are made necessary by reason of the amendment to section 115 (h) of the bill.

SECTION 115 (H). EFFECT OF DISTRIBUTIONS ON EARNINGS AND PROFITS

Under existing law, distributions of any property by a corporation which under the provisions of section 112 (b) or (c) are received by the shareholder without the recognition of gain to him (irrespective

of what basis the property takes in the hands of such shareholder) are not regarded as being in any respect distributions of earnings or profits. Consequently, such earnings or profits remain unimpaired out of which taxable dividends may subsequently be declared either by the corporation making the distribution or by another corporation which, as to property acquired in an exchange described in section 112, takes in whole or in part the transferor's basis, so that the earnings or profits of the transferor corporation become in whole or in part the earnings or profits of such other corporation.

In view of the fact that sections 112 (b) (6) and (7) permit the distribution of property (including money), in addition to stock or securities, without the recognition of gain to the distributee, appropriate changes are made in section 115 (h) of the House bill in the interest of added clarity.

SECTION 117. CAPITAL GAINS AND LOSSES

This section of the bill as reported makes substantial changes over the House bill in the treatment of capital gains and losses in the case of taxpayers other than corporations.

SHORT-TERM GAINS AND LOSSES

Under the House bill short-term capital gains and short-term capital losses are defined to be those which occur on the sale or exchange of a capital asset held for not more than 1 year. The bill as reported extends the period so that a short-term gain or loss is one which occurs on the sale or exchange of a capital asset held for not more than 18 months. This change also has the effect, in the case of assets held over 13 months and not over 18 months, of requiring 100 percent of the gain or loss to be taken into account. Under the holding period schedule of the House bill the amount of the gain or loss taken into account was reduced depending on the number of months held so that on an asset held 18 months the loss was considered to be only 90 percent of the actual amount of the loss. A similar provision applied to gain. As under the House bill, the amount of the gain or loss is the amount of the "recognized" gain or loss. The bill as reported, as does the House bill, permits short-term capital losses to be deducted only to the extent of short-term capital gains.

The excess is not deductible against ordinary income or against net long-term capital gains. The bill as reported also contains the same allowance of a 1-year net short-term capital loss carry-over as does the House bill. The effect of this provision is to permit an individual who, in a taxable year, beginning after December 31, 1937, sustains short-term capital losses in excess of his short-term capital gains for such year, to carry over that excess to the next subsequent year to apply against his short-term capital gains for such succeeding year. The carry-over may not exceed the net income for the year of the excess loss. In the subsequent year the excess is treated as if it were a short-term capital loss and is deductible in full against short-term capital gains for the year, if any. Since the short-term capital loss carry-over is a 1-year carry-over, the excess loss is not included in the net short-term loss for the subsequent year. To do this would be to make the carry-over available for more than 1 year.

LONG-TERM CAPITAL GAINS AND LOSSES

The House bill treated as a long-term capital gain or loss the gain or loss occurring on the sale or exchange of a capital asset held more than 1 year. The reported bill makes gain or loss on the sale or exchange of a capital asset held more than 18 months a long-term capital gain or loss.

Under the House bill the amount of long-term gain or loss taken into account is reduced as the period of holding becomes longer. Thus, with respect to gain or loss on an asset held just over 4 years, 52 percent of the amount is taken into account; if held over 5 years, 40 percent of the amount is taken into account. The reported bill eliminates the schedule of holding periods entirely and treats all gains and losses on assets held over 18 months alike. Whereas under the House bill the amount which was considered a long-term capital gain or loss was the amount reduced in accordance with the schedule, under the reported bill the amount of a long-term capital gain is the entire amount recognized. The same is true as to losses.

The reported bill does contain a provision which is somewhat similar in purpose to the holding-period provision of the House bill. This provision (sec. 117 (b)) provides that only 50 percent of the long-term capital gains or long-term capital losses is taken into account in computing net income. Thus if a share of stock held for 2 years is sold for $100 more than its cost the recognized gain is $100 and that amount is the long-term capital gain. Section 117 (b) provides that only 50 percent of that amount, or $50, however, shall be taken into account in computing net income. This provision has the same general effect as the holding-period schedule in the House bill in that it diminishes the amount of tax on such a gain by reason of the length of time the asset has been held.

ALTERNATIVE TAXES IN CASE OF NET LONG-TERM GAINS AND LOSSES

A taxpayer is considered to have had a net long-term gain in a taxable year if the sum of his recognized long-term gains for the year exceeds the sum of his recognized long-term losses for the year. Thus, if he sold two long-term assets and made $500 on one and $200 on another, the total long-term capital gain is $700. If, in the same year, he sold two long-term assets and lost $300 on one and $100 on the other, his long-term capital loss is $400. His net long-term capital gain is $300.

Section 117 (c) (1) provides an alternative method of tax when a net long-term capital gain is realized in the taxable year. This alternative tax is applicable only where the result of its application is to produce less tax. Its effect is to put an upper limit on the amount of tax levied upon the net long-term gain equal to 15 percent of the amount of the gain. Thus, suppose the case of an individual whose net long-term gain is $10,000. In computing his net income only $5,000 (50 percent) of that amount is included.

If the total normal and surtax on his net income computed by so adding the $5,000 to his salary and other income (including net short-term capital gains) is greater than the tax computed under the alternative tax then the alternative tax is applied. The alternative tax is, in effect, a tax computed on his net income, as if there were no net

long-term capital gain, to which is added 15 percent of the net long-term capital gain. This is accomplished by calculating a tax on his net income reduced by 50 percent of the net long-term capital gain. Since 50 percent of the net long-term capital gain has already been included in net income, it is necessary to reduce the net income by the same amount in order that a tax may be computed without regard to net long-term capital gain. On the net income so reduced (that is, the salary and other income) a tax at normal and surtax rates is calculated. To that tax is added 15 percent of the entire amount of the net long-term capital gain. The sum of the two is the alternative tax

A correlative limitation is imposed by section 117 (c) (2) with respect to the inclusion of net long-term capital losses. The effect of this provision is to deny a tax benefit of more than 15 percent of the net long-term capital loss, as a result of the operation of section 117 (b) which, standing alone, would permit 50 percent of the recognized long-term capital losses to be taken into account in computing a taxpayer's net income.

To illustrate, suppose that a taxpayer other than a corporation derives recognized long-term capital gains for the taxable year of $10,000 and recognized long-term capital losses for such year of $20,000. He therefore has a net long-term capital loss for the year of $10,000. The combined effect of section 117 (b) and section 23 (g) is that the taxpayer is permitted to take into account in computing net income only 50 percent of such loss or $5,000. Under the general rule the taxpayer would compute his net income by including in gross income 50 percent ($5,000) of his long-term capital gains and in his deductions 50 percent ($10,000) of his long-term capital losses and the regular normal and surtax rates would be applied to the net income, if any, resulting from such computation. Under this method 50 percent of the long-term losses would be allowed in full as a deduction from gross income. Since, however, the taxpayer has sustained a net long-term capital loss f[illegible] the taxable year, section 117 (c) (2) of the bill, as reported, requires the tax liability to be computed by the alternative method provided therein, and, if the tax computed under such alternative method is greater than the tax computed under the general rule, the larger amount must be paid.

The computation under the alternative method is made as follows, using the above example. A partial tax is first computed upon the net income, increased by 50 percent of the amount of the net long-term capital loss, at the regular normal and surtax rates (that is, a tax is computed as if there were no net long-term capital loss at all, since in calculating the tax under the general rule, 50 percent of such net loss had been included in computing the net income). From this partial tax is then subtracted 15 percent of the net long-term capital loss. The remainder is the tax under the alternative rule, and is the tax which must be paid if it is in excess of the tax computed under the general rule.

The purpose and effect of the alternative method is simply to limit the reduction of the tax otherwise payable, in any case where a taxpayer sustains a net long-term capital loss, to an amount which does not exceed 15 percent of such net capital loss. It is entirely consistent with the 15-percent maximum rate of tax on net long-term capital gains provided by the bill.

The provisions of the House bill allowing long-term capital losses to the extent of $2,000 plus long-term capital gains has been eliminated. This change, as well as the elimination of the net long-term capital loss carry-over of the House bill, is justified in view of the more liberal treatment generally in deducting from income long-term capital losses in the bill as reported.

PARTICIPANTS IN COMMON TRUST FUNDS AND PARTNERS

Under the bill as reported, the treatment of capital gains and losses of a common trust fund and of a partnership is similar to that in the House bill. Since these entities are not taxable, the participants and partners are considered to have received their proportionate share of the short-term capital gains or losses or long-term capital gains or losses of the fund or partnership. Thus if a partnership sold for $30,000 an asset held over 18 months for which it paid $10,000—the gain is a long-term gain of the partnership of $20,000. If there are two partners each entitled to one-half the partnership profits, since the "long-term gain" as defined in section 117 (a) (4) of the partnership is $20,000, each partner must include in computing his net income his part of the $20,000 or $10,000. Of course, when he includes his share, the taxability of that amount is governed by the rules applicable to the long-term gains of individuals—his long-term capital losses in his nonpartnership capacity may exceed this gain and so he will have a net long-term capital loss. Similarly, only 50 percent of the entire amount he is considered to have received of the net long-term gains of the partnership is the amount he is required by section 117 (b) to include in computing his net income. The same principles apply to common trust funds and participants in them.

Section 117 (b), in other words, applies only after the appropriate allocation of net long-term capital gains and losses of the partnership or common trust fund has been made to the individual partners or participants; it has no application in the computation of such net gains and losses by the partnership or common trust fund.

Section 117 (h) (3). Determination for Period of Which Property is Held

This subsection of the House bill is retained by the committee but with a change made necessary by the provisions of section 371 (c) of the reported bill. This latter section of the bill provides for the nonrecognition of gain to shareholders on the receipt by them of distributions (in obedience to orders of the Securities and Exchange Commission) of stock or securities without the surrender by them of their stock or securities in the distributing corporation. Hence, the principle of the rule provided for in section 117 (h) (3) of the House bill for determining the holding period of stock or securities received in distributions described in section 112 (g) of the 1928 and 1932 Acts (which for present purposes are similar to those described in section 371 (c) of the reported bill) is made applicable to distributions described in such section 371 (c).

