

1 of less than \$20,000, 25 per centum of the adjusted
2 excess profits net income.

3 \$5,000 upon adjusted excess profits net incomes
4 of \$20,000; and upon adjusted excess profits net
5 incomes in excess of \$20,000, and not in excess of
6 \$50,000, 30 per centum in addition of such excess.

7 \$14,000 upon adjusted excess profits net in-
8 comes of \$50,000; and upon adjusted excess profits
9 net incomes in excess of \$50,000, and not in excess
10 of \$100,000, 35 per centum in addition of such
11 excess.

12 \$31,500 upon adjusted excess profits net in-
13 comes of \$100,000; and upon adjusted excess profits
14 net incomes in excess of \$100,000, and not in excess
15 of \$250,000, 40 per centum in addition of such
16 excess.

17 \$61,500 upon adjusted excess profits net in-
18 comes of \$250,000; and upon adjusted excess profits
19 net incomes in excess of \$250,000, and not in excess
20 of \$500,000, 45 per centum in addition of such
21 excess.

22 \$204,000 upon adjusted excess profits net in-
23 comes of \$500,000; and upon adjusted excess profits
24 net incomes in excess of \$500,000, 50 per centum in
25 addition of such excess.

<i>If the adjusted excess profits net income is:</i>	<i>The tax shall be:</i>
<i>Not over \$20,000-----</i>	<i>35% of the adjusted excess profits net income.</i>
<i>Over \$20,000, but not over \$50,000.</i>	<i>\$7,000, plus 40% of excess over \$20,000.</i>
<i>Over \$50,000, but not over \$100,000.</i>	<i>\$19,000, plus 45% of excess over \$50,000.</i>
<i>Over \$100,000, but not over \$250,000.</i>	<i>\$41,500, plus 50% of excess over \$100,000.</i>
<i>Over \$250,000, but not over \$500,000.</i>	<i>\$116,500, plus 55% of excess over \$250,000.</i>
<i>Over \$500,000-----</i>	<i>\$254,000, plus 60% of excess over \$500,000.</i>

1 (2) *SPECIAL RULE IN CERTAIN CASES WHERE*
2 *INVESTED CAPITAL CREDIT IS USED.*—*In the case of a*
3 *taxpayer entitled to have its excess profits credit com-*
4 *puted under either section 713 (income credit) or sec-*
5 *tion 714 (invested capital credit), if the use of the*
6 *credit under section 714 is more advantageous to the*
7 *taxpayer, the tax imposed by this section shall be the*
8 *sum of—*

9 (A) *an amount determined under paragraph*
10 (1) *of this subsection with the use of the credit*
11 *provided in section 714, plus—*

12 (B) *10 per centum of the amount, if any, by*
13 *which—*

14 (i) *the adjusted excess profits net income*
15 *computed with the use of the credit under sec-*
16 *tion 713 and with the excess profits credit carry-*
17 *over which would be available for the taxable*
18 *year if the excess profits credit applicable to*
19 *each of the preceding taxable years for which*

1 *tax is imposed by this subchapter had been the*
2 *excess profits credit computed under section 713,*
3 *exceeds*

4 *(ii) the adjusted excess profits net income*
5 *computed with the use of the credit under sec-*
6 *tion 714.*

7 **(3) LIMITATION ON APPLICATION OF SPECIAL**
8 **RULE.**—*If the tax under paragraph (2) is greater than*
9 *the amount determined, with the use of the credit pro-*
10 *vided in section 713, under paragraph (1) of this*
11 *subsection, the tax shall be the amount so determined*
12 *under paragraph (1).*

13 ~~(2)~~ **(4) APPLICATION OF RATES IN CASE OF CER-**
14 **TAIN EXCHANGES.**—*If the taxpayer's highest bracket*
15 *amount for the taxable year computed under section 752*
16 *(relating to certain exchanges) is less than \$500,000,*
17 *then in the application of the table in paragraph (1)*
18 *of this subsection to such taxpayer, in lieu of each*
19 *amount, other than the percentages, specified in such*
20 ~~paragraph~~ *table, there shall be substituted an amount*
21 *which bears the same ratio to the amount so specified*
22 *as the highest bracket amount so computed bears to*
23 *\$500,000.*

24 **(b) DEFINITION OF ADJUSTED EXCESS PROFITS NET**
25 **INCOME.**—*As used in this section, the term "adjusted excess*

1 profits net income" in the case of any taxable year means
2 the excess profits net income (as defined in section 711)
3 minus the sum of:

4 (1) **SPECIFIC EXEMPTION.**—A specific exemption
5 of \$5,000;

6 (2) **EXCESS PROFITS CREDIT.**—The amount of the
7 excess profits credit allowed under section 712; and

8 (3) **UNUSED EXCESS PROFITS CREDIT.**—The
9 amount of the excess profits credit carry-over for the
10 taxable year, computed in accordance with subsection
11 (c).

12 (c) **EXCESS PROFITS CREDIT CARRY-OVER.**—

13 (1) **DEFINITION OF UNUSED EXCESS PROFITS**
14 **CREDIT.**—The term "unused excess profits credit" means
15 the excess, if any, of the excess profits credit for any
16 taxable year beginning after December 31, 1939, over
17 the excess profits net income for such taxable year,
18 computed on the basis of the excess profits credit
19 applicable to such taxable year. *For such purpose the*
20 *excess-profits credit and the excess-profits net income for*
21 *any taxable year beginning in 1940 shall be computed*
22 *under the law applicable to taxable years beginning in*
23 *1941.*

24 (2) **COMPUTATION OF EXCESS PROFITS CREDIT**

1 CARRY-OVER.—The excess profits credit carry-over for
2 any taxable year shall be the sum of the following:

3 (A) The unused excess profits credit for the
4 first preceding taxable year; and

5 (B) The unused excess profits credit for the
6 second preceding taxable year reduced by the
7 amount, if any, by which the excess profits net
8 income for the first preceding taxable year exceeds
9 the sum of—

10 (i) the excess profits credit for such first
11 preceding taxable year, plus

12 (ii) the unused excess profits credit for the
13 third preceding taxable year.

14 **SEC. 711. EXCESS PROFITS NET INCOME.**

15 (a) **TAXABLE YEARS BEGINNING AFTER DECEMBER**
16 **31, 1939.**—The excess profits net income for any taxable
17 year beginning after December 31, 1939, shall be the normal-
18 tax net income, as defined in section 13 (a) (2), for such
19 year except that the following adjustments shall be made:

20 (1) **EXCESS PROFITS CREDIT COMPUTED UNDER**
21 **INCOME CREDIT.**—If the excess profits credit is computed
22 under section 713, the adjustments shall be as follows:

23 ~~(A)~~ **Income Taxes.**—The deduction for taxes
24 shall be increased by an amount equal to the tax

1 ~~(not including the tax under section 102)~~ under
2 Chapter 1 for such taxable year;

3 (A) *Income Taxes.*—In computing such nor-
4 mal-tax net income the deduction for the tax im-
5 posed by this subchapter shall not be allowed;

6 (B) *Long-term Gains and Losses.*—There shall
7 be excluded long-term capital gains and losses.
8 There shall be excluded the excess of gains from the
9 sale or exchange of property held for more than
10 eighteen months which is of a character which is
11 subject to the allowance for depreciation provided in
12 section 23 (1) over the losses from the sale or ex-
13 change of such property;

14 (C) *Income From Retirement or Discharge*
15 *of Bonds, and So Forth.*—There shall be excluded,
16 in the case of any taxpayer, income derived from the
17 retirement or discharge by the taxpayer of any bond,
18 debenture, note, or certificate or other evidence of
19 indebtedness, if the obligation of the taxpayer has
20 been outstanding for more than eighteen months, in-
21 cluding, in case the issuance was at a premium, the
22 amount includible in income for such year solely be-
23 cause of such retirement or discharge;

24 (D) *Refunds and Interest on Agricultural Ad-*

1 justment Act Taxes.—There shall be excluded income
2 attributable to refund of tax paid under the Agricul-
3 tural Adjustment Act of 1933, as amended, and in-
4 terest upon any such refund;

5 (E) Recoveries of Bad Debts.—There shall be
6 excluded income attributable to the recovery of a
7 bad debt if a deduction with reference to such debt
8 was allowable from gross income for any taxable
9 year beginning prior to January 1, 1940;

10 (F) Dividends Received.—The credit for divi-
11 dends received shall apply, without limitation, to
12 dividends on stock of domestic corporations.

13 (G) *Computation of Charitable, Etc., Deduc-*
14 *tions.—In determining any deduction the amount of*
15 *which is limited to a percentage of the taxpayer's*
16 *net income (or net income from the property), such*
17 *net income (or net income from the property) shall*
18 *be computed without regard to the deduction on*
19 *account of the tax imposed by this subchapter.*

20 (2) **EXCESS PROFITS CREDIT COMPUTED UNDER**
21 **INVESTED CAPITAL CREDIT.**—If the excess profits credit
22 is computed under section 714, the adjustments shall be
23 as follows:

24 (A) Dividends Received.—The credit for divi-
25 dends received shall apply, without limitation, to

1 all dividends on stock of all corporations, except
2 dividends (actual or constructive) on stock of for-
3 eign personal-holding companies. This subpara-
4 graph shall not apply to dividends on stock which
5 is not a capital asset;

6 (B) Interest.—The deduction for interest shall
7 be reduced by an amount equal to 50 per centum
8 of so much of such interest as represents interest
9 on the indebtedness included in the daily amounts
10 of borrowed capital (determined under section
11 719 (a));

12 ~~(C) Income Taxes.—The deduction for taxes~~
13 ~~shall be increased by an amount equal to the tax~~
14 ~~(not including the tax under section 102) under~~
15 ~~Chapter 1 for such taxable year;~~

16 *(C) Income Taxes.—In computing such nor-*
17 *mal-tax net income the deduction for the tax im-*
18 *posed by this subchapter shall not be allowed;*

19 (D) Long-term Gains and Losses.—There shall
20 be excluded long-term capital gains and losses.
21 There shall be excluded the excess of gains from the
22 sale or exchange of property held for more than
23 eighteen months which is of a character which is
24 subject to the allowance for depreciation provided

1 in section 23 (1) over the losses from the sale or
2 exchange of such property;

3 (E) Income From Retirement or Discharge of
4 Bonds, and So Forth.—There shall be excluded, in
5 the case of any taxpayer, income derived from the
6 retirement or discharge by the taxpayer of any bond,
7 debenture, note, or certificate or other evidence of
8 indebtedness, if the obligation of the taxpayer has
9 been outstanding for more than eighteen months,
10 including, in case the issuance was at a premium,
11 the amount includible in income for such year solely
12 because of such retirement or discharge;

13 (F) Refunds and Interest on Agricultural Ad-
14 justment Act Taxes.—There shall be excluded income
15 attributable to refund of tax paid under the Agri-
16 cultural Adjustment Act of 1933, as amended, and
17 interest upon any such refund;

18 (G) Interest on Certain Government Oblig-
19 ations.—The normal-tax net income shall be increased
20 by an amount equal to the amount of the interest
21 on obligations held during the taxable year which
22 are described in section 22 (b) (4) any part of
23 the interest from which is excludible from gross in-
24 come or allowable as a credit against net income, if

1 the taxpayer has so elected under section 720 (d) ;
2 and

3 (H) Recoveries of Bad Debts.—There shall be
4 excluded income attributable to the recovery of a
5 bad debt if a deduction with reference to such debt
6 was allowable from gross income for any taxable
7 year beginning prior to January 1, 1940.

8 (I) Computation of Charitable, Etc., Deduc-
9 tions.—In determining any deduction the amount of
10 which is limited to a percentage of the taxpayer's net
11 income (or net income from the property), such net
12 income (or net income from the property) shall be
13 computed without regard to the deduction on account
14 of the tax imposed by this subchapter.

15 (3) TAXABLE YEAR LESS THAN TWELVE
16 MONTHS.—If the taxable year is a period of less than
17 twelve months the excess profits net income shall be
18 placed on an annual basis by multiplying the amount
19 thereof by the number of days in the twelve months
20 ending with the close of the taxable year and dividing
21 by the number of days in the taxable year. The tax
22 shall be such part of the tax computed on such annual
23 basis as the number of days in the taxable year is of the
24 number of days in the twelve months ending with the
25 close of the taxable year.

