TITLE 26.—INTERNAL REVENUE CODE

Act Aug. 16, 1954, ch. 736, 68A Stat. 3

An Act to revise the internal revenue laws of the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That

(a) Citation.

(1) The provisions of this Act set forth under the heading "Internal Revenue Title" may be cited as the "Internal Revenue Code of 1954".

(2) The Internal Revenue Code enacted on February 10, 1939, as amended, may be cited as the "Internal Revenue Code of 1939".

(b) Publication.

This Act shall be published as volume 68A of the United States Statutes at Large, with a comprehensive table of contents and an appendix; but without an index or marginal references. The date of enactment, bill number, public law number, and chapter number, shall be printed as a headnote.

(c) Cross reference.

For saving provisions, effective date provisions, and other related provisions, see chapter 80 (sec. 7801 and following) of the Internal Revenue Code of 1954.

(d) Enactment of Internal Revenue Title into law.

The Internal Revenue Title referred to in subsection (a) (1) is as follows: * * *.

(Aug. 16, 1954, ch. 736, 68A Stat. 3.)

INTERNAL REVENUE TITLE

Subtitle

A. Income taxes §§ 1—1552.
B. Estate and gift taxes §§ 2001—2524.
C. Employment taxes §§ 3101—3504.
D. Miscellaneous excise taxes §§ 4001—4907.
E. Alcohol, tobacco, and certain other excise taxes §§ 5001—5862.
F. Procedure and administration §§ 6001—7852.
G. The Joint Committee on Internal Revenue Taxation §§ 8001—8023.

Subtitle A.—Income Taxes

Chapter

1. Normal taxes and surtaxes.
2. Tax on self-employment income.
3. Withholding of tax on nonresident aliens and foreign corporations and tax-free covenant bonds.
4. Rules applicable to recovery of excessive profits on government contracts.
5. Tax on transfers to avoid income tax.
6. Consolidated returns.

Chapter 1.—NORMAL TAXES AND SURTAXES

Subchapter

A. Determination of tax liability.
B. Computation of taxable income.
C. Corporate distributions and adjustments.
D. Deferred compensation, etc.
E. Accounting periods and methods of accounting.
F. Exempt organizations.
G. Corporations used to avoid income tax on shareholders.
H. Banking institutions.
I. Natural resources.
J. Estates, trusts, beneficiaries, and decedents.
K. Partners and partnerships.
L. Insurance companies.
M. Regulated investment companies and real estate investment trusts.
N. Tax based on income from sources within or without the United States.
O. Gain or loss on disposition of property.
P. Capital gains and losses.
Q. Readjustment of tax between years and special limitations.
S. Election of certain small business corporations as to taxable status.
T. Cooperatives and their patrons.

AMENDMENTS

1966—Pub. L. 89-389, § 4(b)(2), Apr. 14, 1966, 80 Stat. 116, struck out Subchapter R effective January 1, 1969.

1962—Pub. L. 87-834, § 17(b)(4), Oct. 16, 1962, 76 Stat. 1051, added subchapter T.

1960—Pub. L. 86-779, § 10(c), Sept. 14, 1960, 74 Stat. 1009, added to Subchapter M the words "and real estate investment trusts."

1958—Pub. L. 85-866, title I § 64(d)(1), Sept. 2, 1958, 72 Stat. 1656, added subchapter S.

CHAPTER REFERRED TO IN OTHER SECTIONS

This chapter is referred to in sections 3402, 6103, 6401, 6654, 6682, of this title; title 7 section 1926; title 12 section 1134*l*; title 22 section 277d-23; title 42 sections 291j-7, 401, 411.

Subchapter A.—Determination of Tax Liability

Part

I. Tax on individuals.
II. Tax on corporations.
III. Changes in rates during a taxable year.
IV. Credits against tax.
V. Tax Surcharge.
VI. Minimum tax for tax preferences.

AMENDMENTS

1969—Pub. L. 91-172, title III, § 301(b)(1), Dec. 30, 1969, 83 Stat. 585, added Part VI.

1968—Pub. L. 90-364, title I, § 102(d), June 28, 1968, 82 Stat. 259, added Part V.

PART I.—TAX ON INDIVIDUALS

Sec.

1. Tax imposed.
2. Definitions and special rules.
3. Optional tax tables for individuals.
4. Rules for optional tax.
5. Cross references relating to tax on individuals.

AMENDMENTS

1969—Pub. L. 91-172, title VIII, § 803(d)(9), Dec. 30, 1969, 83 Stat. 685, substituted "Definitions and special rules" and "Optional tax tables for individuals" for "Tax in case of joint return or return of surviving spouse" and "Optional tax if adjusted gross income is less than $5,000" in items 2 and 3, respectively.

§ 1. Tax imposed.

(a) Married individuals filing joint returns and surviving spouses.