Section 120. Unlimited Deduction for Charitable Contributions

This section permits an unlimited deduction of charitable contributions in the case of an individual whose charitable gifts exceeded, for each of the 10 preceding taxable years, 90 percent of the taxpayer's net income. The amendments to the section are necessary on account of the differences between the new bill and existing law. The effect of the changes is to permit the unlimited deduction in years after December 31, 1937, if the gifts in previous years were within the provisions of the prior acts.

Section 141 (d) (3). Street and Suburban Transportation Systems

The reported bill expands the definition of the term "railroad" as used in section 141 (d) defining an affiliated group of corporations entitled to file a consolidated return. There has been included in the term "railroad," a street or suburban trackless trolley system of transportation and a street or suburban bus system of transportation. The definition has been made sufficiently broad to cover a street or suburban system of transportation which is operated by electric railway, trackless trolleys, and busses, or any combination of such methods.

Section 141 (j). Consolidated Income in Receivership Cases

Since under the reported bill, corporations in receivership are subject to the same rate of tax applicable to other corporations, the amendment to this subsection strikes out the provision under which a consolidated group of corporations was given the rate of corporations in receivership only if the parent corporation in the group is in receivership.

Section 142. Fiduciary Returns

Under the House bill a return was required to be filed for a trust having a net income of $50 or more. The amendment requires a return only if the net income of the trust is $100 or more. This is consistent with the amendment to section 163 (a) under which the credit of a trust is increased from $50 to $100.

Section 145 (c). Penalty for a False Return

For a discussion of this subsection of the reported bill, relating to false returns, see section 51 (a).

Section 148 (f). Reports of Compensation of Officers and Employees of Corporations

The committee amendment dispenses with the requirement contained in the House bill that an annual report be made to Congress by the Secretary of the Treasury showing the names and salaries of officers and employees of corporations whose compensation exceeds $75,000. The $75,000 limit is retained but the list is to be made available to the public by the Secretary instead of submitting it to Congress.

SECTION 163 (A). CREDITS OF TRUST

This amendment to this subsection increases the specific credit of a trust from $50 to $100.

SECTION 165. EMPLOYEES' TRUSTS

This section of the House bill, relating to the exemption from tax of employees' trusts, is retained in the bill, except with a change which is deemed advisable in fairness to employers. Under the House bill an employees' trust, for taxable years beginning after December 31, 1938, is not exempt from tax if it is possible at any time for any part of the trust principal or income to be used for, or diverted to, purposes other than the exclusive benefit of employees. However, it is quite possible that after satisfaction of all pension liability under the trust, an additional amount of funds of the trust will remain, due to erroneous actuarial computations during the previous life of the trust. It seems desirable to allow the employer to provide for the return of such an amount in the trust without the trust losing its exempt status under section 165. Of course, under the provisions of section 23 (p), the amount recovered by the employer must be reported by him as income. Accordingly, section 165 of the reported bill provides that an employees' trust will be exempt from tax if at any time before the pension liabilities with respect to employees under the trust have been satisfied, it is impossible for any part of the trust fund, including principal and income, to be used for, or diverted to, purposes other than the exclusive benefit of employees.

SECTION 169. COMMON TRUST FUNDS

The only substantive change made in this section by the reported bill is the inclusion of a definition of the term "bank." This is necessitated by the exclusion from the bill of section 104 of the House bill which contained the same definition. The definition of bank here provided also serves to define "bank" when used in title IA.

SECTION 169 (D) (3) AND SECTION 183 (C). CHARITABLE CONTRIBUTIONS OF COMMON TRUST FUNDS AND PARTNERSHIPS

The bill as reported makes no change in the treatment of charitable contributions of partnerships and common trust funds in the House bill. No deduction for such contributions is allowed to either the partnership or the common trust fund, as such. However, in the case of a partnership each individual partner is allowed to include in his deduction for charitable contributions his proportionate share of the contributions of the partnership, payment of which is made by the partnership within its taxable year. No similar privilege is extended to the participants in a common trust fund for the reason that such a fund, by virtue of its inherent nature, could not properly make charitable contributions from the assets or income of the trust.

SECTIONS 201-207. SUPPLEMENT G—INSURANCE COMPANIES

The changes made in the provisions relating to insurance companies are entirely clerical in nature. "Special class net income" defined in the House bill has been eliminated from the reported bill. The various types of insurance companies taxed under supplement G are taxed at the rate of 18 percent upon their normal-tax net income.

These companies have the advantage of the reduction in tax under section 13 on account of normal-tax net income of less than $25,000. Except for special provisions relating to the computation of their net income provided in this supplement, the various provisions of title I such as the limitation on the credit for dividends received applies.

SECTION 231. TAX ON FOREIGN CORPORATIONS

Under section 14 (e) of the House bill, foreign corporations doing business in the United States or having an office or place of business therein are taxed at the rate of 20 percent of their "special class net income" irrespective of amount. Inasmuch as section 14 has been eliminated from the reported bill, section 231 of the reported bill provides that such foreign corporations shall be taxed on their normal-tax net income from United States sources at the rate of 18 percent (subject to the 10 percent reduction) under section 13. Other changes in this section are merely clerical.

SECTION 251 (c) (HOUSE BILL). TAX ON CORPORATIONS DERIVING INCOME FROM SOURCES WITHIN POSSESSIONS OF THE UNITED STATES

Under section 14 (d) of the House bill, corporations, deriving a large portion of their gross income from sources within a possession of the United States, are taxed at the rate of 16 percent of their "special class net income," irrespective of amount. Inasmuch as section 14 has been eliminated entirely from the reported bill, section 251 (c) of the House bill which imposes the 16 percent tax is likewise eliminated from the reported bill. Accordingly, domestic corporations entitled to the benefits of section 251 are taxed in accordance with the provisions of section 13.

SUPPLEMENT K—CHINA TRADE ACT CORPORATIONS

In view of the elimination of section 14 of the House bill from the reported bill all references in supplement K, relating to taxation of China Trade Act Corporations, to that section are omitted. Such corporations are, under the reported bill, taxable in accordance with the provisions of section 13.

SECTION 272 (J). EXTENSION OF TIME FOR PAYMENT OF DEFICIENCIES

This section of the reported bill provides that extensions of time for payment of deficiencies need not in every case be approved, as under existing law, by the Secretary of the Treasury in order to be binding on the parties. Such extensions, however, must be approved by the Commissioner of Internal Revenue under regulations prescribed by him with the approval of the Secretary. Such regulations may require, in some cases, the express approval of the Secretary. For reasons supporting this change, see discussion under section 56 (c) (2).

SECTION 273. ABATEMENT OF JEOPARDY ASSESSMENTS

Under the Revenue Act of 1926 and subsequent revenue acts the Commissioner has no authority to abate jeopardy assessments in whole or in part, once they are made. The committee believes that it is desirable to empower the Commissioner to reduce or abate entirely jeopardy assessments in certain circumstances. The reported bill therefore contains a new sentence in section 273 (c) providing that at any time before a decision is rendered by the Board of Tax Appeals a jeopardy assessment, or any unpaid portion thereof, may be abated by the Commissioner to the extent that he believes the assessment to be excessive in amount. It should be noted that this authority to abate can be exercised only if the Commissioner finds that the amount of the assessment is too great and not where it appears that jeopardy does not actually exist. In order to avoid any possibility of the action of the Commissioner conflicting with the jurisdiction of the Board of Tax Appeals or appellate courts, the authority is limited to the period ending with the date the decision of the Board is rendered. If no petition is filed with the Board, the Commissioner may abate the excessive amount at any time before payment of the assessment. A change is also made in subsection (c) to require the Commissioner to notify the Board of the amount of any such abatement of a jeopardy assessment if a proceeding involving the assessment is pending before the Board, so that the Board may make appropriate adjustments.

A change is made in section 273 (f) to provide that if a jeopardy assessment is abated in whole or in part by the Commissioner under the authority given in section 273 (c), the amount of a bond given to stay collection shall be proportionately reduced at the request of the taxpayer.

Changes similar to those described above are made in section 818 of the reported bill with respect to prior revenue acts.

SECTION 275 (E). DISTRIBUTIONS IN LIQUIDATION TO SHAREHOLDERS

This new subsection is added because of the change made by the reported bill in section 115 (c) extending the period from 2 years to 3 years, within which complete liquidation of corporations, other than foreign personal holding companies, must be made in order to obtain the benefits of the capital-gains rate. This new provision permits assessment of a tax on the shareholder on account of items omitted from gross income, which should have been included under section 115 (c), at any time within 4 years after the return was filed.

This new subsection in no way supersedes or affects section 275 (d) which provides for a 7-year statute of limitations on assessments in the case of shareholders of a foreign personal holding company.

SUPPLEMENT P—FOREIGN PERSONAL HOLDING COMPANIES

SECTION 336 (A) (2). DEDUCTIONS IN DETERMINING SUPPLEMENT P NET INCOME

The change made in this subsection, relating to the amount deductible for charitable and other contributions or gifts in kind, has been discussed in connection with sections 23 (o) and 23 (q) of the reported bill.

Section 331. Definition of Companies

The reported bill, like the House bill, eliminates the reference to title IA in the first sentence of section 331 (a) for the reason that the retention of such reference is unnecessary, since all the definitions for the purposes of title I are equally applicable for the purposes of title IA.

SUPPLEMENT Q (HOUSE BILL)—MUTUAL INVESTMENT COMPANIES

Sections 361 and 362 (House Bill). Mutual Investment Companies

Section 361 of the House bill retains the definition of mutual investment companies found in the existing law, except that such companies, under the House bill, are limited to domestic corporations. Section 362 of the House bill provides that mutual investment companies are taxed at the rate of 16 percent of their "Supplement Q net income." In the reported bill these sections have been eliminated and no special treatment is given mutual investment companies. They are taxed under section 13 in the same manner as corporations generally.

SUPPLEMENT Q—CORPORATION CREDITS ON ACCOUNT OF DIVIDENDS PAID

Section 361. Corporation Dividends Paid Credit

For the reasons stated with respect to sections 26 and 27, a portion of the provisions in those sections of the House bill have been placed without substantial change in section 361 of the reported bill. These provisions which relate primarily to the dividends paid credit and the basic surtax credit will be applicable only to the surtaxes imposed by section 102 and title IA since these are the only taxes in the reported bill based on undistributed profits and for the purposes of supplement P relating to foreign personal holding companies.