1 **(b) TAXABLE YEARS IN BASE PERIOD.—**

2 **(1) GENERAL RULE AND ADJUSTMENTS.—**The ex-
3 cess profits net income for any taxable year subject to
4 the Revenue Act of 1936 shall be the normal-tax net
5 income, as defined in section 13 (a) of such Act; and for
6 any other taxable year beginning after December 31,
7 1937, and before January 1, 1940, shall be the special-
8 class net income, as defined in section 14 (a) of the
9 applicable revenue law. In either case the following
10 adjustments shall be made (for additional adjustments in
11 case of certain reorganizations, see section 742 (e)) :

12 **(A) Income Taxes.—**The deduction for taxes
13 shall be increased by an amount equal to the tax
14 ~~(not including the tax under section 102)~~ for such
15 taxable year under Title I or Chapter 1, as the case
16 may be, of the revenue law applicable to such year;

17 **(B) Long-Term Gains and Losses.—**There shall
18 be excluded long-term capital gains and losses.
19 There shall be excluded the excess of gains from the
20 sale or exchange of property held for more than
21 eighteen months which is of a character which is sub-
22 ject to the allowance for depreciation provided in
23 section 23 (1) over the losses from the sale or ex-
24 change of such property;

25 **(C) Income From Retirement or Discharge of**

1 **Bonds, and So Forth.**—There shall be excluded, in
2 the case of any taxpayer, income derived from the
3 retirement or discharge by the taxpayer of any bond,
4 debenture, note, or certificate or other evidence of
5 indebtedness, if the obligation of the taxpayer has
6 been outstanding for more than eighteen months,
7 including, in case the issuance was at a premium, the
8 amount includible in income for such year solely
9 because of such retirement or discharge;

10 **(D) Deductions on Account of Retirement or**
11 **Discharge of Bonds, and So Forth.**—If during the
12 taxable year the taxpayer retires or discharges any
13 bond, debenture, note, or certificate or other evidence
14 of indebtedness, if the obligation of the taxpayer has
15 been outstanding for more than eighteen months, the
16 following deductions for such taxable year shall not
17 be allowed:

18 (i) The deduction allowable under section
19 23 (a) for expenses paid or incurred in connec-
20 tion with such retirement or discharge;

21 (ii) The deduction for losses allowable by
22 reason of such retirement or discharge; and

23 (iii) In case the issuance was at a dis-
24 count, the amount deductible for such year solely
25 because of such retirement or discharge;

1 **(E) Casualty, Demolition, and Similar Losses.—**

2 Deductions under section 23 (f) for losses arising
3 from fires, storms, shipwreck, or other casualty, or
4 from theft, or arising from the demolition, aban-
5 donment, or loss of useful value of property, not
6 compensated for by insurance or otherwise, shall
7 not be allowed;

8 **(F) Repayment of Processing Tax to Ven-**
9 **dees.—**The deduction under section 23 (a), for any
10 taxable year, for expenses shall be decreased by an
11 amount which bears the same ratio to the amount
12 deductible on account of any repayment or credit
13 by the corporation to its vendee of any amount at-
14 tributable to any tax under the Agricultural Ad-
15 justment Act of 1933, as amended, as the excess of
16 the aggregate of the amounts so deductible in the
17 base period over the aggregate of the amounts at-
18 tributable to taxes under such Act collected from
19 its vendees which were includible in the corpora-
20 tion's gross income in the base period and which
21 were not paid, bears to the aggregate of the amounts
22 so deductible in the base period;

23 **(G) Dividends Received.—**The credit for divi-
24 dends received shall apply, without limitation, to
25 dividends on stock of domestic corporations;

1 (H) Payment of Judgments, and So Forth.—
2 Deductions attributable to any claim, award, judg-
3 ment, or decree against the taxpayer, or interest on
4 any of the foregoing, if abnormal for the taxpayer,
5 shall not be allowed, and if normal for the taxpayer,
6 but in excess of 125 per centum of the average
7 amount of such deductions in the four previous
8 taxable years, shall be disallowed in an amount equal
9 to such excess;

10 (I) Intangible Drilling and Development
11 Costs.—Deductions attributable to intangible drill-
12 ing and development costs paid or incurred in or
13 for the drilling of wells or the preparation of wells
14 for the production of oil or gas, and for develop-
15 ment costs in the case of mines, if abnormal for
16 the taxpayer, shall not be allowed, and if normal
17 for the taxpayer, but in excess of 125 per centum
18 of the average amount of such deductions in the
19 four previous taxable years, shall be disallowed in
20 an amount equal to such excess; and

21 (J) Abnormal Deductions.—Under regulations
22 prescribed by the Commissioner, with the approval
23 of the Secretary, for the determination, for the pur-
24 poses of this subparagraph, of the classification of
25 deductions—

1 (i) Deductions of any class shall not be
2 allowed if deductions of such class were ab-
3 normal for the taxpayer, and

4 (ii) If the class of deductions was normal
5 for the taxpayer, but the deductions of such
6 class were in excess of 125 per centum of the
7 average amount of deductions of such class for
8 the four previous taxable years, they shall be
9 disallowed in an amount equal to such excess.

10 (K) Rules for Application of Subparagraphs
11 (H), (I), and (J).—For the purposes of subpara-
12 graphs (H), (I), and (J)—

13 (i) If the taxpayer was not in existence for
14 four previous taxable years, then such average
15 amount specified in such subparagraphs shall be
16 determined for the previous taxable years it was
17 in existence and the succeeding taxable years
18 which begin before the beginning of the taxpay-
19 er's second taxable year under this subchapter.
20 If the number of such succeeding years is greater
21 than the number necessary to obtain an aggre-
22 gate of four taxable years there shall be omitted
23 so many of such succeeding years, beginning
24 with the last, as are necessary to reduce the
25 aggregate to four.

1 (ii) Deductions shall not be disallowed un-
2 der such subparagraphs unless the taxpayer
3 establishes that the abnormality or excess is not
4 a consequence of an increase in the gross income
5 of the taxpayer in its base period or a decrease in
6 the amount of some other deduction in its base
7 period, and is not a consequence of a change
8 at any time in the type, manner of operation,
9 size, or condition of the business engaged in by
10 the taxpayer.

11 (iii) The amount of deductions of any class
12 to be disallowed under such subparagraphs with
13 respect to any taxable year shall not exceed the
14 amount by which the deductions of such class
15 for such taxable year exceed the deductions of
16 such class for the taxable year for which the tax
17 under this subchapter is being computed.

18 (2) CAPITAL GAINS AND LOSSES.—For the pur-
19 poses of this subsection the normal-tax net income and
20 the special-class net income referred to in paragraph
21 (1) shall be computed as if section 23 (g) (2), sec-
22 tion 23 (k) (2), and section 117 were part of the
23 revenue law applicable to the taxable year the excess
24 profits net income of which is being computed, with
25 the exception that the net short-term capital loss carry-

1 over provided in subsection (e) of section 117 shall
2 be applicable to net short-term capital losses for taxable
3 years beginning after December 31, 1934. Such excep-
4 tion shall not apply for the purposes of computing
5 the tax under this subchapter for any taxable year begin-
6 ning before January 1, 1941.

7 **SEC. 712. EXCESS PROFITS CREDIT—ALLOWANCE.**

8 (a) **DOMESTIC CORPORATIONS.**—In the case of a
9 domestic corporation which was in existence before January
10 1, 1940, the excess profits credit for any taxable year shall
11 be an amount computed under section 713 or section 714,
12 whichever amount results in the lesser tax under this sub-
13 chapter for the taxable year for which the tax under this
14 subchapter is being computed. In the case of all other
15 domestic corporations the excess profits credit for any tax-
16 able year shall be an amount computed under section 714.
17 (For allowance of excess profits credit in case of certain
18 reorganizations of corporations, see section 741.)

19 (b) **FOREIGN CORPORATIONS.**—In the case of a foreign
20 corporation engaged in trade or business within the United
21 States or having an office or place of business therein, the
22 first taxable year of which under this subchapter begins on
23 any date in 1940, which was in existence on the day forty-
24 eight months prior to such date and which at any time during
25 each of the taxable years in such forty-eight months was

1 engaged in trade or business within the United States or
 2 had an office or place of business therein, the excess profits
 3 credit for any taxable year shall be an amount computed
 4 under section 713 or section 714, whichever amount results
 5 in the lesser tax under this subchapter for the taxable year
 6 for which the tax under this subchapter is being computed.
 7 In the case of all other foreign corporations the excess profits
 8 credit for any taxable year shall be an amount computed
 9 under section 714.

10 (c) EFFECT OF DISCLAIMER OF CREDIT.—If the tax-
 11 payer states in its return for the taxable year under this
 12 subchapter that it disclaims the use of the credit computed
 13 under section 713 or the use of the credit computed under
 14 section 714, the credit so disclaimed *section 714, such credit*
 15 shall not, for the purposes of the internal revenue laws, be
 16 applicable to the computation of the tax under this sub-
 17 chapter for such taxable year.

18 **SEC. 713. EXCESS PROFITS CREDIT—BASED ON INCOME.**

19 (a) AMOUNT OF EXCESS PROFITS CREDIT.—The ex-
 20 cess profits credit for any taxable year, computed under this
 21 section, shall be—

22 (1) DOMESTIC CORPORATIONS.—In the case of a
 23 domestic corporation—

24 (A) 95 per centum of the average base period
 25 net income, as defined in subsection (d),

1 (B). Plus 8 per centum of the net capital addi-
2 tion as defined in subsection (g), or

3 (C) Minus 6 per centum of the net capital re-
4 duction as defined in subsection (g).

5 (2) FOREIGN CORPORATIONS.—In the case of a
6 foreign corporation, 95 per centum of the average base
7 period net income.

8 (b) BASE PERIOD.—

9 (1) DEFINITION.—As used in this section the term
10 “base period”—

11 (A) If the corporation was in existence during
12 the whole of the forty-eight months preceding the
13 beginning of its first taxable year under this sub-
14 chapter, means the period commencing with the be-
15 ginning of its first taxable year beginning after
16 December 31, 1935, and ending with the close of its
17 last taxable year beginning before January 1, 1940;
18 and

19 (B) In the case of a corporation which was in
20 existence during only part of the forty-eight months
21 preceding the beginning of its first taxable year
22 under this subchapter, means the forty-eight months
23 preceding the beginning of its first taxable year
24 under this subchapter.

25 (2) DIVISION INTO HALVES.—For the purposes of

1 subsections (d) and (f) the base period of the taxpayer
2 shall be divided into halves, the first half to be composed
3 of one-half the entire number of months in the base
4 period and to begin with the beginning of the base
5 period.

6 (c) **DEFICIT IN EXCESS PROFITS NET INCOME.—**For
7 the purposes of this section the term “deficit in excess profits
8 net income” with respect to any taxable year means the
9 amount by which the deductions plus the credit for dividends
10 received exceeded the gross income. For the purposes of
11 this subsection in determining whether there was such an
12 excess and in determining the amount thereof, the adjust-
13 ments provided in section 711 (b) (1) shall be made.

14 (d) **AVERAGE BASE PERIOD NET INCOME—DETERMI-**
15 **NATION.—**

16 (1) **DEFINITION.—**For the purposes of this section
17 the average base period net income of the taxpayer shall
18 be the amount determined under subsection (e), subject
19 to the exception that if the aggregate excess profits net
20 income for the last half of its base period, reduced by the
21 aggregate of the deficits in excess profits net income for
22 such half, is greater than such aggregate so reduced for
23 the first half, then the average base period net income
24 shall be the amount determined under subsection (f),

1 if greater than the amount determined under sub-
2 section (e).

3 (2) For the purposes of subsections (e) and (f), if
4 the taxpayer was in existence during only part of the 48
5 months preceding the beginning of its first taxable year
6 under this subchapter, its excess profits net income—

7 (A) for each taxable year of twelve months
8 (beginning with the beginning of its base period)
9 during which it was not in existence, shall be an
10 amount equal to 8 per centum of the excess of—

11 (i) the daily invested capital for the first
12 day of the taxpayer's first taxable year beginning
13 after December 31, 1939, over

14 (ii) an amount equal to the same per-
15 centage of such daily invested capital as is ap-
16 plicable under section 720 in reduction of the
17 average invested capital of the preceding taxable
18 year;

19 (B) for the taxable year of less than twelve
20 months consisting of that part of the remainder of
21 its base period during which it was not in existence,
22 shall be the amount ascertained for a full year under
23 subparagraph (A), multiplied by the number of
24 days in such taxable year of less than twelve months
25 and divided by the number of days in the twelve
26 months ending with the close of such taxable year.

1 (3) In no case shall the average base period net
2 income be less than zero.

3 (4) For the computation of average base period net
4 income in the case of certain reorganizations, see section
5 742.

6 (e) AVERAGE BASE PERIOD NET INCOME--GENERAL
7 AVERAGE.—The average base period net income determined
8 under this subsection shall be determined as follows:

9 (1) By computing the aggregate of the excess
10 profits net income for each of the taxable years of the
11 taxpayer in the base period, reduced, if for more than
12 one of such taxable years there was a deficit in excess
13 profits net income, by the sum of such deficits, exclud-
14 ing the greatest;

15 (2) By dividing the amount ascertained under para-
16 graph (1) by the total number of months in all such
17 taxable years; and

18 (3) By multiplying the amount ascertained under
19 paragraph (2) by twelve.

20 (f) AVERAGE BASE PERIOD NET INCOME--INCREASED
21 EARNINGS IN LAST HALF OF BASE PERIOD.—The average
22 base period net income determined under this subsection shall
23 be determined as follows:

24 (1) By computing, for each of the taxable years
25 of the taxpayer in its base period, the excess profits net

1 income for such year, or the deficit in excess profits net
2 income for such year;

3 (2) By computing for each half of the base period
4 the aggregate of the excess profits net income for each
5 of the taxable years in such half, reduced, if for one or
6 more of such years there was a deficit in excess profits
7 net income, by the sum of such deficits. For the pur-
8 poses of such computation, if any taxable year is partly
9 within each half of the base period there shall be allo-
10 cated to the first half an amount of the excess profits net
11 income or deficit in excess profits net income, as the
12 case may be, for such taxable year, which bears the same
13 ratio thereto as the number of months falling within such
14 half bears to the entire number of months in such taxable
15 year; and the remainder shall be allocated to the second
16 half;

17 (3) If the amount ascertained under paragraph
18 (2) for the second half is greater than the amount
19 ascertained for the first half, by dividing the difference
20 by two;

21 (4) By adding the amount ascertained under para-
22 graph (3) to the amount ascertained under paragraph
23 (2) for the second half of the base period;

24 (5) By dividing the amount found under para-
25 graph (4) by the number of months in the second half

1 of the base period and by multiplying the result by
2 twelve;

3 (6) The amount ascertained under paragraph (5)
4 shall be the average base period net income determined
5 under this subsection, except that the average base period
6 net income determined under this subsection shall in no
7 case be greater than the highest excess profits net income
8 for any taxable year in the base period. For the pur-
9 pose of such limitation if any taxable year is of less
10 than twelve months, the excess profits net income for
11 such taxable year shall be placed on an annual basis by
12 multiplying by twelve and dividing by the number of
13 months included in such taxable year.