In section 361 (c) (House bill sec. 26 (d)) relating to the bank affiliate credit additional language has been inserted in the provision limiting the aggregate of the credits allowable under the subsection to the amounts required under section 5144 of the Revised Statutes. This additional language is merely for clarification to make it clear that in determining the aggregate of the credits allowable only credits for years beginning after December 31, 1935, shall be considered since no credit was permitted for taxable years beginning prior to that date and since the credits for taxable years beginning after that date and prior to January 1, 1938, should be included for the purpose of determining when the aggregate amount of allowable credits is exhausted.

Section 362. Dividends Included in Basic Surtax Credit

In this section appear, without substantial change, the provisions which were in subsections (d) to (i) of section 27 of the House bill.

Additional language has been inserted in subsection 362 (b) for purposes of clarification. This subsection provides that where a corporation redeems its obligations which were previously used to pay

dividends, the difference between the amount for which redeemed and the fair market value at the time of the dividend payment shall be treated as a dividend paid in the taxable year in which the redemption occurs. The additional language inserted is intended to make it clear that this rule does not apply if the obligation redeemed was originally used for payment of a dividend paid in a taxable year of the corporation commencing before January 1, 1936. This is the correct rule since the undistributed profits tax imposed by the Revenue Act of 1936 was not applicable in such a year.

Section 363. Consent Dividends Credit

This section appeared as section 28 of the House bill. With two exceptions, no change has been made in the provision which appeared in the House bill.

In section 363 (b) (1) language has been added to make it clear that for the credit to be available all preferred dividends must have been paid even though they were payable in taxable years beginning prior to January 1, 1938.

Section 28 (d) of the House bill provided that if under section 143 (b) or 144 the corporation would have been required to deduct and withhold a tax if a real dividend had been paid, the consent filed by the corporation must be accompanied by cash, a money order, or a certified check for the amount of such tax. Since such remittances would often come from foreign sources, it was believed undesirable to permit payment in money orders or certified checks. This provision (sec. 363 (d)) has therefore been revised to require payment in cash or its equivalent. Under this provision, the Commissioner may, under his general authority to prescribe regulations, prescribe the media of payment other than cash which will be permitted.

SUPPLEMENT R—EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

As provided in section 112 (b) (7) of the bill, section 371 of this supplement specifies the extent to which gain or loss will not be recognized in cases where property is disposed of upon an exchange, or received upon a distribution, made in obedience to an order of the Securities and Exchange Commission. These provisions create new exceptions to the general rule of section 112 (a) that the entire amount of the gain or loss from the disposition of property shall be recognized. These exceptions are restricted by their own terms to the gain or loss directly attributable to the disposition as such of property in one of the exchanges specifically described, or directly attributable to the receipt as such of property in a distribution specifically described. These new exceptions should be strictly construed as in the case of the exceptions in existing law. Unless the requirements of section 371 are clearly met, gain or loss will be recognized upon the exchange or distribution. Moreover, even though a taxable transaction occurs in connection or simultaneously with a realization in an exchange or distribution to which nonrecognition is accorded under such section, nevertheless, as under the provisions of existing law, nonrecognition will not be accorded to such taxable transaction.

It is contemplated that the application of the provisions of this supplement will result only in postponing the recognition of gain or loss until a disposition of property is made which is not covered by such provisions. The continuation of the basis as provided in section 372 is designed to effect this result. Although the time of recognition may be shifted, there must be a true reflection of income in all cases, and it is intended that the provisions of this supplement shall not be construed or applied in such a way that this purpose will be defeated. It is further contemplated that in the discharge of its functions under section 11 of the Public Utility Holding Company Act of 1935, and in making its orders to effectuate the provisions of such section, the Securities and Exchange Commission will scrutinize carefully all plans submitted to it in order to prevent abuses of the provisions of this supplement, and to that end will cooperate fully with the Treasury Department. Furthermore, the general principles of law with respect to tax avoidance and evasion, including the doctrine enunciated by the Supreme Court in *Gregory* v. *Helvering* (1935) 293 U. S. 465, will be applicable to any transaction arising in the form of a simplification or integration of a holding-company system, notwithstanding any order pertaining to the transaction which may be entered by the Securities and Exchange Commission.

SECTION 371. NONRECOGNITION OF GAIN OR LOSS

Section 371 (a) prescribes the prerequisites for the nonrecognition of gain or loss resulting from the disposition by a holder of stock or securities in a registered holding company or a majority-owned subsidiary company, where the holder disposes of such stock or securities in exchange for stock or securities. In order that there be no recognition of gain or loss to such holder upon such disposition, it is essential that (1) the exchange be made with the company which issued the stock or securities disposed of, or with a registered holding company or a majority-owned subsidiary company which is in the same holding-company system with the issuing company; (2) none of the stock or securities received by such holder be nonexempt property as defined in section 373 (e); and (3) the exchange be made with a transferee corporation which is acting in obedience to an order of the Securities and Exchange Commission directed to such corporation.

Section 371 (b) provides for nonrecognition of gain or loss to a corporation which is a registered holding company or an associate company of a registered holding company, if such corporation (1) disposes of property by transferring it in exchange solely for property (other than nonexempt property as defined in sec. 373 (e)); (2) is acting in obedience to an order of the Securities and Exchange Commission; and (3) such order recites that the exchange is necessary or appropriate to the simplification or integration of the holding-company system of which such corporation is a member.

Example.—Registered holding company A is a member of holding-company system No. 1 which comprises an integrated utility system in region X, except for the fact that company A owns all of the voting stock of company B with transmission lines in region Y. Registered holding company C is a member of holding-company system No. 2 which comprises an integrated utility system in region Y, except for the fact that company C owns all of the voting stock of operating

company D with a generating plant and transmission lines in region X. In obedience to an appropriate order of the Securities and Exchange Commission relative to the integration of holding-company system No. 1, the company B transfers its transmission lines in region Y to operating company D in exchange for the generating plant and transmission lines of company D in region X. Under section 371 (b), no gain or loss is recognized to company B upon the disposition of its transmission lines in region Y. However, the provisions of section 371 (b) do not apply to the disposition by company D of its generating plant and transmission lines in region X unless such disposition is made in obedience to an appropriate order of the Securities and Exchange Commission which relates to such disposition and recites that it is necessary or appropriate to the integration of holding-company system No. 2.

Section 371 (c) provides for the nonrecognition of gain to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company, if such corporation, acting in obedience to an order of the Securities and Exchange Commission, distributes to such shareholder stock or securities other than those which are nonexempt property as defined in section 373 (e). The gain not recognized in any such case is only that from the distribution as such. However, the provisions of this subsection will apply only in cases where such distributions are made without the surrender by the shareholder of stock or securities. Distributions involving such a surrender are governed by the provisions relating to exchanges.

Section 371 (d) (1) provides for nonrecognition of gain or loss to a corporation which is a member of a system group, as defined in section 373 (d), if such corporation disposes of property by transferring it to another corporation which is a member of the same system group in exchange for other property (including money). It should be noted, however, that no distinction is made under this paragraph between money and other property, and in this respect the treatment is to be the same as under section 112 (b) (6). This paragraph also provides for nonrecognition of gain to a corporation which is a member of a system group if property or money is distributed to such corporation as a shareholder in a corporation which is a member of the same system group, without the surrender by such shareholder of stock or securities in the distributing corporation. In respect of these exchanges and distributions, section 371 (d) and the basis provisions of section 372 (d) are designed to effect the result now attained with respect to intercompany transfers between affiliated corporations which are allowed to file consolidated returns. It is not contemplated that there shall be nonrecognition of any realization which occurs at the time of the described transfer and which must be accounted for as of that time in order to properly reflect income.

An exchange or distribution will be within the provisions of this paragraph only if all the corporations which are parties to such exchange or distribution are acting in obedience to an order of the Securities and Exchange Commission. The provisions of this paragraph only shall apply, even though the exchange or distribution may also be considered to be within some other provision of this section.

Under section 371 (d) (2), if a corporation which is a member of a system group transfers property to another corporation which is a member of the same system group and receives in exchange stock or

securities issued by such other corporation, such stock or securities, to the extent that they are preferred as to both dividends and assets, may be sold to any party outside the system, without the recognition of gain or loss, if (1) the proceeds thereof are applied in retirement or cancelation of stock or securities of the corporation making the sale which were outstanding at the time the corporation received the stock or securities sold by it, and (2) both the sale of the stock or securities and the application of the proceeds thereof are made in obedience to an order of the Securities and Exchange Commission. If any part of such proceeds is not applied as required, any gain realized is recognized to the extent of the proceeds not so applied. In any event, if the proceeds from the stock or securities sold exceed the fair market value of such stock or securities when received, any gain realized is recognized to the extent of such excess.

Example.—Suppose that companies A and B are members of the same system group. In obedience to an appropriate order of the Securities and Exchange Commission applicable to each of the companies, company A transfers all of its assets to company B in exchange for common stock, preferred stock, and bonds in company B. At the time of the exchange, company A has X preferred stock outstanding. In obedience to an order of the Securities and Exchange Commission, company A sells to the public the preferred stock and bonds in company B, and applies the entire proceeds in retirement and cancelation of its own outstanding X preferred stock. The proceeds derived from the sale of the preferred stock and bonds in company B do not exceed the fair market value of such stock and securities at the time they were received by company A. Under section 371 (d) (2), no gain or loss is recognized to company A upon this sale.

Section 371 (e) corresponds to the provisions of section 112 (c) and (e) of existing law, and (1) provides the rule with respect to cases in which other property is received in addition to the property permitted by subsection (a) or (b) of section 371 to be received without the recognition of gain, and (2) provides that an amount distributed by a corporation in this type of transaction which has the effect of a taxable dividend shall be taxable as a dividend.

Section 371 (f) provides that in order that gain or loss be not recognized upon these exchanges and distributions (1) the order of the Commission shall recite that the exchange or distribution is necessary or appropriate to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935, (2) the order shall specify and itemize the stock and securities and other property and money which are ordered to be transferred and received upon the exchange or distribution, and (3) the exchange or distribution shall be made in obedience to the order and shall be completed within the time prescribed in the order. Although these latter requirements will simplify the administration of the provisions of section 371, they are not to be considered as pertaining only to administrative matters. Each requirement of section 371 (f) must be met if gain or loss is not to be recognized upon the transaction.

Section 371 (g) provides that an exchange or distribution which is within section 371 shall be governed only by such section, in order to prevent overlapping of the provisions of such section and the provisions of existing law, and to facilitate the determination of the pertinent provisions with respect to basis. If the exchange or distribution

is within the nonrecognition provisions of existing law and if the section does not provide for any nonrecognition of gain or loss to a particular party, it is contemplated that nonrecognition of gain or loss to such party shall be accorded to the extent provided by existing law.

Section 115 (c) provides that a distribution in liquidation of a corporation shall be treated as an exchange and hence such a distribution is to be so treated under the provisions of this supplement.

The provisions of section 371 do not extend in any case to gain or loss other than that realized from a disposition of property as such or from the receipt of a corporate distribution as such. None of such provisions extends nonrecognition to gains realized from the discharge, or the removal of the burden, of the taxpayer's pecuniary obligations, even though such obligations are acquired upon a transfer or distribution specifically described in section 371; but the fact that the acquisition of such obligations was upon a transfer or distribution specifically described in section 371 may, because of the basis provisions of section 372, affect the cost to the taxpayer of such discharge or its equivalent. In such cases, as the obligations have become extinct, nonrecognition cannot be accorded, since no postponement is possible and the gain must then, if ever, be recognized.

SECTION 372. BASIS FOR DETERMINING GAIN OR LOSS

Section 372 expands section 113 (a) of existing law in order to make adequate provision with respect to the basis of property acquired in a transfer made in obedience to an order of the Securities and Exchange Commission in connection with which the recognition of gain or loss is prohibited by the provisions of section 112 (b) (7) and section 371 with respect to the whole or any part of the property received. In general, it is intended that the basis for determining gain or loss pertaining to the property prior to its transfer, as well as the basis for determining the amount of depreciation or depletion deductible and the amount of earnings or profits available for distribution, shall continue notwithstanding the nontaxable conversion of the asset in form or its change in ownership. The continuance of the basis may be reflected in a shift thereof from one asset to another in the hands of the same owner, or in its transfer with the property from one owner into the hands of another.

Section 372 (a) prescribes the basis of property acquired upon exchanges described in subsection (a), (b), or (e) of section 371; that is, exchanges of stock or securities solely for exempt stock or securities (subsection (a)), exchanges of property solely for exempt property (subsection (b)), and exchanges of a character similar to those described in (a) and (b) except for the fact that there was received, in addition to the property specified in those subsections, certain nonexempt property (including money) (subsection (e)). The parties to the exchange who were wholly exempt from the recognition of gain or loss are required to carry as their basis for the newly acquired property a figure equal to the basis (adjusted to the date of the exchange) at which they had theretofore carried the property transferred upon the exchange. In order to comply with this rule, it may become necessary, of course, for the taxpayer to effect, under rules and regulations prescribed by the Commissioner, a proper apportionment of this substituted basis over the several items of property received upon the exchange.

If some portion of the gain realized in the exchange is recognized by reason of the receipt of nonexempt property (including money) as a part of the consideration for the transfer, a proper adjustment must be made with respect to the substituted basis. Section 372 (a) also provides that the basis of the newly acquired property shall be the same as that of the property transferred, reduced in the amount of any money received and increased in the amount of any gain recognized in the transaction. It is further provided that the substituted basis so adjusted shall be apportioned among the several items of property received other than money, allocating to the nonexempt property (other than money) from the receipt of which gain is recognized an amount equal to the fair market value thereof as of the date of the exchange. This treatment corresponds to that provided in section 113 (a) (6) of existing law with respect to exchanges generally.

The provisions of section 372 (a) do not apply in the case of a corporation acquiring property in an exchange in which the consideration for the transfer consisted, in whole or in part, of stock or securities issued by such corporation.

Section 372 (b) provides that in the case of property acquired by a corporation as paid-in surplus or as a contribution to capital, or in exchange for stock or securities issued by it, including those cases in which a part of the consideration for the acquisition consisted of property or money in addition to such stock or securities, the basis of the property acquired will be the basis of the property transferred with adjustment to the date of the exchange and adjustment for the amount of any gain to the transferor recognized in the exchange. This treatment corresponds to that provided by section 113 (a) (8) of existing law.

Section 372 (c) prescribes the basis of stock or securities acquired in a distribution, the gain from which is not recognized under section 371 (c). The taxpayer's basis of the stock with respect to which the distribution is made shall be properly apportioned, under rules and regulations prescribed by the Commissioner, between the newly acquired property and the stock with respect to which such newly acquired property was distributed. This treatment corresponds to that provided by section 113 (a) (9) of the Revenue Act of 1932 with respect to distributions pursuant to a plan of reorganization.

Section 372 (d) prescribes the basis of property acquired in certain transactions between corporations both of which are members of the same system group as defined in section 373 (d). It is intended in general to apply in these cases the basis rule to which the Treasury Department has adhered in connection with intercompany transactions subject to the consolidated-return provisions of the existing law. In such cases, the basis for determining gain or loss, depreciation, and depletion, as well as the basis for determining the earnings or profits of the corporation available for distribution insofar as that question will depend upon a particular asset, shall be the same in the hands of the transferee as it was in the hands of the transferor. This rule will apply equally to cases involving tangible property, stock or securities, money, and other property, or any of them. It is contemplated that an ultimate true reflection of income will be obtained in all cases by a proper application of such bases in connection with a proper application of section 371 (d), notwithstanding any peculiarities in form which the various transactions may assume. For example, suppose that

corporations A and B are both members of the same system group; that A holds at a cost of $900 a bond issued by B at par, $1,000; and that A and B enter into an exchange subject to the provisions of section 371 (d) (1) in which the $1,000 bond of B is transferred from A to B. The $900 basis reflecting the cost to A which would have been the basis available to B if the property transferred had been something other than the bond of B will, in this type of transaction, reflect the cost to B of effecting a retirement of its $1,000 bond. The $100 gain reflected in the retirement will be recognized in accordance with the principle announced by the Supreme Court in *United States* v. *Kirby Lumber Co.* (1931) 284 U. S. 1.

An exception to the general basis rule prescribed by section 372 (d) is made with respect to those cases in which the consideration for the transfer is represented, in whole or in part, by stock or securities issued by the transferee. In cases in which the consideration for the transfer consists wholly of such stock or securities, the stock or securities would be carried by the recipient at a basis the same as the adjusted basis of the property transferred, or the fair market value of such stock or securities at the time of their receipt, whichever is the lower. In cases in which a portion of the consideration consists of other property or money, such other property or money would be carried by the recipient at its transferred basis, but the stock or securities issued in the transaction would be carried at a basis bearing the same ratio to the adjusted basis of the property transferred as the fair market value of such stock or securities at the time of their receipt bears to the total fair market value of the entire consideration, or the fair market value of such stock or securities at the time of their receipt, whichever is the lower.

To illustrate: Suppose corporation A which has property with an adjusted basis of $600,000 transfers such property to corporation B in exchange for cash in the amount of $100,000, tangible property worth $400,000 which has an adjusted basis in the hands of B of $300,000, and stock or securities issued by B having a par value and a fair market value as of the date of their receipt in the amount of $500,-000. B would take the assets onto its books at the $600,000 basis available to A. The receipts of A would be taken onto its books as follows: Cash, at par $100,000; tangible property, at the basis of B, the former owner $300,000; stock or securities issued by B, at an amount equal to 500,000/1,000,000ths of $600,000, or $300,000.

Suppose that the property of A transferred to B had an adjusted basis of $1,100,000 instead of $600,000, and that all other factors in the illustration remain the same. The amount established as 500,000/1,000,000ths of $1,100,000, or $550,000 should be rejected as the basis of the stock or securities of B in the hands of A in favor of $500,000 which was the fair market value of such stock or securities at the time of their receipt by A.

Section 373. Definitions

For the purposes of supplement R, an order of the Securities and Exchange Commission is defined by section 373 (a) to be an order (whether mandatory or permissive) made to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935, and hence must be one requiring or approving action which the Commission finds to be necessary or appropriate to effect a simplification or geographical integration of a particular public utility

holding-company system. A further requirement is that such an order must have been issued after the date of the enactment of the revenue bill of 1938 and prior to January 1, 1940, except in the case of amendatory or supplemental orders, which may be issued at any time after the date of the enactment of this bill provided they merely implement a general order issued prior to January 1, 1940 (including general orders issued prior to the date of the enactment of this bill). A corporation will not be considered to have acted "in obedience to" such an order of the Securities and Exchange Commission unless such order either requires the corporation to take such action or permits or approves the taking of such action by the corporation. In all cases the order must have become final in accordance with law; i. e., it must be valid, outstanding, and not subject to further appeal.

Section 373 (b) provides that the terms "registered holding company," "holding-company system," and "associate company" shall have the meanings assigned to them by section 2 of the Public Utility Holding Company Act of 1935. A registered holding company, by the terms of that act, is any holding company which has registered with the Securities and Exchange Commission. Insofar as material for the purposes of supplement R, a holding company, unless declared not to be such by the Commission, is any corporation which (1) owns or controls 10 percent of the voting securities of any public utility company as defined by that act, or of any other holding company, or (2) which, after hearing, the Commission determines is exercising a controlling influence over any public utility company or any other holding company so great as to make regulation essential in the public interest. A holding-company system is, in turn, any holding company, together with all its subsidiary companies, i. e., all public utility companies 10 percent of whose voting securities is owned directly or indirectly by such holding company, and all mutual service companies of which the holding company or any of its subsidiaries is a member. Two companies are associate companies of each other if they are members of the same holding-company system.

The term "majority-owned subsidiary company" is specially defined in section 373 to mean a subsidiary, the stock of which, representing more than 50 percent of the total combined voting power of all classes of stock (except stock entitled to vote only in special circumstances), is owned by a registered holding company either directly or through other majority-owned subsidiaries.