14 (7) For the purposes of this subsection, the excess
15 profits net income for any taxable year ending after
16 May 31, 1940, shall not be greater than an amount
17 computed as follows:

18 (A) By reducing the excess profits net income
19 by an amount which bears the same ratio thereto
20 as the number of months after May 31, 1940, bears
21 to the total number of months in such taxable year;
22 and

23 (B) By adding to the amount ascertained under
24 subparagraph (A) an amount which bears the
25 same ratio to the excess profits net income for the

1 last preceding taxable year as such number of
2 months after May 31, 1940, bears to the number of
3 months in such preceding year. The amount added
4 under this subparagraph shall not exceed the amount
5 of the excess profits net income for such last pre-
6 ceding taxable year.

7 (C) If the number of months in such pre-
8 ceding taxable year is less than such number of
9 months after May 31, 1940, by adding to the
10 amount ascertained under subparagraph (B) an
11 amount which bears the same ratio to the excess
12 profits net income for the second preceding taxable
13 year as the excess of such number of months after
14 May 31, 1940, over the number of months in such
15 preceding taxable year bears to the number of
16 months in such second preceding taxable year.

17 (g) ADJUSTMENTS IN EXCESS PROFITS CREDIT ON
18 ACCOUNT OF CAPITAL CHANGES.—For the purposes of this
19 section—

20 (1) The net capital addition for the taxable year
21 shall be the excess, divided by the number of days in the
22 taxable year, of the aggregate of the daily capital addi-
23 tion for each day of the taxable year over the aggregate
24 of the daily capital reduction for each day of the taxable
25 year.

1 (2) The net capital reduction for the taxable year
2 shall be the excess, divided by the number of days in
3 the taxable year, of the aggregate of the daily capital
4 reduction for each day of the taxable year over the
5 aggregate of the daily capital addition for each day of
6 the taxable year.

7 (3) The daily capital addition for any day of the
8 taxable year shall be the aggregate of the amounts of
9 money and property paid in for stock, or as paid-in
10 surplus, or as a contribution to capital, after the begin-
11 ning of the taxpayer's first taxable year under this sub-
12 chapter and prior to such day. In determining the
13 amount of any property paid in, such property shall be
14 included in an amount determined in the manner pro-
15 vided in section 718 (a) (2). A distribution by the
16 taxpayer to its shareholders in its stock or rights to
17 acquire its stock shall not be regarded as money or
18 property paid in for stock, or as paid-in surplus, or as
19 a contribution to capital. The amount ascertained under
20 this paragraph shall be reduced by the excess, if any,
21 of the excluded capital for such day over the excluded
22 capital for the first day of the taxpayer's first taxable
23 year under this subchapter. For the purposes of this
24 paragraph the excluded capital for any day shall be an
25 amount equal to the sum of the following:

1 (A) The aggregate of the adjusted basis (for
2 determining loss upon sale or exchange) as of the
3 beginning of such day, of obligations held by the
4 taxpayer at the beginning of such day, which are
5 described in section 22 (b) (4) (A), (B), or (C)
6 any part of the interest from which is excludible
7 from gross income or allowable as a credit against
8 net income; and

9 (B) The aggregate of the adjusted basis (for
10 determining loss upon sale or exchange) as of the
11 beginning of such day, of stock of domestic cor-
12 porations held by the taxpayer at the beginning of
13 such day.

14 The daily capital addition shall in no case be less than
15 zero. (For daily capital additions and reductions in case
16 of certain reorganizations, see section 743.)

17 (4) The daily capital reduction for any day of the
18 taxable year shall be the aggregate of the amounts of
19 distributions to shareholders, not out of earnings and
20 profits, after the beginning of the taxpayer's first taxable
21 year under this subchapter and prior to such day.

22 **SEC. 714. EXCESS PROFITS CREDIT—BASED ON INVESTED**
23 **CAPITAL.**

24 The excess profits credit, for any taxable year, computed
25 under this section, shall be an amount equal to 8 per centum

1 of the taxpayer's invested capital for the taxable year, deter-
 2 mined under section 715.

3 *The excess profits credit, for any taxable year, computed*
 4 *under this section, shall be the amount shown in the following*
 5 *table:*

*If the invested capital for the
 taxable year, determined
 under section 715, is:*

The credit shall be:

<i>Not over \$5,000,000-----</i>	<i>8% of the invested capital.</i>
<i>Over \$5,000,000-----</i>	<i>\$400,000, plus 7% of the excess over \$5,000,000.</i>

6 **SEC. 715. DEFINITION OF INVESTED CAPITAL.**

7 For the purposes of this subchapter the invested capital
 8 for any taxable year shall be the average invested capital
 9 for such year, determined under section 716, reduced by an
 10 amount computed under section 720 (relating to inadmis-
 11 sible assets). If the Commissioner finds that in any case
 12 the determination of invested capital, on a basis other than
 13 a daily basis, will produce an invested capital differing by
 14 not more than \$1,000 from an invested capital determined
 15 on a daily basis, he may, under regulations prescribed by him
 16 with the approval of the Secretary, provide for such deter-
 17 mination on such other basis. (For computation of invested
 18 capital in case of foreign corporations and corporations en-
 19 titled to the benefits of section 251, see section 724.)

20 **SEC. 716. AVERAGE INVESTED CAPITAL.**

21 The average invested capital for any taxable year shall
 22 be the aggregate of the daily invested capital for each day of

1 such taxable year, divided by the number of days in such
2 taxable year.

3 **SEC. 717. DAILY INVESTED CAPITAL.**

4 The daily invested capital for any day of the taxable year
5 shall be the sum of the equity invested capital for such day
6 plus the borrowed invested capital for such day determined
7 under section 719.

8 **SEC. 718. EQUITY INVESTED CAPITAL.**

9 (a) **DEFINITION.**—The equity invested capital for any
10 day of any taxable year shall be determined as of the begin-
11 ning of such day and shall be the sum of the following
12 amounts, reduced as provided in subsection (b)—

13 (1) **MONEY PAID IN.**—Money previously paid in
14 for stock, or as paid-in surplus, or as a contribution to
15 capital;

16 (2) **PROPERTY PAID IN.**—Property (other than
17 money) previously paid in (regardless of the time paid
18 in) for stock, or as paid-in surplus, or as a contribution
19 to capital. Such property shall be included in an amount
20 equal to its basis (unadjusted) for determining loss upon
21 sale or exchange. If the property was disposed of be-
22 fore such taxable year, such basis shall be determined in
23 the same manner as if the property were still held at
24 the beginning of such taxable year. If such unadjusted
25 basis is a substituted basis it shall be adjusted, with

1 respect to the period before the property was paid in,
2 in the manner provided in section 113 (b) (2);

3 (3) DISTRIBUTION IN STOCK.—Distributions in
4 stock—

5 (A) Made prior to such taxable year to the ex-
6 tent to which they are considered distributions of
7 earnings and profits; and

8 (B) Previously made during such taxable year
9 to the extent to which they are considered distribu-
10 tions of earnings and profits other than earnings and
11 profits of such taxable year;

12 (4) EARNINGS AND PROFITS AT BEGINNING OF
13 YEAR.—The accumulated earnings and profits as of the
14 beginning of such taxable year; and

15 (5) INCREASE ON ACCOUNT OF GAIN ON TAX-
16 FREE LIQUIDATION.—In the case of the previous re-
17 ceipt of property (other than property described in the
18 last sentence of section 113 (a) (15)) by the taxpayer
19 in complete liquidation of another corporation under sec-
20 tion 112 (b) (6), or the corresponding provision of a
21 prior revenue law, an amount, with respect to each such
22 liquidation, equal to the amount by which the aggregate
23 of the amount of the money so received and of the ad-
24 justed basis, at the time of receipt, of all property (other
25 than money) so received, exceeds the sum of:

1 (A) The aggregate of the adjusted basis of each
2 share of stock with respect to which such property
3 was received; such adjusted basis of each share to
4 be determined immediately prior to the receipt of
5 any property in such liquidation with respect to such
6 share, and

7 (B) The aggregate of the liabilities of such
8 other corporation assumed by the taxpayer in con-
9 nection with the receipt of such property, of the lia-
10 bilities (not assumed by the taxpayer) to which
11 such property so received was subject, and of any
12 other consideration (other than the stock with re-
13 spect to which such property was received) given
14 by the taxpayer for such property so received.
15 *received; and*

16 (6) *NEW CAPITAL.*—An amount equal to 25 per
17 centum of the new capital for such day. The term
18 “new capital” for any day means so much of the amounts
19 of money or property includible for such day under
20 paragraphs (1) and (2) as was previously paid in
21 during a taxable year beginning after December 31,
22 1940, and so much of the distributions in stock in-
23 cludible for such day under paragraph (3) as was pre-
24 viously made during a taxable year beginning after
25 December 31, 1940, subject to the following limitations:

1. (A) There shall not be included money or
2. property paid in by a corporation in an exchange to
3. which section 112 (b) (3), (4), or (5), or so
4. much of section 112 (c), (d), or (e) as refers to
5. section 112 (b) (3), (4), or (5) is applicable, or
6. would have been applicable if the term "control" had
7. been defined in section 112 (h) to mean the owner-
8. ship of stock possessing more than 50 per centum of
9. the total combined voting power of all classes of
10. stock entitled to vote or more than 50 per centum
11. of the total value of shares of all classes of stock.

12. (B) There shall not be included money or
13. property paid in to the taxpayer by a transferor cor-
14. poration if immediately after such transaction the
15. transferor and the taxpayer are members of the same
16. controlled group. As used in this subparagraph and
17. subparagraph (C), a controlled group means one or
18. more chains of corporations connected through stock
19. ownership with a common parent corporation if (i)
20. more than 50 per centum of the total combined
21. voting power of all classes of stock entitled to vote,
22. or more than 50 per centum of the total value of
23. shares of all classes of stock, of each of the cor-
24. porations (except the common parent corporation)
25. is owned directly by one or more of the other

1 corporations, and (ii) the common parent cor-
2 poration owns directly more than 50 per centum
3 of the total combined voting power of all classes
4 of stock entitled to vote, or more than 50 per
5 centum of the total value of shares of all classes
6 of stock, of at least one of the other corporations.

7 (C) There shall not be included a distribution
8 in stock described in paragraph (3) made to another
9 corporation, if immediately after the distribution the
10 taxpayer and the distributee are members of the
11 same controlled group.

12 (D) Increase in Inadmissible Assets.—The new
13 capital for any day of the taxable year, computed
14 without the application of subparagraph (E), shall
15 be reduced by the excess, if any, of the amount com-
16 puted under section 720 (b) with respect to inad-
17 missible assets held on such day, over the amount
18 computed under section 720 (b) with respect to
19 inadmissible assets held on the first day of the tax-
20 payer's first taxable year beginning after December
21 31, 1940. For the purposes of this subparagraph,
22 in determining whether obligations which are de-
23 scribed in section 22 (b) (4) any part of the interest
24 from which is excludible from gross income or
25 allowable as a credit against net income are to be

1 *treated as admissible or inadmissible assets, such*
2 *obligations shall be treated in the same manner as*
3 *they are treated for the taxable year for which tax*
4 *under this subchapter is being computed.*

5 *(E) Maximum New Capital Allowable.—The*
6 *new capital for any day of the taxable year shall not*
7 *be more than the amount, if any, by which—*

8 *(i) the sum of the equity invested capital*
9 *(computed without regard to this paragraph)*
10 *and the borrowed capital (as defined in section*
11 *719 (a)) of the taxpayer as of such day, re-*
12 *duced by the amount of money or property paid*
13 *in which is excluded by reason of the limitation*
14 *of subparagraph (A) or (B) of this para-*
15 *graph, exceeds*

16 *(ii) the sum of such equity invested capital*
17 *and borrowed capital as of the beginning of the*
18 *first day of such taxpayer's first taxable year*
19 *beginning after December 31, 1940, reduced by*
20 *the amount, if any, by which the accumulated*
21 *earnings and profits as of such first day of such*
22 *first taxable year exceed the accumulated*
23 *earnings and profits (computed without regard*
24 *to distributions made in taxable years beginning*
25 *after December 31, 1940) as of the beginning*

1 *of the first day of the taxable year for which*
2 *the tax under this subchapter is being com-*
3 *puted.*

4 (b) **REDUCTION IN EQUITY INVESTED CAPITAL.—**

5 The amount by which the equity invested capital for any day
6 shall be reduced as provided in subsection (a) shall be the
7 sum of the following amounts—

8 (1) **DISTRIBUTIONS IN PREVIOUS YEARS.—**Distri-
9 butions made prior to such taxable year which were not
10 out of accumulated earnings and profits;

11 (2) **DISTRIBUTIONS DURING THE YEAR.—**Distribu-
12 tions previously made during such taxable year which
13 are not out of the earnings and profits of such taxable
14 year;

15 (3) **EARNINGS AND PROFITS OF ANOTHER COR-**
16 **PORATION.—**The earnings and profits of another cor-
17 poration which previously at any time were included in
18 accumulated earnings and profits by reason of a trans-
19 action described in section 112 (b) to (e), both inclu-
20 sive, or in the corresponding provision of a prior revenue
21 law, or by reason of the transfer by such other corpora-
22 tion to the taxpayer of property the basis of which in
23 the hands of the taxpayer is or was determined with
24 reference to its basis in the hands of such other corpora-

tion, or would have been so determined if the property had been other than money; and

(4) REDUCTION ON ACCOUNT OF LOSS ON TAX-

FREE LIQUIDATION.—In the case of the previous receipt of property (other than property described in the last sentence of section 113 (a) (15)) by the taxpayer in complete liquidation of another corporation under section 112 (b) (6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the sum of—

(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the taxpayer for such property so received,

1 exceeds the aggregate of the amount of the money so
2 received and of the adjusted basis, at the time of receipt,
3 of all property (other than money) so received. The
4 amount of the reduction under this paragraph shall not
5 exceed the accumulated earnings and profits as of the
6 beginning of such taxable year.