To describe the special group which is the subject of the provisions of section 371 (d) the term "system group" has been devised. In section 373 (d) this term is defined to mean one or more chains of registered holding companies or majority-owned subsidiaries connected through stock ownership with a common parent corporation, if 90 percent of each class of stock (other than stock preferred as to both dividends and assets) of each corporation is owned directly by one or more of the other corporations and the common parent owns at least 90 percent of each class of such stock of at least one of such corporations. It is to be observed that while the type of stock which must be 90 percent owned for this purpose may be different from the type of stock which must be 50 percent owned for the purpose of the definition of a majority-owned subsidiary, both ownership tests must be met, since a corporation, in order to be a member of a system group, must also be a registered holding company or a majority-owned subsidiary.

Except in the case of section 371 (d) only certain types of property may be received upon an exchange or distribution without the recognition of the gain resulting from such exchange or distribution. In section 371 (a) and (c) the permitted type of property is stock or securities other than stock or securities which are nonexempt property; in section 371 (b), the permitted type is "property (other than nonexempt property)." In section 371 (e) the permitted type of property is determined by reference to section 371 (a) and (b). Included in the type of property which is treated as "nonexempt property" is (1) cash or its equivalent and (2) securities acquired solely for the purpose of converting assets into a tax-free form. More specifically, the term "nonexempt property" is defined to include—

(1) The amount of any debts or other liabilities canceled or assumed as part or all of the consideration for a transfer of property and, similarly, the amount of any encumbrance subject to which property is transferred. For example, if the X corporation transfers property to the Y corporation in exchange for property with a fair market value of $6 and the cancelation by the Y corporation of indebtedness to the extent of $4 owed by the X corporation to the Y corporation, the X corporation will be considered to have received nonexempt property to the extent of $4. Similarly, if, instead of canceling indebtedness owed to it by the X corporation, the Y corporation assumes the indebtedness of the X corporation to A in the amount of $4, the X corporation will be considered to have received nonexempt property to the extent of $4. The same result would also follow if the Y corporation had, in lieu of a cancelation or assumption of indebtedness, merely taken the property conveyed to it by the X corporation subject to a mortgage of $4.

(2) Short-term obligations, such as notes, drafts, bills of exchange, bankers' acceptances, etc., having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace.

(3) Securities issued or guaranteed by a government or a subdivision or instrumentality thereof.

(4) Stock or securities not otherwise defined as nonexempt property if such stock or securities were acquired after February 28, 1938, other than in obedience to an order of the Securities and Exchange Commission.

(5) Money, and the right to receive money not evidenced by a security. While a security is not nonexempt property by virtue of this provision, it may still be nonexempt property by virtue of other parts of the definition of nonexempt property. The term "the right to receive money" is intended to be construed in its broadest sense and not to be limited by considerations of the time when suit may be brought, of whether the money is receivable immediately, of whether the amounts are liquidated, etc. Accounts receivable, damage claims, rights to tax refunds, and the like are rights to receive money within the meaning of this provision.

In order to facilitate exchanges or distributions in furtherance of the policies of section 11 (b) of the Public Utility Holding Company Act of 1935, the term "stock or securities" is given a broader meaning in section 373 (f) than it possesses in connection with the reorganization provisions of section 112. It is defined to mean stock or other certificates of interest in a corporation on the one hand, and notes, bonds, debentures, and other evidences of indebtedness, whether of a corporation or an individual, on the other. Since voting-

trust certificates, stock rights or warrants, etc., are merely evidences of the ownership of or the right to acquire more direct interests, such instruments are also included.

TITLE IA—PERSONAL HOLDING COMPANIES

SECTION 402 (c). CORPORATIONS MAKING CONSOLIDATED RETURNS

This amendment inserts a new provision in the personal holding company title relating to the taxability of corporations making consolidated returns. It provides that if such a corporation (mainly parent railroad corporations) satisfies the stock-ownership test of a personal holding company and the income of affiliated corporations satisfies the gross income test, then the corporation is a personal holding company. This provision prevents classification as a personal holding company of a company or group of companies, which, while deriving large revenue from dividends and interest from members of the group, is really deriving the group income from railroad operations.

SECTION 406 (A) (2). CHARITABLE DEDUCTIONS OF PERSONAL HOLDING COMPANIES

The provision of the House bill limiting the deduction of personal holding companies for charitable contributions in kind to the adjusted basis or the fair market value (whichever is lower) of the property has been eliminated in the reported bill. This change is made to conform with the similar change made in sections 23 (o) and (q). (See discussion under those sections.)

SECTION 407. DEFICIENCY DIVIDENDS

Section 407 affords to taxpayers subject to the tax imposed by title IA a new credit against tax based upon dividend distributions made subsequent to the final determination of a deficiency under that title.

Under prior revenue acts, a personal holding company has no opportunity, by virtue of dividend distributions, of avoiding the title IA tax on the portion of its undistributed net income reflected in the increase thereof upon which a deficiency in tax is based. Such increase may be due to the inclusion by the Commissioner in gross income of amounts omitted in the corporation's return or to the disallowance of deductions, credits, or exemptions claimed in the return. By virtue of this section, the corporation is afforded a 60-day period following a final determination of a title IA tax deficiency within which to effect dividend distributions which would serve as a basis for a credit against the established deficiency.

A deficiency in tax under title IA may be finally established either by a decision of the Board of Tax Appeals which has become final; by a closing agreement between the Commissioner and the corporation; or by a final judgment in court in a suit to which the United States is a party either as plaintiff or defendant. As of the date on which such deficiency is so established, the whole of the deficiency may be unpaid; or it may have been previously paid in whole or in part. With respect to the unpaid portion of the deficiency so finally established, a credit is allowed based upon the amount of the dividends

distributed within the 60-day period. With respect to the portion of the deficiency paid prior to the date on which the correct amount was so established, a credit or refund is allowed pursuant to the general provisions of section 322 but without regard to the limitations as to the filing of claims or the amount refundable as provided in subsections (b) and (c) thereof. The credit, or the credit or refund, as the case may be, is an amount equal to 65 percent of the dividends distributed not in excess of $2,000 and 75 percent of the balance of the dividends made subject to the provisions of this section.

The revenue of the Government with respect to the earnings and profits of the corporation accumulated in the taxable year for which the deficiency is finally established and distributed subject to the provisions of this section, will be reflected in the taxes payable by the shareholders of the corporation for the year of distribution, and not for the year of the accumulation. The delayed distribution accordingly will result in a revenue lag. With a view to overcoming in some degree the consequences of this lag, and, further, with a view to discouraging any abuse of the privilege afforded by this section, the benefit thereof is not extended to the saftisfaction of any interest, additional amounts, or additions to the tax provided by law with respect to the deficiency. Such amounts will remain payable as if this section had not been enacted. The benefit of this section is also denied with respect to any deficiency attributable, in whole or in part, to fraud with intent to evade the tax or to a failure to file a timely return without reasonable cause for such failure.

As a condition to the right of a corporation to seek the benefit of the provisions of this section, the corporation, in conformity with such regulations as the Commissioner may prescribe with the approval of the Secretary, is required to notify the Commissioner within the first 30 days of such 60-day period of its intentions in this respect, specifying to the Commissioner the amount of the credit intended to be claimed. The corporation, within such 60-day period and subsequent to the making of its dividend distributions, is also required to file with the Commissioner, in such form as the Commissioner may by regulations prescribe, a claim for credit under subsection (a) or for credit or refund under subsection (b) of this section, as the case may be, supported by an appropriate showing with respect to the distributions on which it is based.

Except in cases in which the collection of the tax may be jeopardized thereby, the collection of any title IA deficiency is stayed for a period of 30 days subsequent to the final determination of the amount thereof. If the corporation should, within such 30-day period, file with the Commissioner the prescribed notification of intention to seek the benefit of this section, the collection of the established deficiency, to the extent of the amount of the credit specified by the corporation in such notification, is stayed for the prescribed 60-day period. The filing of a claim for credit will effect a further stay of collection of that portion of the established deficiency covered by the claim until such time as the claim is approved or rejected by the Commissioner. The Commissioner, notwithstanding the provisions of section 272 (b), may refrain from assessing the title IA deficiency (plus interest, additional amounts, and additions to the tax) until the claim for the deficiency dividends credit is disposed of. After such claim is allowed or rejected, either in whole or in part, the entire amount of the defi-

ciency (plus interest, additional amounts, and additions to the tax) is to be assessed, if not already assessed. The amount of the claim for the deficiency dividends credit to the extent allowed is to be credited against the amount so assessed, and the remainder of the amount assessed is to be collected in the usual manner.

The dividend distribution contemplated for the purposes of this section is such as will meet all statutory requirements material to its inclusion within the corporation's basic surtax credit for the purposes of the provisions of title I for the year in which the distributions are made. No duplication of credit allowances with respect to any such dividend distributions is permitted. If a corporation claims the benefit of the provisions of this section based upon any dividends distributed, that distribution does not become a part of the basic surtax credit under title IA for the year of distribution; nor is it made the basis of the 2½-month carry-back credit provided for in section 405 (c). Moreover, the dividend must be nonpreferential in order for the credit to be allowed.

In order to afford the Commissioner an adequate opportunity to give proper consideration to the claim of the corporation to the credit and to the showing upon which such claim is based, and to the character of the distributions as they will appear in his examination of the corporation's records for the year of the distribution, it is provided that the filing by the corporation of its notification of intent to seek the benefit of this section shall operate to suspend for a period of 2 years the running of the statute of limitations upon the assessment and collection of the established deficiency and all interest, additional amounts, and additions to the tax provided by law.

TITLE II—ESTATE AND GIFT TAXES

Section 501 (House Bill). Estate Tax Rates

This section of the House bill amends section 301 (a) of the Revenue Act of 1926 to provide for a single schedule of estate-tax rates, applicable to estates of decedents dying after December 31, 1939, in substitution for the existing schedules of estate-tax rates under the Revenue Acts of 1926 and 1932. This section is omitted from the reported bill.

Section 502 (House Bill). Credit of Local Death Taxes on Estate Tax

This section of the House bill amends section 301 (c) of the Revenue Act of 1926, as amended, to provide for a credit of 16⅔ percent for local death taxes against the estate tax computed under the rates provided in section 501 of the House bill, in the case of estates of decedents dying after December 31, 1939. This section is omitted from the reported bill.

Section 503 (House Bill). Priority of Credit for Local Death Taxes

This section of the House bill also amends section 301 (c) of the Revenue Act of 1926, as amended, to provide that, as to estates of decedents dying after the date of the enactment of the bill, the credit

for local death taxes paid shall be deducted before deducting the credit for gift tax paid. This section is omitted from the reported bill.

SECTION 504 (HOUSE BILL). CREDIT OF GIFT TAX ON ESTATE TAX

This section of the House bill, amending section 301 (b) of the Revenue Act of 1926, as amended, to conform with the amendment made by section 503 of the House bill, is omitted in the reported bill.

SECTION 505 (HOUSE BILL). CREDIT OF GIFT TAX ON ADDITIONAL ESTATE TAX

This section of the House bill, amending section 402 (b) of the Revenue Act of 1932 to conform with the amendment made by section 504 of the House bill, is omitted in the reported bill.

SECTION 506 (HOUSE BILL). ESTATE TAX SPECIFIC EXEMPTION

This section of the House bill amends section 303 (a) (4) of the Revenue Act of 1926 to provide that, as to estates of decedents dying after December 31, 1939, the present specific exemption of $100,000 shall be reduced to $40,000 less the aggregate of the amounts claimed and allowed as gift tax specific exemption. This section is omitted from the reported bill.

SECTION 507 (HOUSE BILL). ADDITIONAL ESTATE TAX SPECIFIC EXEMPTION

This section of the House bill amends section 401 (c) of the Revenue Act of 1932, as amended, to provide that, as to estates of decedents dying after the date of the enactment of the bill, the specific exemption of $40,000 for purposes of the additional estate tax shall be reduced by the aggregate of the amounts claimed and allowed as gift tax specific exemption. This section is omitted from the reported bill.

SECTION 508 (HOUSE BILL). ESTATE TAX RETURNS

SECTION 509 (HOUSE BILL). RETURNS OF ADDITIONAL ESTATE TAX

These sections of the House bill amend the estate-tax titles of the Revenue Acts of 1926 and 1932 to provide that, in the case of the estate of a citizen or resident of the United States, an estate-tax return shall be made if the value of the gross estate is greater than the allowable specific exemption. Both sections are omitted from the reported bill.

SECTION 501. EXTENSIONS OF TIME FOR PAYMENT OF ESTATE TAX

This section of the reported bill allows the Commissioner to extend the payment of any part of the estate tax determined by the executor as the tax to 12 years from the due date. Under the present law, the period is 8 years. Extensions under these provisions, as under present law, are permitted only in cases where undue hardship is found.

The section also permits the Commissioner to require, as a condition of the extension, the executor to furnish security for the payment

of the part extended. The present law provides for security in the form of a bond, not exceeding double the amount of the part of the tax, extensions of payment of which is granted. The amendment permits security other than a bond to be furnished and leaves the amount of security to be determined by the Commissioner.

Section 502. Rate of Interest on Extensions of Time for Payment of Estate Tax

The amendment made by this section reduces the interest rate on extensions of estate-tax payments from 6 percent per annum to 4 percent per annum. The new rate applies to extensions granted after March 31, 1938. This date is fixed as the fairest date in order to avoid the arbitrariness of the date of enactment of the bill, and so as not to stimulate or retard extensions or applications for extensions between the time of reporting the bill and the date of enactment of the bill. The new rate does not apply to extensions granted on or prior to March 31, but does apply to an extension made after that date, even though an extension has been granted before that date.

Section 503. Computation of Net Gifts

In ascertaining the total amount of gifts made by a donor in a given calendar year, there is wholly excluded by the existing law (sec. 504 (b) of the Revenue Act of 1932) a gift or gifts to any one person of an amount or value of $5,000, or less, or the first $5,000 in amount or value of a gift or gifts to any one person in excess of that amount, with the exception that, if the gift is of a future interest in property, no amount thereof is excluded. By section 510 of the House bill the exclusion is reduced to $3,000, but in the judgment of the committee the reduced amount is insufficient, and the committee has restored to the bill the amount prescribed by the present law. The committee is also proposing an amendment by which the exclusion would not apply to gifts in trust. The Board of Tax Appeals and several of the Federal courts have held, with respect to gifts in trust, that the trust entities were the donees and on that account the gifts were of present and not of future interests. The statute, as thus construed, affords ready means of tax avoidance, since a donor may create any number of trusts in the same year in favor of the same beneficiary with a $5,000 exclusion applying to each trust, whereas the gifts, if made otherwise than in trust, would in no case be subject to more than a single exclusion of $5,000. The proposed change does not reduce the $40,000 specific exemption for gifts. The amendment will apply only when computing the tax for the calendar year 1939 and succeeding calendar years.

TITLE III—CAPITAL-STOCK AND EXCESS-PROFITS TAXES

Section 601. New Capital Stock Tax Valuation in Certain Cases

In the House bill, section 601 imposes a capital stock tax for the year ending June 30, 1939, and subsequent years. A new declaration of value of capital stock is permitted in the return for the year ending June 30, 1939, and for every third year thereafter. These years in which new declarations of value are permitted are called

"declaration years." For years between declaration years, the value declared in the preceding declaration year must be used with certain adjustments. When new stock is issued during the income tax year ending with or within the capital-stock tax year involved, such an adjustment must be made increasing the declared value. It has been called to the committee's attention that in the case of corporations which emerge from bankruptcy or receivership, if they discharge obligations to creditors by issuing new stock to them, the increase in declared value which must be made results in hardship because of the increased capital-stock tax liability. In addition the estimated earnings (upon which the declaration of value is usually based because of the excess-profits tax) of such corporations will usually be less than it was in the preceding declaration year. The reported bill therefore provides in section 601 (f) (6) that where a bankruptcy or receivership, due to insolvency, of a domestic corporation is terminated during an income tax year with or within which the capital-stock tax year begins, a new declaration of value will be permitted. As used in section 601 (f) (6) and section 603 of the bill as reported, the term "insolvency" means either excess of liabilities over assets or inability to meet the claims of creditors as they mature.

It is contemplated that usually the termination of the bankruptcy or receivership will be deemed to occur when custody and control of the property is returned by the trustee in bankruptcy or receiver to the management of the corporation and the supervision of the court ceases. In the case of proceedings under sections 77 or 77B of the Bankruptcy Act, the proceedings will usually be deemed to be terminated when a final decree is entered therein.

Section 603. New Declaration in 1938 in Certain Cases

It also seems desirable to eliminate any similar hardship upon corporations which may have emerged from bankruptcy or receivership since the last declaration of value which was permitted, which was for the capital-stock tax year ending June 30, 1936. Section 603 of the reported bill therefore contains an amendment to section 105 (f) of the Revenue Act of 1935 (which governs capital stock-tax liability for the year ending June 30, 1938). This amendment provides that any corporation shall be entitled to a new declaration of value for the capital-stock tax year ending June 30, 1938, if a bankruptcy or receivership, due to insolvency, with respect to it, is terminated after June 30, 1936, and prior to July 1, 1938.

TITLE IV—EXCISE TAXES

Section 701 (j) and Section 707 (House Bill). Sales of Produce for Future Delivery

The House bill reduces, as of July 1, 1938, the existing tax on sales of produce for future delivery on exchanges from 3 cents per $100 of value to 1 cent per $100. It also eliminated the exemption of so-called scratch or transferred sales.

Section 701 (j) eliminates the tax entirely on sales after June 30, 1938. This subsection also repeals the provision of the 1932 Revenue Act under which the tax was to be reduced on July 1, 1939, from 3 cents to 1 cent.

Section 702. Limitation on Exemption From Tax on Certain Oils

Complaint has been made to the committee that whale oil is being brought into the United States on vessels of the United States free of the tax imposed by section 601 (c) (8) of the Revenue Act of 1932, as amended, although the whales from which the oil was produced were taken and captured by vessels of other countries. An amendment has been inserted in section 601 (c) (8) (A) as it appears in section 702 (a) of the reported bill to prevent tax-free entry of such oil. It is provided that no whale oil, fish oil, or marine-animal oil shall be admitted to entry free from the tax imposed by the section unless it was produced on vessels of the United States or in the United States or its possessions, from whales, fish or marine animals or parts thereof taken and captured by vessels of the United States. This amendment does not become effective until after June 30, 1939, in order to give producers a reasonable time to make necessary adjustments.

Section 702. Rapeseed Oil

Section 702 adds to section 601 (c) (8) of the Revenue Act of 1932, as amended, subparagraph (F). This new subparagraph provides that the tax imposed under subparagraph (B) shall not apply to rapeseed oil imported to be used in the manufacture of rubber substitutes. Authority is given to the Commissioner of Customs to prescribe (with the approval of the Secretary) methods and regulations for carrying out the exemption. This amendment is effective on July 1, 1938.

Section 702. Oil From Guam or American Samoa

Section 702 adds to section 601 (c) (8) of the Revenue Act of 1932, subparagraph (G) which provides that the taxes imposed by section 601 of the Revenue Act of 1932, as amended, shall not apply to any article, merchandise, or combination by reason of the presence therein of any coconut oil produced in Guam or American Samoa, or any direct or indirect derivative of such oil. Section 702 (b) adds an amendment to section 601 (b) (5) of the Revenue Act of 1932, as amended, making a clerical change to except the products of Guam or American Samoa referred to from the operation of that paragraph. These amendments are made effective July 1, 1938.

Section 703 (House Bill). Tax on Certain Meat Products

The amendment to this section eliminates the import excise tax on pork and pork products contained in the House bill.

Section 704. Elimination of Exemption of Engelmann Spruce

The House bill exempted from the tax imposed upon lumber by section 601 (c) (6) of the Revenue Act of 1932, northern white pine, Norway pine, Engelmann spruce, and western white spruce. The committee believes that this exemption is justified except as to Engelmann spruce. Considerable testimony was presented to the committee showing that very large quantities of Engelmann spruce are available in the United States with which imported spruce of this variety would compete. The reported bill therefore eliminates the

exemption of Engelmann spruce from the tax imposed by section 601 (c) (6) of the Revenue Act of 1932.