7 (c) RULES FOR APPLICATION OF SUBSECTIONS (A)
8 AND (B).—For the purposes of subsections (a) and (b)—

9 (1) DISTRIBUTIONS TO SHAREHOLDERS.—The
10 term “distribution” means a distribution by a corporation
11 to its shareholders, and the term “distribution in stock”
12 means a distribution by a corporation in its stock or
13 rights to acquire its stock. To the extent that a distribu-
14 tion in stock is not considered a distribution of earnings
15 and profits it shall not be considered a distribution. A
16 distribution in stock shall not be regarded as money or
17 property paid in for stock, or as paid-in surplus, or as a
18 contribution to capital.

19 (2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF TAX-
20 ABLE YEAR.—In the application of such subsections to
21 any taxable year beginning after December 31, 1940,
22 so much of the distributions (taken in the order of time)
23 made during the first sixty days thereof as does not
24 exceed the accumulated earnings and profits as of the
25 beginning thereof (computed without regard to this

1 paragraph) shall be considered to have been made on
2 the last day of the preceding taxable year.

3 (3) COMPUTATION OF EARNINGS AND PROFITS OF
4 TAXABLE YEAR.—For the purposes of subsections (a)
5 (3) (B) and (b) (2) in determining whether a dis-
6 tribution is out of the earnings and profits of any taxable
7 year, such earnings and profits shall be computed as of
8 the close of such taxable year without diminution by
9 reason of any distribution made during such taxable year
10 or by reason of the tax under this subchapter or Chapter
11 1 for such year and the determination shall be made
12 without regard to the amount of earnings and profits at
13 the time the distribution was made.

14 (4) STOCK IN CASE OF MERGER OR CONSOLIDATION.—If a corporation owns stock in another corpora-
15 tion, and—
16

17 (A) such corporations are merged or consoli-
18 dated in a statutory merger or consolidation, or

19 (B) such corporations are parties to a transac-
20 tion which results in the elimination of such stock
21 in a manner similar to that resulting from a statutory
22 merger or consolidation,

23 then such stock shall not be considered as property paid
24 in for stock of, or as paid-in surplus of, or as a contribu-
25 tion to capital of, the corporation resulting from the

1 transaction referred to in subparagraph (A) or (B).

2 (d) For special rules affecting computation of property
3 paid in for stock in connection with certain exchanges and
4 liquidations, see section 751 (a).

5 (e) For determination of equity invested capital in
6 special cases, see section 728.

7 **SEC. 719. BORROWED INVESTED CAPITAL.**

8 (a) **BORROWED CAPITAL.**—The borrowed capital for
9 any day of any taxable year shall be determined as of the
10 beginning of such day and shall be the sum of the following:

11 (1) The amount of the outstanding indebtedness
12 (not including interest, and not including indebtedness
13 described in section 751 (b) relating to certain ex-
14 changes) of the taxpayer which is evidenced by a bond,
15 note, bill of exchange, debenture, certificate of indebted-
16 ness, mortgage, or deed of trust, plus,

17 (2) In the case of a taxpayer having a contract
18 (made before the expiration of 30 days after the date of
19 the enactment of the Second Revenue Act of 1940) with
20 a foreign government to furnish articles, materials, or
21 supplies to such foreign government, if such contract
22 provides for advance payment and for repayment by the
23 vendor of any part of such advance payment upon can-
24 cellation of the contract by such foreign government,
25 the amount which would be required to be so repaid if

1 cancellation occurred at the beginning of such day, but
 2 no amount shall be considered as borrowed capital under
 3 this paragraph which has been includible in gross income.

4 (b) **BORROWED INVESTED CAPITAL.**—The borrowed
 5 invested capital for any day of any taxable year shall be
 6 determined as of the beginning of such day and shall be an
 7 amount equal to 50 per centum of the borrowed capital for
 8 such day.

9 **SEC. 720. ADMISSIBLE AND INADMISSIBLE ASSETS.**

10 (a) **DEFINITIONS.**—For the purposes of this sub-
 11 chapter—

12 (1) The term “inadmissible assets” means—

13 (A) Stock in corporations except stock in a
 14 foreign personal-holding company, and except stock
 15 which is not a capital asset; and

16 (B) Except as provided in subsection (d),
 17 obligations described in section 22 (b) (4) any
 18 part of the interest from which is excludible from
 19 gross income or allowable as a credit against net
 20 income.

21 (2) The term “admissible assets” means all assets
 22 other than inadmissible assets.

23 (b) **RATIO OF INADMISSIBLES TO TOTAL ASSETS.**—

24 The amount by which the average invested capital for any
 25 taxable year shall be reduced as provided in section 715

1 shall be an amount which is the same percentage of such
2 average invested capital as the percentage which the total
3 of the inadmissible assets is of the total of admissible and in-
4 admissible assets. For such purposes, the amount attribut-
5 able to each asset held at any time during such taxable year
6 shall be determined by ascertaining the adjusted basis thereof
7 (or, in the case of money, the amount thereof) for each day
8 of such taxable year so held and adding such daily amounts.
9 The determination of such daily amounts shall be made under
10 regulations prescribed by the Commissioner with the approval
11 of the Secretary. The adjusted basis shall be the adjusted
12 basis for determining loss upon sale or exchange as deter-
13 mined under section 113.

14 (c) COMPUTATION IF SHORT-TERM CAPITAL GAIN.—
15 If during the taxable year there has been a short-term capital
16 gain with respect to an inadmissible asset, then so much of the
17 amount attributable to such inadmissible asset under subsec-
18 tion (b) as bears the same ratio thereto as such gain bears
19 to the sum of such gain plus the dividends and interest on
20 such asset for such year, shall, for the purpose of determining
21 the ratio of inadmissible assets to the total of admissible and
22 inadmissible assets, be added to the total of admissible assets
23 and subtracted from the total of inadmissible assets.

24 (d) TREATMENT OF GOVERNMENT OBLIGATIONS AS
25 ADMISSIBLE ASSETS.—If the excess profits credit for any

1 taxable year is computed under section 714, the taxpayer may
2 in its return for such year elect to increase its normal-tax net
3 income for such taxable year by an amount equal to the
4 amount of the interest on all obligations held during the tax-
5 able year which are described in section 22 (b) (4) any
6 part of the interest from which is excludible from gross in-
7 come or allowable as a credit against net income. In such
8 case, for the purposes of this section, the term "admissible
9 assets" includes such obligations, and the term "inadmissible
10 assets" does not include such obligations.

11 **SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PE-**
12 **RIOD.**

13 (a) **DEFINITIONS.**—For the purposes of this section—

14 (1) **ABNORMAL INCOME.**—The term "abnormal
15 income" means income of any class includible in the gross
16 income of the taxpayer for any taxable year under this
17 subchapter if it is abnormal for the taxpayer to derive
18 income of such class, or, if the taxpayer normally de-
19 rives income of such class but the amount of such income
20 of such class includible in the gross income of the tax-
21 able year is in excess of 125 per centum of the average
22 amount of the gross income of the same class for the four
23 previous taxable years, or, if the taxpayer was not in
24 existence for four previous taxable years, the taxable
25 years during which the taxpayer was in existence.

1 (2) SEPARATE CLASSES OF INCOME.—Each of the
2 following subparagraphs shall be held to describe a
3 separate class of income:

4 (A) Income arising out of a claim, award,
5 judgment, or decree, or interest on any of the fore-
6 going; or

7 (B) Income constituting an amount payable
8 under a contract the performance of which required
9 more than 12 months; or

10 (C) Income resulting from exploration, discov-
11 ery, prospecting, research, or development of tangi-
12 ble property, patents, formulae, or processes, or any
13 combination of the foregoing, extending over a
14 period of more than 12 months; or

15 (D) Income includible in gross income for the
16 taxable year rather than for a different taxable
17 year by reason of a change in the taxpayer's ac-
18 counting period or method of accounting; or

19 (E) In the case of a lessor of real property,
20 income included in gross income for the taxable year
21 by reason of the termination of the lease; or

22 (F) Income consisting of dividends on stock of
23 foreign corporations, except foreign personal holding
24 companies.

25 All the income which is classifiable in more than one of
26 such subparagraphs shall be classified under the one

1 which the taxpayer irrevocably elects. The classifica-
2 tion of income of any class not described in subparagraphs
3 (A) to (F), inclusive, shall be subject to regulations
4 prescribed by the Commissioner with the approval of the
5 Secretary.

6 (3) **NET ABNORMAL INCOME.**—The term “net ab-
7 normal income” means the amount of the abnormal in-
8 come less, under regulations prescribed by the Com-
9 missioner with the approval of the Secretary, (A) 125
10 per centum of the average amount of the gross income
11 of the same class determined under paragraph (1),
12 and (B) an amount which bears the same ratio to the
13 amount of any direct costs or expenses, deductible in
14 determining the normal-tax net income of the taxable
15 year, through the expenditure of which such abnormal
16 income was in whole or in part derived as the excess of
17 the amount of such abnormal income over 125 per
18 centum of such average amount bears to the amount of
19 such abnormal income.

20 (b) **AMOUNT ATTRIBUTABLE TO OTHER YEARS.**—
21 The amount of the net abnormal income that is attributable
22 to any previous or future taxable year or years shall be
23 determined under regulations prescribed by the Commissioner
24 with the approval of the Secretary. In the case of amounts
25 otherwise attributable to future taxable years, if the tax-

1 payer either transfers substantially all its properties or dis-
2 tributes any property in complete liquidation, then there shall
3 be attributable to the first taxable year in which such trans-
4 fer or distribution occurs (or if such year is previous to the
5 taxable year in which the abnormal income is includible in
6 gross income, to such latter taxable year) all amounts so
7 attributable to future taxable years not included in the gross
8 income of a previous taxable year.

9 (c) COMPUTATION OF TAX FOR CURRENT TAXABLE
10 YEAR.—The tax under this subchapter for the taxable year,
11 in which the whole of such abnormal income would without
12 regard to this section be includible, shall not exceed the
13 sum of:

14 (1) The tax under this subchapter for such taxable
15 year computed without the inclusion in gross income of
16 the portion of the net abnormal income which is attrib-
17 utable to any other taxable year, and

18 (2) The aggregate of the increase in the tax under
19 this subchapter which would have resulted for each pre-
20 vious taxable year to which any portion of such net
21 abnormal income is attributable, computed as if an
22 amount equal to such portion had been included in the
23 gross income for such previous taxable year.

24 (d) COMPUTATION OF TAX FOR FUTURE TAXABLE
25 YEAR.—The amount of the net abnormal income attributable
26 to any future taxable year shall, for the purposes of this sub-

1 chapter, be included in the gross income for such taxable
2 year. The tax under this subchapter for such future taxable
3 year shall not exceed the sum of—

4 (1) the tax under this subchapter for such future
5 taxable year computed without the inclusion in excess
6 profits net income of the portion of such net abnormal
7 income which is attributable to such year, and

8 (2) the decrease in the tax under this subchapter
9 for the previous taxable year in which the whole of such
10 abnormal income would without regard to this section
11 be includible, which resulted by reason of the exclusion
12 of the whole or a part of the abnormal income from the
13 gross income for such previous taxable year; but the
14 amount of such decrease shall be diminished by the
15 aggregate of the increases in the tax under this sub-
16 chapter which have resulted for the taxable years inter-
17 vening between such previous taxable year and such
18 future taxable year because of the inclusion in the gross
19 income of the portions of such net abnormal income
20 attributable to such intervening years.

21 **SEC. 722. ADJUSTMENT OF ABNORMAL BASE PERIOD NET**
22 **INCOME.**

23 (a) **GENERAL RULE.**—In the case of a taxpayer whose
24 first taxable year under this subchapter begins in 1940; if
25 the taxpayer establishes—

1 (1) that the character of the business engaged in
2 by the taxpayer as of January 1, 1940, is different from
3 the character of the business engaged in during one or
4 more of the taxable years in its base period (as defined
5 in section 713 (b) (1)); or

6 (2) that in one or more of the taxable years in
7 such base period normal production, output, or operation
8 was interrupted or diminished because of the occurrence
9 of events abnormal in the case of such taxpayer; and

10 (3) the amount that would have been its average
11 base period net income—

12 (A) if the character of the business as of Janu-
13 ary 1, 1940, had been the same during each of the
14 taxable years of such base period; and

15 (B) if none of the abnormal events referred
16 to in paragraph (2) had occurred; and

17 (C) if in each of such taxable years none of
18 the items of gross income had been abnormally
19 large, and none of the items of deductions had been
20 abnormally small; and

21 (4) that the amount established under paragraph
22 (3) is greater than the average base period net income
23 computed under section 713 (d) or section 742; as
24 the case may be,

25 then the amount established under paragraph (3) shall be

1 considered as the average base period net income of the
2 taxpayer for the purposes of this subchapter.

3 (b) RULES FOR APPLICATION OF SUBSECTION (a) —

4 For the purposes of subsection (a) —

5 (1) High prices of materials, labor, capital, or any
6 other agent of production, low selling price of the prod-
7 uct of the taxpayer, or low physical volume of sales
8 owing to low demand for such product or for the output
9 of the taxpayer, shall not be considered as abnormal.