Section 705. Reciprocal Exemption from Excise Tax of Supplies for Certain Aircraft

The House bill contained a provision including civil aircraft employed in foreign trade or trade between the United States and any of its possessions within the definition in section 630 of the Revenue Act of 1932 of vessels. Sales of supplies for such aircraft are thus exempt from the various excise taxes imposed by title IV of that act. This exemption is retained in the reported bill. In the case of civil aircraft registered in a foreign country, however, the reported bill provides that the exemption shall be available to them only if the Secretary of the Treasury shall have been advised by the Secretary of Commerce that the foreign country in which such aircraft are registered allows, or will allow, substantially reciprocal privileges in respect of aircraft registered in the United States. It is further provided that if, after the exemption for such foreign aircraft has been in effect, the Secretary of Commerce shall advise the Secretary of the Treasury that such foreign country has discontinued or will discontinue the allowance of such reciprocal privileges, then the exemption for foreign aircraft registered in such country shall no longer be allowed. The committee believes that this limitation is fair and will be of assistance in promoting the development of international operations by United States aircraft.

Section 706. Tax on Matches

This section amends the House bill so as to apply a rate of 2 cents per thousand matches on all matches, wood or paper, except in the case of fancy wooden matches or wooden matches having a colored stick or stem, on which the rate is 5 cents per thousand. The House bill applied the 5-cent rate to the fancy and colored wooden matches and eliminated the tax on other wooden and on paper matches. The difference between the reported bill and the present law is an increase in the rate on paper matches from one-half cent per thousand to 2 cents per thousand. The amendment is effective with respect to sales made after June 30, 1938.

Section 708 (House Bill). Exemption from Tax on Filled Cheese

This amendment eliminates the amendment in the House bill which exempts certain substances and compounds from the tax on filled cheese.

Section 709. Tax on Tires and Inner Tubes

This amendment reduces the tax on tires from 2¼ cents a pound to 1¾ cents a pound and reduces the tax on inner tubes from 4 cents a pound to 2½ cents a pound. The reductions are effective with respect to sales made after June 30, 1938.

Section 711. Exemption From Stamp Tax on Certain Transfers of Stocks and Bonds

Under subdivisions 3 and 9 of schedule A of title VIII of the Revenue Act of 1926, as amended, a stamp tax is imposed upon transfers or deliveries of legal title to shares or certificates of stock, and to bonds and similar evidences of indebtedness. The tax is also imposed upon transfers or deliveries of rights to subscribe for or to receive such shares or certificates of stock. Under these provisions a stamp tax is imposed when the owner of a share of stock or a bond transfers or delivers the legal title of it to a nominee or custodian for purposes of convenience or for other reasons. In addition another stamp tax is imposed if such a custodian or nominee transfers or delivers the legal title of the stock or bond to a new nominee even though the latter continues to hold the stock or bond for the same owner. Furthermore, an additional tax is collected when such nominee returns the stock or bond to the custodian, or when a custodian or nominee returns it to the owner. The committee believes that the collection of stamp taxes in these situations where there is no transfer of beneficial ownership is undesirable.

Section 711 of the reported bill therefore provides that these stamp taxes shall not be imposed upon deliveries or transfers from the owner to a nominee or custodian. Similarly it provides that the tax shall not be imposed upon deliveries or transfers from a custodian to a nominee or from one nominee to another nominee. The exemption from the tax applies in each of these situations only if the new holder continues to hold the stock or bonds for the same purposes for which they would be held if retained by the owner. The section also provides that the tax shall not be imposed upon a transfer or delivery of stock or bonds from a nominee back to the owner or custodian from whom he received it, or from a custodian back to the owner from whom he received it.

It is provided in section 711 that in the case of each of the transfers or deliveries referred to which are exempt from tax, the transfer or delivery must be accompanied by a certificate setting forth the facts. As a necessary protection to the revenue, it is provided that any person who, with intent to evade tax, falsely makes such a certificate, shall be deemed guilty of a misdemeanor, punishable by fine of not more than $1,000 or imprisonment for not more than 6 months, or both.

It should be noted that there previously existed in these subdivisions of schedule A, requirements for certificates setting forth the facts with respect to certain transfers of fiduciaries. No penalty was provided for falsely making such certificates. The penalty referred to above in the reported bill will be applicable to such certificates relating to transactions of fiduciaries.

The amendments in section 711 will become effective with respect to transfers or deliveries made after June 30, 1938.

Section 712 (House Bill). Tax on Distilled Spirits

Section 712 of the House bill amended section 600 of the Revenue Act of 1918 by raising from $2 to $2.25 the rate of tax per proof gallon on distilled spirits, except brandy. The committee has concluded

that this increase in tax is not justified and this provision is, therefore, not included in the reported bill.

SECTION 710. SALES CONSIDERED ARM'S-LENGTH TRANSACTIONS

This section amends section 619 (b) of the Revenue Act of 1932 which deals with sales of articles by the manufacturer, producer, or importer, giving rise to excise-tax liability. Section 619 (b) provides among other things, that if an article is sold (otherwise than through an arm's-length transaction) at less than the fair market price, the tax shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

The amendment made by section 710 establishes a rule of presumption that in the case of a sale by a manufacturer to a selling corporation, the transaction shall be presumed to be otherwise than at arm's length if either the manufacturer or the selling corporation owns more than 75 percent of the outstanding stock of the other, or if more than 75 percent of the outstanding stock of both corporations is owned by the same persons in substantially the same proportions. Sales by a manufacturer to a selling corporation shall, in all other cases, be presumed to be at arm's length. The amendment made by this section is effective only with respect to sales made after the date of enactment of the bill.

TITLE V—MISCELLANEOUS PROVISIONS

SECTION 802. CLOSING AGREEMENTS

This section of the reported bill amends section 606 of the Revenue Act of 1928, relating to the making of closing agreements, to provide in effect that the Secretary or Undersecretary of the Treasury need not personally approve every closing agreement, as under existing law, in order to make such agreement binding on the parties. Such agreements, however, must be approved by the Commissioner under such regulations prescribed by him with the approval of the Secretary. Such regulations may require, in some cases, the express approval of the Secretary or Under Secretary. For reasons supporting this amendment, see discussion under section 56 (c) (2).

SECTION 805. INTEREST ON UNPAID ASSESSMENTS

Section 804 of the House bill amends section 3184 of the Revised Statutes to provide that if, after notice and demand for payment of tax has been made, the taxpayer fails to pay within 10 days from the date of such notice, interest accrues from the date of such notice to date of payment. That section of the House bill is retained as section 805 of the reported bill with a change to make clear that the amendment is effective only with respect to notices served or sent on or after the day following the enactment of the bill.

SECTION 808. BASIS OF PROPERTY ACQUIRED IN CONNECTION WITH LIQUIDATION

This section allows a corporation which has received certain property prior to June 23, 1936, in connection with the complete liquidation of another corporation, to elect to have the basis provisions of the 1934 act apply to that property. The changes made in the 1936 act by this amendment are fully explained in connection with section 113 (a) (15).

SECTION 814. COMPROMISE BEFORE SUIT

This section of the reported bill amends section 3229 of the Revised Statutes, relating to compromises of tax liability before suit, to provide in effect that the Secretary of the Treasury need not approve every compromise, as under existing law, to be binding on the parties. Such compromises, however, must be approved by the Commissioner of Internal Revenue under regulations prescribed by him with the approval of the Secretary. Such regulations may require, in some cases, the express approval of the Secretary. For reasons supporting this amendment, see discussion under section 56 (c) (2).

SECTION 815. EXTENSION OF TIME FOR PAYMENT OF DEFICIENCIES

This section of the reported bill provides in effect that as to extensions of time for payment of deficiencies in income, estate or gift tax under the Revenue Acts of 1926, 1928, 1932, 1934, and 1936, made after the enactment of the Revenue Act of 1938, the same rule found in section 272 (j) of the reported bill as to approval by the Commissioner on extensions of time for payment of deficiencies in income tax shall be applicable. See discussion under sections 56 (c) (2) and 272 (j) of the reported bill.

SECTION 816. GAIN ON OBLIGATIONS AND MORTGAGES OF JOINT-STOCK LAND BANKS

This section subjects to Federal income taxation the capital gain realized by a joint-stock land bank on the purchase of its own obligations or of mortgages made by it. It has been brought to the attention of the committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation, is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint-stock land banks, such income is exempt. The committee is of the opinion that such income ought to be taxed. A similar situation exists with respect to mortgages issued by such banks and acquired at less than cost. For constitutional reasons the provision is confined to gain realized upon bonds and mortgages issued after and acquired after the date of the enactment of the bill.

SECTION 817. TAXES OF INSOLVENT BANKS

Section 22 of the act of March 1, 1879 (20 Stat. 351; 12 U. S. C. 570), provides an exemption from Federal taxes in the case of certain insolvent banks. This exemption is not as broad as modern condi-

tions require, and section 817 of the reported bill contains an amendment broadening it. Under the amendment, a conditional exemption will apply to assets segregated from the other assets of a bank and established as a separate fund for the benefit of creditors. The amendment also brings trust companies within the exemption, and allows the exemption with respect to assets held for all creditors, and not merely for depositors. The exemption does not apply, however, unless a substantial portion of the business of the bank or trust company consists of receiving deposits and making loans and discounts. The amendment makes the exemptions conditional for it provides for reassessment and collection of remitted taxes where subsequent developments make it possible for the taxes to be paid without diminishing the assets necessary for payment of creditors. It also suspends the running of limitation periods while assessment or collection is stayed by the section, both with respect to original assessment and reassessment of tax liability, and provides that nothing in the section shall relieve any bank, trust company, or other person from payments due under the Social Security Act.

Section 818. Abatement of Jeopardy Assessments

This section provides for authority to the Commissioner to abate excessive jeopardy assessments made under prior revenue acts in the same manner as is provided in section 273 (see discussion under that section). The provisions affected are the sections providing for jeopardy assessments of income, estate, and gift taxes in the revenue acts of 1926 and 1936, inclusive. It should be noted, however, that in order to avoid an undue burden upon the Commissioner and unnecessary confusion, no authority is given to the Commissioner to abate, for any reason, jeopardy assessments made on or prior to the effective date of this act. Section 818 (f) provides that the amendment giving the Commissioner this authority is effective only as to jeopardy assessments made after the effective date of this act.

Section 819. Mitigation of the Effect of Limitation and Other Provisions in Income Tax Cases

This section of the bill provides an equitable solution of certain classes of income-tax problems, now very numerous, which have caused much hardship to taxpayers and great difficulty to the Commissioner, the Board of Tax Appeals, and the courts. The general nature of these problems is best disclosed by examples:

A. Taxpayer A, who reports income on the cash basis, erroneously included in his return for 1933 an item of accrued rent, and upon audit the return was accepted as filed. In 1938, after the period of limitations on refund claims for 1933 had expired, the Commissioner discovered that A received this rent in 1934, and consequently asserted and, after decision of the Board of Tax Appeals upholding such assertion, collected a deficiency assessment for the latter year. To prevent A from being subjected to an unfair double tax burden on account of a single item of income, an adjustment would be made under the proposed legislation.

B. A father and son conducted a partnership business in which each had an equal interest. The father included the entire partnership income in his return for 1933 and the son included no portion of

this income in his return for that year. One week before the statute of limitations had run with respect to deficiencies and refund claims for both father and son for 1933, the father filed a refund claim for that portion of his 1933 tax attributable to the half of the partnership income which should have been included in the son's return. The court sustained the claim for refund. To prevent the two partners from entirely avoiding payment of tax with respect to one-half of the partnership income through such inconsistent action by the father, an adjustment would be made under the proposed legislation.

C. In 1931 the taxpayer received securities of corporation A having a fair market value of $5,000 in exchange for securities of corporation B which cost him $12,000. The taxpayer treated the exchange as one in which gain or loss was not recognizable and upon audit the return was accepted as filed. He sold the A securities in 1937 for $15,000 and reported $3,000 gain. After the statute of limitations had run on refund claims for 1931, the Commissioner asserted a deficiency for 1937 on the ground that the loss realized on the exchange in 1931 was erroneously treated as nonrecognizable, and that the basis for gain or loss upon the sale was $5,000, resulting in a gain of $10,000. The taxpayer and the Commissioner then entered into a closing agreement for 1937 in which the taxpayer agreed to the Commissioner's determination. To prevent the inconsistent resort to the lower basis resulting in complete denial of a deduction for the loss sustained in 1931, an adjustment would be made under the proposed section.

In each case, under existing law, an unfair benefit would have been obtained by assuming an inconsistent position and then taking shelter behind the protective barrier of the statute of limitations. Such resort to the statute of limitations is a plain misuse of its fundamental purpose. The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running of the statute. The Federal courts in many somewhat similar tax cases have sought to prevent inequitable results by applying principles variously designated as estoppel, quasi-estoppel, recoupment and set-off. For various reasons, mostly technical, these judicial efforts cannot extend to all problems of this type. Nor can they provide a uniform, systematic solution of these problems. Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.

The legislation here proposed is based upon the following principles:

(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax save with respect to the influence of the particular items involved in the adjustment.

(2) Subject to the foregoing principles, disputes as to the year in which income or deductions belong, or as to the person who should

have the tax burden of income or the tax benefit of deductions, should never result in a double tax or a double reduction of tax, or an inequitable avoidance of tax.

(3) Disputes as to the basis of property should not allow the taxpayer or the Commissioner to obtain an unfair tax advantage by taking one position at the time of the acquisition of property and an inconsistent position at the time of its disposition.

(4) Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer, and of establishing the proper basis.

Other provisions of the internal-revenue laws, as well as the statute of limitations, make profitable the taking of inconsistent positions by providing a safe shelter for the party changing his position. Thus, in example A, suppose the statute of limitations had not yet run on refund claims for 1933 when the Commissioner asserted a deficiency for 1934, but the taxpayer and the Commissioner had entered into a closing agreement for the year 1933 so that the taxpayer would be prevented from reopening that year. The result of a double tax would likewise follow from the collection of the deficiency. While cases involving these other provisions are less frequent, the results produced are just as inequitable, and as they admit of the same adjustment as cases involving the statute of limitations, they are also covered by the proposed legislation.

Subsection (b) provides that the effect of the error shall be corrected in the manner provided in this section only if, at the time the determination becomes final, correction would be prevented by some provision of the internal-revenue laws. Thus, in example A above, if the period for filing claims for refund had not expired at the time the decision of the Board sustaining the deficiency for 1934 became final so that the taxpayer could proceed to file a refund claim for 1933, this section would not be operative. In other words, this section does not prescribe an exclusive procedure for correcting the errors dealt with, but merely authorizes this particular procedure if correction is otherwise prevented. It should be observed that the section applies either where correction is barred by the running of the statute of limitations, by the execution of a closing agreement, by the collateral consequences of a Board proceeding, etc., prior to the date of enactment of this act, or by similar events happening after the effective date of this act.

Inasmuch as an adjustment should not be made until the inconsistent position asserted by the taxpayer or the Commissioner has been successfully maintained, subsection (b) is not operative until there is a final "determination" which gives authoritative sanction to the inconsistent action. Subsection (a) describes the types of determinations which are prerequisite to the operation of this section.

Subsection (b), with the interpretations afforded by the definitions in subsection (a), describes the circumstances under which an adjustment is authorized by this section. As the above examples indicate, the section is not restricted to single taxpayers but covers two or more taxpayers in appropriate cases. Paragraphs (1)–(4) of subsection (b) group these taxpayers under the term "related taxpayer" and this term is defined in paragraph (2) of subsection (a). The definition covers those situations in which, for reasons apparent from the nature of the relationship, the problems dealt with by this section

are likely to arise. Paragraph (5) of subsection (b) covers both the person who acquired the property and any subsequent transferees and donees who have a substituted basis ascertained by reference to the basis in the hands of such person.

It should be noted that only such transfers as occur subsequent to the transaction erroneously treated are covered by this paragraph, so as to avoid the confusion, hardship, and wasted effort which would result if reorganizations and other transactions were entirely readjusted when any one participant took inconsistent stands. For example, if partnership assets are transferred to a corporation in exchange for its stock and one of the partners on later disposition of the stock adopts a position with respect to the basis of the stock inconsistent with that taken at the time of the transfer, an adjustment would be made under this section only with respect to such partner. If the other partner, however, later shifted his position, an adjustment with respect to him would then be authorized under this section. An adjustment with respect to the corporation is not authorized by reason of the inconsistent position taken by either or both of the partners as the corporation derived title at the time of the erroneously treated transaction and not subsequent thereto. But if the corporation later shifted its position, an adjustment with respect to the corporation would then be authorized.

The adjustment is described in subsections (c), (d), and (e). Subsection (c) describes the first stage in the process, that of ascertaining the amount of the adjustment. In ascertaining the amount of the adjustment, two steps are involved:

(a) The tax previously determined for the taxable year with respect to which the error was made must first be ascertained. In ordinary cases this will simply be the amount of tax shown on the taxpayer's return. If any changes in that amount have been made, however, they must be taken into account. In such cases, the tax previously determined will be the tax as shown on the return, increased by any amounts previously assessed as deficiencies and decreased by any amounts previously repaid in respect of such tax.

(b) With the tax previously determined as the datum point, a recomputation must then be made to ascertain the increase or decrease, if any, resulting from correction of the error. In the ordinary case this will merely require a recomputation of the tax shown on the return, as affected by correct treatment of the item involved in the determination. If the amount of tax shown on the return had previously been increased or decreased by reason of deficiencies assessed or amounts repaid, the return would in effect be reconstructed to reflect these changes and the recomputation to ascertain the increase or decrease made on the basis of such reconstructed return. Such increase or decrease, together with any amounts wrongfully collected from the taxpayer, as additions to the tax or interest, as a result of the error, constitutes the amount of the adjustment.

The recomputation does not involve consideration of the treatment of any other items for the taxable year with respect to which the recomputation is made, except, of course, those items considered in ascertaining the tax previously determined to serve as the basis of the recomputation. Thus, in example A, if the taxpayer had failed to take a deduction properly allowable for a loss sustained in 1933, and the statute had run on claims for refund, the recomputation to ascer-

tain the change necessitated by correction of the erroneous inclusion in gross income of the rent item would not permit correct treatment of the loss. Similarly, if the taxpayer had failed to include in his gross income commissions received in that year, and the statute had run on deficiency assessments, the recomputation would not permit inclusion of such commissions.

As indicated above, this section is predicated on the principle that correction is made only with respect to the item involved in the determination. The operation of the bar of statute of limitations is not affected with respect to any other item, even though such other item also had been erroneously treated in the same year. As to these items there has been no change of position, no double tax or double deduction, to call for the relief provided by this section. Accordingly, if the amount of the adjustment in example A ascertained by a recomputation of the tax after exclusion of the rent item from gross income were a decrease of $500 in tax, and the inclusion of the commissions erroneously omitted from the return would have not only eliminated such decrease but would have resulted in a $100 increase in tax, the amount of the adjustment nevertheless remains $500 decrease in tax and, under subsection (d), is to be refunded to the taxpayer.

Subsection (d) prescribes the method of adjustment. If the amount of the adjustment ascertained pursuant to subsection (c) represents an increase in tax, it is to be considered as a deficiency for the taxable year with respect to which the error was made; if it represents a decrease in tax, it is to be considered as an overpayment for that year. The amount of the adjustment considered as a deficiency or as an overpayment, as the case may be, will bear interest to the extent provided by the internal-revenue laws for deficiencies and overpayments for the taxable year with respect to which the error was made. Likewise if the amount of the adjustment represents an increase in tax, any appropriate additions to the tax are also to be assessed and collected. By considering the amount of the adjustment as a deficiency or as an overpayment, subsection (d) permits the utilization of the procedural devices applicable to assessment, collection, refunding, etc., of deficiencies and overpayments.

Subsection (e) supplements the limitations provided in subsection (c) to the effect that the adjustment is unaffected by any other items not taken into consideration in ascertaining the tax previously determined.