10 (2) The character of the business engaged in by the
11 taxpayer as of January 1, 1940, shall be considered dif-
12 ferent from the character of the business engaged in
13 during one or more of the taxable years in its base period
14 only if—

15 (A) there is a difference in the products or serv-
16 ices furnished; or

17 (B) there is a difference in the capacity for
18 production or operation; or

19 (C) there is a difference in the ratio of non-
20 borrowed capital to total capital; or

21 (D) the taxpayer was in existence during only
22 part of its base period; or

23 (E) the taxpayer acquired, before January 1,
24 1940, all or part of the assets of a competitor, with

1 the result that the competition of such competitor
2 was eliminated or diminished.

3 (3) The average base period net income determined
4 under subsection (a) (3) shall be computed in the
5 same manner as provided in section 713 (d), except
6 paragraphs (2) and (4), but for such purposes com-
7 puting excess profits net income and deficit in excess
8 profits net income on the basis of the assumptions made
9 in subsection (a) (3).

10 (4) If subsection (a) (1), or both subsections (a)
11 (1) and (a) (2) are applicable to any taxpayer, its
12 average base period net income under subsection (a)
13 (3) shall not exceed the excess profits net income (as
14 computed for the purposes of subsection (a) (3)) for
15 the last taxable year in such base period. For the pur-
16 poses of this paragraph, if such last taxable year is of
17 less than twelve months, the excess profits net income
18 for such taxable year shall be placed on an annual basis
19 by multiplying by twelve and dividing by the number
20 of months included in such taxable year.

21 (c) LIMITATION ON APPLICATION OF GENERAL
22 RULE.—This section shall not be applicable unless—

23 (1) the tax under this subchapter for the taxable
24 year computed without reference to this section, exceeds

1 6 per centum of the taxpayer's normal-tax net income for
2 such year; and

3 (2) the application of this section would result in a
4 diminution of the tax otherwise payable under this sub-
5 chapter for the taxable year by more than 10 per centum
6 thereof.

7 *For the purposes of this subsection and subsection (d) the*
8 *taxpayer's normal-tax net income shall be computed without*
9 *deduction of the tax imposed by this subchapter.*

10 (d) **EXTENT OF REDUCTION IN TAX UNDER THIS**
11 **SECTION.**—The application of this section shall not reduce
12 the tax payable under this subchapter for the taxable year
13 below 6 per centum of the taxpayer's normal-tax net income
14 for such year. The tax under this subchapter computed with
15 the application of subsection (a) shall be increased by an
16 amount equal to 10 per centum of the tax computed without
17 reference to this section.

18 (e) **APPLICATION FOR RELIEF UNDER THIS SEC-**
19 **TION.**—The taxpayer shall compute its tax and file its return
20 under this subchapter without the application of this section.
21 The benefits of this section shall not be allowed unless the
22 taxpayer, within six months from the date prescribed by law
23 for the filing of its return, makes application therefor in ac-
24 cordance with regulations to be prescribed by the Commis-

1 sioner with the approval of the Secretary, except that if the
2 Commissioner in the case of any taxpayer with respect to the
3 tax liability of any taxable year—

4 (1) issues a preliminary notice stating a deficiency
5 in the tax imposed by this subchapter such taxpayer may,
6 within ninety days after the date of such notice, make
7 such application, or

8 (2) mails a notice of deficiency (A) without having
9 previously issued a preliminary notice thereof or (B)
10 within ninety days after the date of such preliminary
11 notice, such taxpayer may claim the benefits of this sec-
12 tion in its petition to the Board or in an amended peti-
13 tion in accordance with the rules of the Board.

14 If the application is not filed within six months after the date
15 prescribed by law for the filing of the return, the application
16 of this section shall not reduce the tax otherwise determined
17 under this subchapter by an amount in excess of the amount
18 of the deficiency finally determined under this subchapter
19 without the application of this section. If the average base
20 period net income has been determined under subsection (a)
21 for any taxable year, the Commissioner may, by regulations
22 approved by the Secretary, prescribe the extent to which the
23 limitations prescribed by this subsection may be waived for
24 the purpose of determining the tax under this subchapter for
25 a subsequent taxable year.

1 SEC. 721. EQUITY INVESTED CAPITAL IN SPECIAL CASES.

2 Where the Commissioner determines that the equity in-
3 vested capital as of the beginning of the taxpayer's first
4 taxable year under this subchapter cannot be determined in
5 accordance with section 718, the equity invested capital as
6 of the beginning of such year shall be an amount equal to
7 the sum of (a) the money plus (b) the aggregate of the
8 adjusted basis of the assets of the taxpayer held by the tax-
9 payer at such time, such sum being reduced by the indebted-
10 ness outstanding at such time. The amount of the money,
11 assets, and indebtedness at such time shall be determined in
12 accordance with rules and regulations prescribed by the Com-
13 missioner with the approval of the Secretary. In such case,
14 the equity invested capital for each day after the beginning
15 of the taxpayer's first taxable year under this subchapter shall
16 be determined, in accordance with rules and regulations pre-
17 scribed by the Commissioner with the approval of the Secre-
18 tary, using as the basic figure the equity invested capital
19 as so determined.

20 SEC. 724. FOREIGN CORPORATIONS AND CORPORATIONS

21 ENTITLED TO BENEFITS OF SECTION 251--
22 INVESTED CAPITAL.

23 Notwithstanding section 715, in the case of a foreign
24 corporation engaged in trade or business within the United
25 States or having an office or place of business therein, and

1 in the case of a corporation entitled to the benefits of section
2 251, the invested capital for any taxable year shall be deter-
3 mined in accordance with rules and regulations prescribed by
4 the Commissioner with the approval of the Secretary, under
5 which—

6 (a) GENERAL RULE.—The daily invested capital for
7 any day of the taxable year shall be the aggregate of the
8 adjusted basis of each United States asset held by the tax-
9 payer on the beginning of such day. In the application of
10 section 720 in reduction of the average invested capital (de-
11 termined on the basis of such daily invested capital), the
12 terms “admissible assets” and “inadmissible assets” shall
13 include only United States assets; or

14 (b) EXCEPTION.—If the Commissioner determines that
15 the United States assets of the taxpayer cannot satisfactorily
16 be segregated from its other assets, the invested capital for
17 the taxable year shall be an amount which is the same per-
18 centage of the aggregate of the adjusted basis of all assets
19 held by the taxpayer as of the end of the last day of the
20 taxable year which the net income for the taxable year from
21 sources within the United States is of the total net income of
22 the taxpayer for such year.

23 (c) DEFINITION OF UNITED STATES ASSET.—As used
24 in this subsection, the term “United States asset” means an
25 asset held by the taxpayer in the United States, determined

1 in accordance with rules and regulations prescribed by the
2 Commissioner with the approval of the Secretary.

3 **SEC. 725. PERSONAL SERVICE CORPORATIONS.**

4 (a) **DEFINITION.**—As used in this subchapter, the term
5 “personal service corporation” means a corporation whose
6 income is to be ascribed primarily to the activities of share-
7 holders who are regularly engaged in the active conduct of
8 the affairs of the corporation and are the owners at all times
9 during the taxable year of at least 70 per centum in value
10 of each class of stock of the corporation, and in which capital
11 is not a material income-producing factor; but does not in-
12 clude any foreign corporation, nor any corporation 50 per
13 centum or more of whose gross income consists of gains,
14 profits, or income derived from trading as a principal. For
15 the purposes of this subsection, an individual shall be con-
16 sidered as owning, at any time, the stock owned at such time
17 by his spouse or minor child or by any guardian or trustee
18 representing them.

19 (b) **ELECTION AS TO TAXABILITY.**—If a personal
20 service corporation signifies, in its return under Chapter 1
21 for any taxable year, its desire not to be subject to the tax
22 imposed under this subchapter for such taxable year, it shall
23 be exempt from such tax for such year, and the provisions
24 of Supplement S of Chapter 1 shall apply to the share-

1 holders in such corporation who were such shareholders on
2 the last day of such taxable year of the corporation.

3 **SEC. 726. CORPORATIONS COMPLETING CONTRACTS UN-**
4 **DER MERCHANT MARINE ACT, 1936.**

5 (a) If the United States Maritime Commission certifies
6 to the Commissioner that the taxpayer has completed within
7 the taxable year any contracts or subcontracts which are
8 subject to the provisions of section 505 (b) of the Merchant
9 Marine Act of 1936, as amended, then the tax imposed by
10 this subchapter for such taxable year shall be, in lieu of a
11 tax computed under section 710, a tax computed under
12 subsection (b) of this section, if, and only if, the tax com-
13 puted under subsection (b) is less than the tax computed
14 under section 710.

15 (b) The tax computed under this subsection shall be the
16 excess of—

17 (1) A tentative tax computed under section 710
18 with the normal-tax net income increased by the amount
19 of any payments made, or to be made, to the United
20 States Maritime Commission with respect to such con-
21 tracts or subcontracts; over

22 (2) The amount of such payments.

23 **SEC. 727. EXEMPT CORPORATIONS.**

24 The following corporations shall be exempt from the tax
25 imposed by this subchapter:

1 (a) Corporations exempt under section 101 from the
2 tax imposed by Chapter 1.

3 (b) Foreign personal-holding companies, as defined in
4 section 331.

5 (c) Mutual investment companies, as defined in section
6 361.

7 (d) Investment companies which under the Investment
8 Company Act of 1940 are registered as diversified companies
9 at all times during the taxable year. For the purposes of this
10 subsection, if a company is so registered before July 1, 1941,
11 it shall be considered as so registered at all times prior to
12 the date of such registration.

13 (e) Personal-holding companies, as defined in section
14 501.

15 (f) Foreign corporations not engaged in trade or busi-
16 ness within the United States and not having an office or
17 place of business therein.

18 (g) Domestic corporations satisfying the following con-
19 ditions:

20 (1) If 95 per centum or more of the gross income
21 of such domestic corporation for the three-year period
22 immediately preceding the close of the taxable year (or
23 for such part of such period during which the corpora-
24 tion was in existence) was derived from sources other
25 than sources within the United States; and

1 (2) If 50 per centum or more of its gross income
2 for such period or such part thereof was derived from the
3 active conduct of a trade or business.

4 (h) Any corporation subject to the provisions of Title
5 IV of the Civil Aeronautics Act of 1938, in the gross income
6 of which for any taxable year beginning after December 31,
7 1939, there is includible compensation received from the
8 United States for the transportation of mail by aircraft if,
9 after excluding from its gross income such compensation,
10 its adjusted excess profits net income for such year is zero
11 or less.

12 **SEC. 728. MEANING OF TERMS USED.**

13 The terms used in this subchapter shall have the same
14 meaning as when used in Chapter 1.

15 **SEC. 729. LAWS APPLICABLE.**

16 (a) **GENERAL RULE.**—All provisions of law (including
17 penalties) applicable in respect of the taxes imposed by Chap-
18 ter 1, shall, insofar as not inconsistent with this subchapter,
19 be applicable in respect of the tax imposed by this sub-
20 chapter.

21 (b) **RETURNS.**—

22 (1) **COMPUTATION OF EXCESS PROFITS CREDITS.**—

23 In the case of a taxpayer which under section 712 or
24 section 741 is entitled to have the excess profits credit
25 computed under section 713 or section 714, whichever.

1 results in the lesser tax under this subchapter, the return
2 under this subchapter for any taxable year shall contain
3 computations of two tentative taxes, one with the credit
4 computed under section 713 and one with the credit
5 computed under section 714; and the return shall con-
6 tain all information which the Commissioner, by regu-
7 lations prescribed by him with the approval of the
8 Secretary, may prescribe as necessary for such compu-
9 tations. If the taxpayer states in such return that it dis-
10 claims the use of one of such credits *the credit computed*
11 *under section 714* in the computation of the tax under
12 this subchapter for the taxable year, the computation
13 and information based on such credit may be omitted
14 from the return.

15 ~~(2) NO RETURN REQUIRED.~~ Notwithstanding sub-
16 section (a), no return under section 52 (a) shall be
17 required to be filed by any taxpayer under this sub-
18 chapter for any taxable year for which its excess profits
19 net income, computed with the adjustments provided in
20 section 711 (a) (2) and placed on an annual basis as
21 provided in section 711 (a) (2), is not greater than
22 \$5,000.

23 (2) NO RETURN REQUIRED.—Notwithstanding sub-
24 section (a), no return under section 52 (a) shall be
25 required to be filed under this subchapter:

1 (A) *By any taxpayer entitled to have its excess-*
 2 *profits credit computed under either section 713 or*
 3 *section 714 for any taxable year for which its excess-*
 4 *profits net income, computed with the adjustments*
 5 *provided in section 711 (a) (1) and placed on an*
 6 *annual basis as provided in section 711 (a) (3),*
 7 *is not greater than \$5,000; or*

8 (B) *By any taxpayer not entitled to have its*
 9 *excess-profits credit computed under section 713 for*
 10 *any taxable year for which its excess-profits net*
 11 *income, computed with the adjustments provided in*
 12 *section 711 (a) (2) and placed on an annual basis*
 13 *as provided in section 711 (a) (3), is not greater*
 14 *than \$5,000.*

15 (c) **FOREIGN TAXES PAID.**—In the application of sec-
 16 tion 181 for the purposes of this subchapter the tax paid or
 17 accrued to any country shall be deemed to be the amount
 18 of such tax reduced by the amount of the credit allowed with
 19 respect to such tax against the tax imposed by Chapter 1.

20 (d) **LIMITATIONS ON AMOUNT OF FOREIGN TAX**
 21 **CREDIT.**—The amount of the credit taken under this section
 22 shall be subject to each of the following limitations:

23 (1) The amount of the credit in respect of the tax
 24 paid or accrued to any country shall not exceed the same
 25 proportion of the tax against which such credit is taken,

1 which the taxpayer's excess profits net income from
2 sources within such country bears to its entire excess
3 profits net income for the same taxable year; and

4 (2) The total amount of the credit shall not exceed
5 the same proportion of the tax against which such credit
6 is taken, which the taxpayer's excess profits net income
7 from sources without the United States bears to its entire
8 excess profits net income for the same taxable year.

9 **SEC. 730. CONSOLIDATED RETURNS.**

10 (a) **PRIVILEGE TO FILE CONSOLIDATED RETURNS.**—

11 An affiliated group of corporations shall, subject to the pro-
12 visions of this section, have the privilege of making a consoli-
13 dated return for the taxable year in lieu of separate returns.

14 The making of a consolidated return shall be upon the con-
15 dition that all the corporations which have been members of
16 the affiliated group at any time during the taxable year for
17 which the return is made consent to all the regulations under
18 subsection (b) prescribed prior to the last day prescribed
19 by law for the filing of such return; and the making of a
20 consolidated return shall be considered as such consent. In
21 the case of a corporation which is a member of the affiliated
22 group for a fractional part of the year the consolidated return
23 shall include the income of such corporation for such part
24 of the year as it is a member of the affiliated group.

25 (b) **REGULATIONS.**—The Commissioner, with the ap-

1 proval of the Secretary, shall prescribe such regulations as he
2 may deem necessary in order that the tax liability of any
3 affiliated group of corporations making a consolidated return
4 and of each corporation in the group, both during and after
5 the period of affiliation, may be returned, determined, com-
6 puted, assessed, collected, and adjusted, in such manner as
7 clearly to reflect the excess profits tax liability and the various
8 factors necessary for the determination of such liability, and
9 in order to prevent avoidance of such tax liability.

10 (c) COMPUTATION AND PAYMENT OF TAX.—In any
11 case in which a consolidated return is made the tax shall be
12 determined, computed, assessed, collected, and adjusted in
13 accordance with the regulations under subsection (b) pre-
14 scribed prior to the last day prescribed by law for the filing
15 of such return. Only one specific exemption of \$5,000 pro-
16 vided in section 710 (b) (1) shall be allowed for the entire
17 affiliated group of corporations.

18 (d) DEFINITION OF "AFFILIATED GROUP".—As used
19 in this section, an "affiliated group" means one or more
20 chains of includible corporations connected through stock
21 ownership with a common parent corporation which is an
22 includible corporation if—

23 (1) At least 95 per centum of each class of the
24 stock of each of the includible corporations (except the
25 common parent corporation) is owned directly by one
26 or more of the other includible corporations; and

1 **(2) The common parent corporation owns directly**
2 **at least 95 per centum of each class of the stock of at**
3 **least one of the other includible corporations.**

4 **As used in this subsection, the term "stock" does not include**
5 **nonvoting stock which is limited and preferred as to divi-**
6 **dends.**

7 **(e) DEFINITION OF "INCLUDIBLE CORPORATION".—**

8 **As used in this section, the term "includible corporation"**
9 **means any corporation except—**

10 **(1) Corporations exempt from the tax imposed by**
11 **this subchapter.**

12 **(2) Foreign corporations.**

13 **(3) Corporations organized under the China Trade**
14 **Act, 1922.**

15 **(4) Corporations entitled to the benefits of section**
16 **251, by reason of receiving a large percentage of their**
17 **income from possessions of the United States.**

18 **(5) Personal service corporations.**

19 **(6) Insurance companies subject to taxation under**
20 **section 201 or 207.**

21 **(f) INCLUDIBLE INSURANCE COMPANIES.—Despite the**
22 **provisions of paragraph (6) of subsection (e), two or more**
23 **domestic insurance companies each of which is subject to**
24 **taxation under the same section of Chapter 1 shall be con-**
25 **sidered as includible corporations for the purpose of the ap-**

1 plication of subsection (d) to such insurance companies
2 alone.

3 (g) **SUBSIDIARY FORMED TO COMPLY WITH FOREIGN**
4 **LAW.**—In the case of a domestic corporation owning or con-
5 trolling, directly or indirectly, 100 per centum of the capital
6 stock (exclusive of directors' qualifying shares) of a cor-
7 poration organized under the laws of a contiguous foreign
8 country and maintained solely for the purpose of complying
9 with the laws of such country as to title and operation of
10 property, such foreign corporation may, at the option of the
11 domestic corporation, be treated for the purpose of this sub-
12 chapter as a domestic corporation.

13 (h) **SUSPENSION OF RUNNING OF STATUTE OF LIM-**
14 **TATIONS.**—If a notice under section 272 (a) in respect of a
15 deficiency for any taxable year is mailed to a corporation,
16 the suspension of the running of the statute of limitations,
17 provided in section 277, shall apply in the case of corpora-
18 tions with which such corporation made a consolidated return
19 for such taxable year.

20 **SEC. 71. CORPORATIONS ENGAGED IN MINING OF STRA-**
21 **TEGIC METALS.**

22 In the case of any domestic corporation engaged in
23 the mining of tungsten, quicksilver, manganese, platinum,
24 antimony, chromite, or tin, the portion of the adjusted excess
25 profits net income attributable to such mining in the United

1 States shall be exempt from the tax imposed by this sub-
2 chapter. The tax on the remaining portion of such adjusted
3 excess profits net income shall be an amount which bears the
4 same ratio to the tax computed without regard to this sec-
5 tion as such remaining portion bears to the entire adjusted
6 excess profits net income.

7 **SEC. 732. REVIEW OF ABNORMALITIES BY BOARD OF TAX**
8 **APPEALS.**

9 (a) **PETITION TO THE BOARD.**—If a claim for refund
10 of tax under this subchapter for any taxable year is dis-
11 allowed in whole or in part by the Commissioner, and the
12 disallowance relates to the application of section 711 (b)
13 (1) (H), (I), (J), or (K), section 721, or section 722,
14 relating to abnormalities, the Commissioner shall send notice
15 of such disallowance to the taxpayer by registered mail.
16 Within ninety days after such notice is mailed (not count-
17 ing Sunday or a legal holiday in the District of Columbia
18 as the ninetieth day) the taxpayer may file a petition with
19 the Board of Tax Appeals for a redetermination of the tax
20 under this subchapter. If such petition is so filed, such
21 notice of disallowance shall be deemed to be a notice of
22 deficiency for all purposes relating to the assessment and
23 collection of taxes or the refund or credit of overpayments.

24 (b) **DEFICIENCY FOUND BY BOARD IN CASE OF**
25 **CLAIM.**—If the Board finds that there is no overpayment of

1 tax in respect of any taxable year in respect of which the
2 Commissioner has disallowed, in whole or in part, a claim
3 for refund described in subsection (a) and the Board fur-
4 ther finds that there is a deficiency for such year, the Board
5 shall have jurisdiction to determine the amount of such defi-
6 ciency and such amount shall, when the decision of the
7 Board becomes final, be assessed and shall be paid upon
8 notice and demand from the collector.

9 (c) **FINALITY OF DETERMINATION.**—If in the deter-
10 mination of the tax liability under this subchapter the deter-
11 mination of any question is necessary solely by reason of
12 section 711 (b) (1) (H), (I), (J), or (K), section 721,
13 or section 722, the determination of such question shall not
14 be reviewed or redetermined by any court or agency except
15 the Board.

16 **SEC. 733. CAPITALIZATION OF ADVERTISING, ETC., EX-**
17 **PENDITURES.**

18 (a) **ELECTION TO CHARGE TO CAPITAL ACCOUNT.**—
19 For the purpose of computing the excess profits credit, a
20 taxpayer may elect, within six months after the date pre-
21 scribed by law for filing its return for its first taxable year
22 under this subchapter, to charge to capital account so much
23 of the deductions for taxable years in its applicable base
24 period on account of expenditures for advertising or the pro-
25 motion of good will, as, under rules and regulations pre-

1 scribed by the Commissioner with the approval of the Secre-
2 tary, may be regarded as capital investments. Such election
3 must be the same for all such taxable years, and must be
4 for the total amount of such expenditures which may be so
5 regarded as capital investments. In computing the excess
6 profits credit, no amount on account of such expenditures
7 shall be charged to capital account:

8 (1) For taxable years in the base period unless the
9 election authorized in subsection (a) is exercised, or

10 (2) For any taxable year prior to the beginning of
11 the base period.

12 (b) EFFECT OF ELECTION.—If the taxpayer exercises
13 the election authorized under subsection (a) —

14 (1) The net income for each taxable year in the
15 base period shall be considered to be the net income
16 computed with such deductions disallowed, and such
17 deductions shall not be considered as having diminished
18 earnings and profits. This paragraph shall be retroac-
19 tively applied as if it were a part of the law applicable
20 to each taxable year in the base period; and

21 (2) The treatment of such expenditures as deduc-
22 tions for a taxable year in the base period shall, for the
23 purposes of section 734 (b) (2), be considered treat-
24 ment which was not correct under the law applicable to
25 such year.

1 **SEC. 734. ADJUSTMENT IN CASE OF POSITION INCONSIST-**
2 **ENT WITH PRIOR INCOME TAX LIABILITY.**

3 **(a) DEFINITIONS.**—For the purposes of this section—

4 **(1) TAXPAYER.**—The term “taxpayer” means any
5 person subject to a tax under the applicable revenue Act.

6 **(2) INCOME TAX.**—The term “income tax” means
7 an income tax imposed by chapter 1 or chapter 2A of this
8 title; Title I and Title IA of the Revenue Acts of 1938,
9 1936, and 1934; Title I of the Revenue Acts of 1932
10 and 1928; Title II of the Revenue Acts of 1926 and
11 1924; Title II of the Revenue Acts of 1921 and 1918;
12 Title I of the Revenue Act of 1917; Title I of the
13 Revenue Act of 1916; or section II of the Act of
14 October 3, 1913; a war profits or excess profits tax im-
15 posed by Title III of the Revenue Acts of 1921 and
16 1918; or Title II of the Revenue Act of 1917; or an
17 income, war profits, or excess profits tax imposed by any
18 of the foregoing provisions, as amended or supplemented.

19 **(3) PRIOR TAXABLE YEAR.**—A taxable year be-
20 ginning after December 31, 1939, shall not be considered
21 a prior taxable year.

22 **(b) CIRCUMSTANCES OF ADJUSTMENT.**—

23 **(1) If—**

24 **(A)** in determining at any time the tax of a tax-
25 payer under this subchapter an item affecting the de-

1 termination of the excess profits credit is treated in a
2 manner inconsistent with the treatment accorded
3 such item in the determination of the income-tax lia-
4 bility of such taxpayer or a predecessor for a prior
5 taxable year or years, and

6 (B) the treatment of such item in the prior tax-
7 able year or years consistently with the determina-
8 tion under this subchapter would effect an increase
9 or decrease in the amount of the income taxes pre-
10 previously determined for such taxable year or years,
11 and

12 (C) on the date of such determination of the tax
13 under this subchapter correction of the effect of the
14 inconsistent treatment in any one or more of the
15 prior taxable years is prevented (except for the pro-
16 visions of section 3801) by the operation of any law
17 or rule of law (other than section 3761, relating to
18 compromises),

19 then the correction shall be made by an adjustment un-
20 der this section. If in a subsequent determination of the
21 tax under this subchapter for such taxable year such in-
22 consistent treatment is not adopted, then the correction
23 shall not be made in connection with such subsequent
24 determination.

25 (2) Such adjustment shall be made only if there is

1 adopted in the determination a position maintained by
2 the Commissioner (in case the net effect of the adjust-
3 ment would be a decrease in the income taxes previously
4 determined for such year or years) or by the taxpayer
5 with respect to whom the determination is made (in
6 case the net effect of the adjustment would be an in-
7 crease in the income taxes previously determined for
8 such year or years) which position is inconsistent with
9 the treatment accorded such item in the prior taxable
10 year or years which was not correct under the law
11 applicable to such year.

12 (c) METHOD AND EFFECT OF ADJUSTMENT.—(1) The
13 adjustment authorized by subsection (b), in the amount
14 ascertained as provided in subsection (d), if a net increase
15 shall be added to, and if a net decrease shall be subtracted
16 from, the tax otherwise computed under this subchapter for
17 the taxable year with respect to which such inconsistent posi-
18 tion is adopted.

19 (2) If more than one adjustment under this section is
20 made because more than one inconsistent position is adopted
21 with respect to one taxable year under this subchapter, the
22 separate adjustments, each an amount ascertained as pro-
23 vided in subsection (d), shall be aggregated, and the aggre-
24 gate net increase or decrease shall be added to or subtracted
25 from the tax otherwise computed under this subchapter for

1 the taxable year with respect to which such inconsistent
2 positions are adopted.

3 (3) If all the adjustments under this section, made on
4 account of the adoption of an inconsistent position or positions
5 with respect to one taxable year under this subchapter, result
6 in an aggregate net increase, the tax imposed by this sub-
7 chapter shall in no case be less than the amount of such
8 aggregate net increase.

9 (d) ASCERTAINMENT OF AMOUNT OF ADJUST-
10 MENT.—In computing the amount of an adjustment under
11 this section there shall first be ascertained the amount of the
12 income taxes previously determined for each of the prior
13 taxable years for which correction is prevented. The amount
14 of each such tax previously determined for each such taxable
15 year shall be (1) the tax shown by the taxpayer, or by the
16 predecessor, upon the return for such prior taxable year,
17 increased by the amounts previously assessed (or collected
18 without assessment) as deficiencies, and decreased by the
19 amounts previously abated, credited, refunded, or otherwise
20 repaid in respect of such tax; or (2) if no amount was
21 shown as the tax by such taxpayer or such predecessor upon
22 the return, or if no return was made by such taxpayer or
23 such predecessor, then the amounts previously assessed (or
24 collected without assessment) as deficiencies, but such
25 amounts previously assessed, or collected without assessment,

1 shall be decreased by the amounts previously abated, cred-
2 ited, refunded, or otherwise repaid in respect of such tax.
3 There shall then be ascertained the increase or decrease in
4 each such tax previously determined for each such year
5 which results solely from the treatment of the item consist-
6 ently with the treatment accorded such item in the determi-
7 nation of the tax liability under this subchapter. To the
8 increase or decrease so ascertained for each such tax for each
9 such year there shall be added interest thereon computed
10 as if the increase or decrease constituted a deficiency or an
11 overpayment, as the case may be, for such prior taxable
12 year. There shall be ascertained the difference between
13 the aggregate of such increases, plus the interest attributable
14 to each, and the aggregate of such decreases, plus the
15 interest attributable to each, and the net increase or de-
16 crease so ascertained shall be the amount of the adjustment
17 under this section with respect to the inconsistent treatment
18 of such item.

19 **Part II—Rules in Connection With Certain Exchanges**

20 **Supplement A—Excess Profits Credit Based on Income**

21 **SEC. 740. DEFINITIONS.**

22 For the purposes of this Supplement—

23 (a) **ACQUIRING CORPORATION.**—The term “acquir-
24 ing corporation” means—

25 (1) A corporation which has acquired—

1 (A) substantially all the properties of another
2 corporation and the whole or a part of the consid-
3 eration for the transfer of such properties is the
4 transfer to such other corporation of all the stock of
5 all classes (except qualifying shares) of the corpo-
6 ration which has acquired such properties, or

7 (B) substantially all the properties of another
8 corporation and the sole consideration for the trans-
9 fer of such properties is the transfer to such other
10 corporation of voting stock of the corporation which
11 has acquired such properties, or

12 (C) before October 1, 1940, properties of an-
13 other corporation solely as paid-in surplus or a
14 contribution to capital in respect of voting stock
15 owned by such other corporation, or

16 (D) substantially all the properties of a part-
17 nership in an exchange to which section
18 112 (b) (5), or so much of section 112 (c) or
19 (e) as refers to section 112 (b) (5), or to which
20 a corresponding provision of a prior revenue law, is
21 or was applicable.

22 For the purposes of subparagraphs (B) and (C) in
23 determining whether such voting stock or such paid-in
24 surplus or contribution to capital is the sole considera-
25 tion; the assumption by the acquiring corporation of a lia-

1 bility of the other, or the fact that property acquired is
 2 subject to a liability, shall be disregarded. Subparagraph
 3 (B) or (C) shall apply only if the corporation trans-
 4 ferring such properties is forthwith completely liquidated
 5 in pursuance of the plan under which the acquisition is
 6 made, and the transaction of which the acquisition is a
 7 part has the effect of a statutory merger or consolidation.

8 (2) A corporation which has acquired property from
 9 another corporation in a transaction with respect to which
 10 gain or loss was not recognized under section 112 (b)
 11 (6) of Chapter 1 or a corresponding provision of a prior
 12 revenue law;

13 (3) A corporation the result of a statutory merger
 14 of two or more corporations; or

15 (4) A corporation the result of a statutory consoli-
 16 dation of two or more corporations.

17 (b) COMPONENT CORPORATION.—The term “com-
 18 ponent corporation” means—

19 (1) In the case of a transaction described in sub-
 20 section (a) (1), the corporation which transferred the
 21 assets;

22 (2) In the case of a transaction described in sub-
 23 section (a) (2), the corporation the property of which
 24 was acquired;

25 (3) In the case of a statutory merger, all corpora-

1 tions merged, except the corporation resulting from the
2 merger; or

3 (4) In the case of a statutory consolidation, all
4 corporations consolidated, except the corporation result-
5 ing from the consolidation; or

6 (5) In the case of a transaction specified in subsec-
7 tion (a) (1) (D), the partnership whose properties
8 were acquired.

9 (c) **QUALIFIED COMPONENT CORPORATION.**—The
10 term “qualified component corporation” means a component
11 corporation which was in existence on the date of the begin-
12 ning of the taxpayer’s base period.

13 (d) **BASE PERIOD.**—In the case of a taxpayer which
14 is an acquiring corporation the base period shall be:

15 (1) If the tax is being computed for any taxable
16 year beginning in 1940, the forty-eight months preced-
17 ing the beginning of such taxable year; or

18 (2) If the tax is being computed for any taxable
19 year beginning after December 31, 1940, the forty-
20 eight months preceding what would have been its first
21 taxable year beginning in 1940 if it had had a taxable
22 year beginning in 1940 on the date on which the taxable
23 year for which the tax is being computed began.

24 (e) **BASE PERIOD YEARS.**—In the case of a taxpayer
25 which is an acquiring corporation its base period years shall

1 be the four successive twelve-month periods beginning on the
2 same date as the beginning of its base period.

3 (f) **EXISTENCE OF ACQUIRING CORPORATION.**—For
4 the purposes of subsection (c) and section 741, if any com-
5 ponent corporation was in existence on the date of the begin-
6 ning of the taxpayer's base period (either actually or by
7 reason of this subsection), its acquiring corporation shall be
8 considered to have been in existence on such date.

9 (g) **COMPONENT CORPORATIONS OF COMPONENT**
10 **CORPORATIONS.**—If a corporation is a component corporation
11 of an acquiring corporation, under subsection (b) or under
12 this subsection, it shall (except for the purposes of section
13 742 (d) (1) and (2) and section 743 (a)) also be a com-
14 ponent corporation of the corporation of which such acquiring
15 corporation is a component corporation.

16 (h) **SOLE PROPRIETORSHIP.**—For the purposes of sec-
17 tions 740 (a) (1) (D), 740 (b) (5), and 742 (g), a
18 business owned by a sole proprietorship shall be considered a
19 partnership.

20 **SEC. 741. ALLOWANCE OF EXCESS PROFITS CREDIT.**

21 (a) **ALLOWANCE.**—In the case of a taxpayer which is
22 an acquiring corporation which was in existence on the date
23 of the beginning of its base period, the excess profits credit
24 for any taxable year shall be an amount computed under
25 section 713 or section 714, whichever amount results in the

1 lesser tax under this subchapter for the taxable year for which
2 the tax under this subchapter is being computed.

3 (b) **EFFECT OF DISCLAIMER OF CREDIT.**—If the tax-
4 payer states in its return for the taxable year under this sub-
5 chapter that it disclaims the use of the credit computed under
6 section 713 or the use of the credit computed under section
7 714, the credit so disclaimed *section 714, such credit* shall not,
8 for the purposes of the internal revenue laws, be applicable
9 to the computation of the tax under this subchapter for such
10 taxable year.

11 **SEC. 742. AVERAGE BASE PERIOD NET INCOME.**

12 In the case of a taxpayer which is an acquiring corpo-
13 ration the excess profits credit of which is allowed under
14 section 741, its average base period net income (for the
15 purpose of the credit computed under section 713) if the
16 taxpayer was actually in existence before January 1, 1940,
17 shall, at the election of the taxpayer made in its return for
18 the taxable year, be computed as follows, and if the taxpayer
19 was not actually in existence before such date, shall be com-
20 puted as follows, in lieu of the method provided in section
21 713:

22 (a) By ascertaining with respect to each of its base
23 period years—

24 (1) The amount of its excess profits net income
25 for each of its taxable years beginning after December

1 31, 1935, and ending with or within such base period
2 year; or, in the case of each such taxable year in which
3 the deductions plus the credit for dividends received
4 exceeded the gross income, the amount of such excess;

5 (2) With respect to each of its qualified component
6 corporations, the amount of its excess profits net income
7 for each of its taxable years beginning after December
8 31, 1935, and ending with or within such base period
9 year of the taxpayer; or, in the case of each such taxable
10 year in which the deductions plus the credit for dividends
11 received exceeded the gross income, the amount of such
12 excess;

13 (3) (A) The aggregate of the amounts of excess
14 profits net income ascertained under paragraphs (1)
15 and (2); (B) the aggregate of the excesses ascertained
16 under paragraphs (1) and (2); and (C) the difference
17 between the aggregates found under clause (A) and
18 clause (B). If the aggregate ascertained under clause
19 (A) is greater than the aggregate found under clause
20 (B), the difference shall for the purposes of subsection
21 (b) be designated a "plus amount", and if the aggregate
22 ascertained under clause (B) is greater than the aggregate
23 found under clause (A), the difference shall for the
24 purposes of subsection (b) be designated a "minus
25 amount".

1 (b) By adding the plus amounts ascertained under sub-
2 section (a) (3) for each year of the base period; and by
3 subtracting from such sum, if for two or more years of the
4 base period there was a minus amount, the sum of such minus
5 amounts, excluding the greatest.

6 (c) By dividing the amount ascertained under subsec-
7 tion (b) by four.

8 (d) In no case shall the average base period net in-
9 come be less than zero. In the case of a taxpayer which
10 becomes an acquiring corporation in any taxable year begin-
11 ning after December 31, 1939, if, on September 11, 1940,
12 and at all times until the taxpayer became an acquiring
13 corporation—

14 (1) the taxpayer owned not less than 75 per
15 centum of each class of stock of each of the qualified
16 component corporations involved in the transaction in
17 which the taxpayer became an acquiring corporation;
18 or

19 (2) one of the qualified component corporations
20 involved in the transaction owned not less than 75 per
21 centum of each class of stock of the taxpayer, and of
22 each of the other qualified component corporations
23 involved in the transaction,

24 the average base period net income of the taxpayer shall not
25 be less than (A) the average base period net income of that

1 one of its qualified component corporations involved in the
2 transaction, the average base period net income of which is
3 greatest, or (B) the average base period net income of the
4 taxpayer computed without regard to the base period net
5 income of any of its qualified component corporations
6 involved in the transaction.

7 (e) For the purposes of subsection (a) (1) and (2)
8 of this section—

9 (1) There shall be excluded, in the various compa-
10 tations, any dividends paid by the taxpayer or any of its
11 qualified component corporations during any of the tax-
12 able years of the payor which are included in the com-
13 putation of the taxpayer's average base period net
14 income. If the payor corporation is a corporation de-
15 scribed in subsection (f) (1) or (2) of this section,
16 the dividends to be excluded under this paragraph shall
17 be only such as are paid after such payor corporation
18 first became an acquiring corporation; and

19 (2) In determining whether, for any taxable year,
20 the deductions plus the credit for dividends received ex-
21 ceeded the gross income, and in determining the amount
22 of such excess, the adjustments provided in section
23 711 (b) (1) shall be made.

24 (f) (1) In the case of a taxpayer which is an acquiring
25 corporation and which was not actually in existence on the

1 date of the beginning of its base period, there shall be ex-
2 cluded from the various computations under subsection
3 (a) (1) of this section the portion of its excess profits net
4 income, or of the excess over gross income therein referred
5 to, which is attributable to any period before it first became
6 an acquiring corporation.

7 (2) In the case of a component corporation which be-
8 came a qualified component corporation only by reason of
9 section 740 (f), there shall be excluded from the various
10 computations under subsection (a) (2) of this section the
11 portion of its excess profits net income, or of the excess over
12 gross income therein referred to, which is attributable to any
13 period before it first became an acquiring corporation.

14 (3) In the case of a qualified component corporation
15 which was actually in existence on the date of the begin-
16 ning of the taxpayer's base period, there shall be excluded
17 from the various computations under subsection (a) (2)
18 of this section the portion of its excess profits net income,
19 or of the excess over gross income therein referred to, which
20 is attributable to the period before such date.

21 (4) If during the taxable year for which tax is com-
22 puted under this subchapter the taxpayer acquires assets in a
23 transaction which constitutes it an acquiring corporation, the
24 amount includible under subsection (a) (2), attributable
25 to such transaction, shall be limited to an amount which

1 bears the same ratio to the amount computed without regard
2 to this paragraph as the number of days in the taxable year
3 after such transaction bears to the total number of days in
4 such taxable year.

5 (g) In the case of a partnership which is a component
6 corporation by virtue of section 740 (b) (5), the computa-
7 tions required by this Supplement shall be made, under
8 rules and regulations prescribed by the Commissioner with
9 the approval of the Secretary, as if such partnership had
10 been a corporation. For the purpose of such computations,
11 in making the adjustment for income taxes required by sec-
12 tion 711 (b) (1) (A), the partnership so regarded as a
13 corporation shall be considered as having distributed all its
14 net income as a dividend.

15 **SEC. 743. NET CAPITAL CHANGES.**

16 (a) For the purposes of section 713 (g), upon the date
17 of the transaction which constitutes a corporation an acquir-
18 ing corporation, there shall be added to its daily capital addi-
19 tion or reduction for such day, the net capital addition or re-
20 duction, as the case may be, of each of the component cor-
21 porations involved in such transaction, but no other capital
22 addition or reduction shall be considered as having been made
23 by reason of such transaction.

24 (b) For the purposes of this section--

25 (1) In computing the net capital addition of each

1 such component corporation there shall be disregarded
2 property paid in to such corporation by the taxpayer or
3 by any of its component corporations.

4 (2) In computing the net capital reduction of each
5 such component corporation there shall be disregarded
6 distributions made to the taxpayer or to any of such
7 component corporations.

8 **SEC. 744. FOREIGN CORPORATIONS.**

9 The term "corporation" as used in this Supplement does
10 not include a foreign corporation.

11 **Supplement B—Highest Bracket Amount and Invested Capital**

12 **SEC. 750. DEFINITIONS.**

13 As used in this Supplement—

14 (a) **EXCHANGE.**—The term "exchange" means an ex-
15 change, to which section 112 (b) (4) or (5) or so much
16 of section 112 (c), (d), or (e) as refers to section 112 (b)
17 (4) or (5), or to which a corresponding provision of a
18 prior revenue law, is or was applicable, by one corporation of
19 its property wholly or in part for stock or securities of an-
20 other corporation, or a transfer of property by one corpora-
21 tion to another corporation after December 31, 1917, the
22 basis of which in the hands of such other corporation is or
23 was determined under section 113 (a) (8) (B), or would
24 have been so determined had such section been in effect.

25 (b) **TRANSFER UPON AN EXCHANGE.**—The term

1 "transferor upon an exchange" means a corporation which
2 upon an exchange transfers property to another corpora-
3 tion in exchange, wholly or in part, for stock or securities
4 of such other corporation, or transfers property to another
5 corporation after December 31, 1917, the basis of which
6 in the hands of such other corporation is or was determined
7 under section 113 (a) (8) (B), or would have been so
8 determined had such section been in effect.

9 (c) TRANSFEREE UPON AN EXCHANGE.—The term
10 "transferee upon an exchange" means a corporation which
11 upon an exchange acquires property from another corpora-
12 tion in exchange, wholly or in part, for its stock or securi-
13 ties, or which acquires property from another corporation
14 after December 31, 1917, the basis of which in its hands
15 is or was determined under section 113 (a) (8) (B), or
16 would have been so determined had such section been in
17 effect.

18 (d) CONTROL.—The term "control" means the owner-
19 ship of stock possessing at least 90 per centum of the total
20 combined voting power of all classes of stock entitled to
21 vote and at least 90 per centum of the total value of shares
22 of all classes of stock of the corporation.

23 (e) HIGHEST BRACKET AMOUNT.—The term "highest
24 bracket amount" means \$500,000 or the highest bracket
25 amount computed under section 752, whichever is the
26 smaller.

1 **SEC. 751. DETERMINATION OF PROPERTY PAID IN FOR**
2 **STOCK AND OF BORROWED CAPITAL IN CON-**
3 **NECTION WITH CERTAIN EXCHANGES.**

4 (a) **PROPERTY PAID IN FOR STOCK.**—In the applica-
5 tion of section 718 (a) to a transferee upon an exchange
6 in determining the amount paid in for stock of the trans-
7 feree, or as paid-in surplus or as a contribution to capital of
8 the transferee, in connection with such exchange, only an
9 amount shall be deemed to have been so paid in equal to
10 the excess of the basis in the hands of the transferee of the
11 property of the transferor received by the transferee upon
12 the exchange over the sum of—

13 (1) Any liability of the transferor assumed upon
14 such exchange and any liability subject to which the
15 property was received upon such exchange, plus

16 (2) The aggregate of the amount of money and the
17 fair market value of any other property transferred to
18 the transferor not permitted to be received by such
19 transferor without the recognition of gain.

20 (b) **BORROWED CAPITAL.**—In the application of section
21 719 (a) to a transferee upon an exchange, the term “bor-
22 rowed capital” shall not include indebtedness originally evi-
23 denced by securities issued by the transferee upon such ex-
24 change as consideration for the property of the transfer-
25 received by the transferee upon such exchange if (1) such

1 securities were property permitted to be received by the per-
2 son to whom such securities were issued without the recog-
3 nition of gain and (2) the indebtedness originally evidenced
4 by such securities did not arise out of indebtedness of the
5 transferor (other than indebtedness which in the transferor's
6 hands was subject to the limitations of this subsection) as-
7 sumed by the transferee in connection with such exchange.

8 **SEC. 752. COMPUTATION OF HIGHEST BRACKET AMOUNT**
9 **IN CONNECTION WITH EXCHANGES.**

10 (a) **SPECIAL APPLICATION OF DAILY INVESTED**
11 **CAPITAL OF TRANSFEROR UPON EXCHANGE.**—For the pur-
12 poses of this section, the daily invested capital of a trans-
13 feror upon an exchange for the day after the exchange shall
14 be the daily invested capital determined under section 717
15 reduced by an amount equal to the amount by which the
16 equity invested capital of the transferee upon such exchange
17 was increased by reason of the receipt of property from such
18 transferor upon such exchange.

19 (b) **HIGHEST BRACKET AMOUNT OF TRANSFEROR.**—

20 (1) **TAXABLE YEAR OF EXCHANGE.**—In the case
21 of a transferor upon an exchange after the beginning of
22 its first taxable year under this subchapter, its highest
23 bracket amount for the taxable year in which the ex-
24 change takes place shall be the sum of—

25 (A) Its highest bracket amount immediately

1 preceding the exchange multiplied by the number
2 of days in the taxable year up to and including the
3 day of the exchange, plus

4 (B) Its highest bracket amount for the tax-
5 able year after the exchange, multiplied by the
6 number of days in the taxable year remaining after
7 the day of the exchange,

8 divided by the number of days in the taxable year.

9 (2) TAXABLE YEARS ATER EXCHANGE INVOLVING
10 CONTROL.—In the case of a transferor upon an exchange
11 after the beginning of its first taxable year under this
12 subchapter, if immediately after the exchange the trans-
13 feror or its shareholders, or both, are in control of the
14 transferee, the transferor's highest bracket amount for
15 any taxable year after the taxable year in which the
16 exchange takes place shall be an amount which is a
17 percentage of its highest bracket amount immediately
18 preceding the exchange equal to the percentage which
19 its daily invested capital for the day after the exchange
20 is of its daily invested capital for the day of the exchange.

21 (3) TAXABLE YEARS AFTER EXCHANGE NOT IN-
22 VOLVING CONTROL.—In the case of a transferor upon
23 an exchange (other than a transferor described in para-
24 graph (4) of this subsection) after the beginning of its
25 first taxable year under this subchapter, if immediately

1 after the exchange no transferor or its shareholders, or
2 both, upon the exchange are in control of the transferee,
3 and if the shareholders of the transferee immediately
4 preceding the exchange are not in control of the trans-
5 feree immediately after the exchange, the transferor's
6 highest bracket amount for any taxable year after the
7 exchange shall be the excess, if any, of the sum of the
8 transferor's highest bracket amount immediately preced-
9 ing the exchange and the transferee's highest bracket
10 amount immediately preceding the exchange, over
11 \$500,000.

12 (4) TAXABLE YEARS AFTER CERTAIN EXCHANGES
13 UNDER SECTION 112 (b) (5).—In the case of an ex-
14 change after the beginning of the first taxable year under
15 this subchapter of any transferor or transferee upon
16 such exchange, involving two or more transferors, or
17 one or more transferors and one or more other persons,
18 if immediately after the exchange no one of such trans-
19 ferors, or its shareholders, or both, and no one or more
20 of such other persons are in control of the transferee
21 and if such exchange is an exchange described in sec-
22 tion 112 (b) (5) or so much of section 112 (c) or
23 112 (e) as refers to section 112 (b) (5), the highest
24 bracket amount of any such transferor for any taxable
25 year after the exchange shall be an amount equal to its

1 highest bracket amount immediately preceding the
2 exchange—

3 (A) Minus an amount which bears the same
4 ratio to its highest bracket amount immediately pre-
5 ceding the exchange as the excess of its daily in-
6 vested capital for the day of the exchange over its
7 daily invested capital for the day after the exchange
8 bears to its daily invested capital for the day of the
9 exchange, and

10 (B) Plus an amount which bears the same ratio
11 to the excess over \$500,000 of the sum of the
12 amounts computed under subparagraph (A) with
13 respect to each transferor, as the amount computed
14 under subparagraph (A) with respect to such trans-
15 feror bears to the sum of the amounts computed
16 under such subparagraph with respect to each trans-
17 feror.

18 (c) HIGHEST BRACKET AMOUNT OF TRANSFEREE.—

19 (1) TAXABLE YEAR OF EXCHANGE INVOLVING
20 CONTROL.—In the case of a transferee upon an exchange
21 after the beginning of the first taxable year under this
22 subchapter of a transferor upon such exchange the trans-
23 feree's highest bracket amount for the taxable year in
24 which the exchange takes place shall be the sum of—

25 (A) Its highest bracket amount immediately

1 preceding the exchange multiplied by the number
 2 of days in the taxable year up to and including the
 3 day of the exchange, plus (A)
 4 (B) Its highest bracket amount for the taxable
 5 year after the exchange multiplied by the number of
 6 days in the taxable year remaining after the day of
 7 the exchange,
 8 divided by the number of days in the taxable year. For
 9 the purposes of this paragraph and subsection (d) of
 10 this section "exchange" includes a liquidation described
 11 in paragraph (5) of this subsection, and such exchange
 12 shall be deemed to have taken place on the day such
 13 liquidation was completed.

14 (2) TAXABLE YEARS AFTER EXCHANGE INVOLV-
 15 ING CONTROL.—In the case of a transferee upon an
 16 exchange after the beginning of the first taxable year
 17 under this subchapter of a transferor upon such ex-
 18 change, if immediately after the exchange any trans-
 19 feror upon such exchange or its shareholders, or both,
 20 are in control of the transferee, the transferee's highest
 21 bracket amount for any taxable year after the exchange
 22 shall be an amount which is a percentage of such trans-
 23 feror's highest bracket amount immediately preceding
 24 the exchange equal to the percentage which the excess
 25 of the transferee's daily invested capital for the day after

1 the exchange over its daily invested capital for the day
2 of the exchange is of such transferor's daily invested
3 capital for the day of the exchange.

4 (3) **TAXABLE YEARS AFTER EXCHANGE NOT IN-**
5 **VOLVING CONTROL.**—In the case of a transferee upon an
6 exchange (other than a transferee described in para-
7 graph (4) of this subsection) after the beginning of the
8 first taxable year under this subchapter of a transferor
9 upon such exchange, if immediately after the exchange
10 no transferor or its shareholders, or both, are in control
11 of the transferee, and if the shareholders of the trans-
12 feree immediately preceding the exchange are not in
13 control of the transferee immediately after the exchange,
14 the transferee's highest bracket amount for any taxable
15 year after the exchange shall be an amount equal to
16 (A) the sum of the transferor's highest bracket amount
17 immediately preceding the exchange and the trans-
18 feree's highest bracket amount immediately preceding
19 the exchange, or (B) \$500,000, whichever is the
20 smaller.

21 (4) **TAXABLE YEARS AFTER CERTAIN EXCHANGES**
22 **UNDER SECTION 112 (b) (5).**—In the case of an ex-
23 change described in subsection (b) (4) of this section,
24 the highest bracket amount of the transferee upon such
25 exchange for any taxable year after the exchange shall

1 be an amount equal (A) to the sum of the amounts com-
2 puted under subparagraph (A) of such subsection with
3 respect to each transferor or (B) \$500,000, whichever
4 is the smaller.

5 (5) TAXABLE YEARS AFTER LIQUIDATION IN CASE
6 OF CORPORATION RECEIVING PROPERTY UNDER SECTION
7 112 (b) (6).—Upon the receipt by a corporation dur-
8 ing any taxable year under this subchapter of property
9 in complete liquidation of another corporation, gain or
10 loss upon which is not recognized by reason of section
11 112 (b) (6), the highest bracket amount of the cor-
12 poration receiving such property for any taxable year
13 after the liquidation is completed shall be an amount
14 equal to its highest bracket amount immediately preced-
15 ing the completion of the liquidation increased, but in no
16 case to an amount above \$500,000, by an amount equal
17 to the highest bracket amount of such other corporation
18 immediately preceding the completion of such liquida-
19 tion, if previously and after the beginning of the first
20 taxable year under this subchapter of the corporation
21 receiving such property such corporation was a transferor
22 upon an exchange with respect to which such other
23 corporation was a transferee.

24 (d) HIGHEST BRACKET AMOUNT IN CASE OF TWO OR
25 MORE EXCHANGES IN SAME TAXABLE YEAR.—

1 (1) If a transferor upon an exchange is in the
2 same taxable year involved in more than one exchange
3 (either as transferor or transferee), its highest bracket
4 amount for such taxable year shall be the amount deter-
5 mined under subsection (b) (1) with respect to the
6 last exchange in such taxable year. Its highest bracket
7 amount immediately preceding any exchange in such
8 taxable year subsequent to the first exchange therein
9 shall be the amount computed under subsection (b) (1)
10 with respect to the immediately preceding exchange as
11 if the taxable year closed on the day of such subsequent
12 exchange.

13 (2) If a transferee upon an exchange is in the same
14 taxable year involved in more than one exchange (either
15 as transferee or transferor), its highest bracket amount
16 for such taxable year shall be the amount determined
17 under subsection (c) (1) with respect to the last ex-
18 change in such taxable year. Its highest bracket amount
19 immediately preceding any exchange in such taxable
20 year subsequent to the first exchange therein shall be
21 the amount computed under subsection (c) (1) with
22 respect to the immediately preceding exchange as if the
23 taxable year closed on the day of such subsequent
24 exchange.

25 (3) If a transferor or transferee upon an exchange

1 is in the same taxable year involved in more than one
2 exchange (either as transferor or transferee), its highest
3 bracket amount for any taxable year after the taxable
4 year in which such exchanges took place shall be the
5 amount computed under subsection (b) (2), (3), or
6 (4), or (c) (2), (3), (4), or (5), as the case may
7 be, with respect to the last such exchange.

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