There is hereby imposed on the taxable income of—

(1) every married individual (as defined in section 143) who makes a single return jointly with his spouse under section 6013, and

(2) every surviving spouse (as defined in section 2(a)),

A tax determined in accordance with the following table:

If the taxable income is:	The tax is:
Not over $1,000	14% of the taxable income.
Over $1,000 but not over $2,000.	$140, plus 15% of excess over $1,000.
Over $2,000 but not over $3,000.	$290, plus 16% of excess over $2,000.
Over $3,000 but not over $4,000.	$450, plus 17% of excess over $3,000.
Over $4,000 but not over $8,000.	$620, plus 19% of excess over $4,000.
Over $8,000 but not over $12,000.	$1,380, plus 22% of excess over $8,000.
Over $12,000 but not over $16,000.	$2,260, plus 25% of excess over $12,000.
Over $16,000 but not over $20,000.	$3,260, plus 28% of excess over $16,000.
Over $20,000 but not over $24,000.	$4,380, plus 32% of excess over $20,000.
Over $24,000 but not over $28,000.	$5,660, plus 36% of excess over $24,000.
Over $28,000 but not over $32,000.	$7,100, plus 39% of excess over $28,000.
Over $32,000 but not over $36,000.	$8,660, plus 42% of excess over $32,000.
Over $36,000 but not over $40,000.	$10,340, plus 45% of excess over $36,000.
Over $40,000 but not over $44,000.	$12,140, plus 48% of excess over $40,000.
Over $44,000 but not over $52,000.	$14,060, plus 50% of excess over $44,000.
Over $52,000 but not over $64,000.	$18,060, plus 53% of excess over $52,000.
Over $64,000 but not over $76,000.	$24,420, plus 55% of excess over $64,000.
Over $76,000 but not over $88,000.	$31,020, plus 58% of excess over $76,000.
Over $88,000 but not over $100,000.	$37,980, plus 60% of excess over $88,000.
Over $100,000 but not over $120,000.	$45,180, plus 62% of excess over $100,000.
Over $120,000 but not over $140,000.	$57,580, plus 64% of excess over $120,000.
Over $140,000 but not over $160,000.	$70,380, plus 66% of excess over $140,000.
Over $160,000 but not over $180,000.	$83,580, plus 68% of excess over $160,000.
Over $180,000 but not over $200,000.	$97,180, plus 69% of excess over $180,000.
Over $200,000	$110,980, plus 70% of excess over $200,000.

(b) Heads of households.

There is hereby imposed on the taxable income of every individual who is the head of a household (as defined in section 2(b)) a tax determined in accordance with the following table:

If the taxable income is:	The tax is:
Not over $1,000	14% of the taxable income.
Over $1,000 but not over $2,000.	$140, plus 16% of excess over $1,000.
Over $2,000 but not over $4,000.	$300, plus 18% of excess over $2,000.
Over $4,000 but not over $6,000.	$600, plus 19% of excess over $4,000.
Over $6,000 but not over $8,000.	$1,040, plus 22% of excess over $6,000.
Over $8,000 but not over $10,000.	$1,480, plus 23% of excess over $8,000.
Over $10,000 but not over $12,000.	$1,940, plus 25% of excess over $10,000.
Over $12,000 but not over $14,000.	$2,440, plus 27% of excess over $12,000.
Over $14,000 but not over $16,000.	$2,980, plus 28% of excess over $14,000.
Over $16,000 but not over $18,000.	$3,540, plus 31% of excess over $16,000.
Over $18,000 but not over $20,000.	$4,160, plus 32% of excess over $18,000.
Over $20,000 but not over $22,000.	$4,800, plus 35% of excess over $20,000.
Over $22,000 but not over $24,000.	$5,500, plus 36% of excess over $22,000.
Over $24,000 but not over $26,000.	$6,220, plus 38% of excess over $24,000.
Over $26,000 but not over $28,000.	$6,980, plus 41% of excess over $26,000.
Over $28,000 but not over $32,000.	$7,800, plus 42% of excess over $28,000.
Over $32,000 but not over $36,000.	$9,480, plus 45% of excess over $32,000.
Over $36,000 but not over $38,000.	$11,280, plus 48% of excess over $36,000.
Over $38,000 but not over $40,000.	$12,240, plus 51% of excess over $38,000.
Over $40,000 but not over $44,000.	$13,260, plus 52% of excess over $40,000.
Over $44,000 but not over $50,000.	$15,340, plus 55% of excess over $44,000.
Over $50,000 but not over $52,000.	$18,640, plus 56% of excess over $50,000.
Over $52,000 but not over $64,000.	$19,760, plus 58% of excess over $52,000.
Over $64,000 but not over $70,000.	$26,720, plus 59% of excess over $64,000.
Over $70,000 but not over $76,000.	$30,260, plus 61% of excess over $70,000.
Over $76,000 but not over $80,000.	$33,920, plus 62% of excess over $76,000.
Over $80,000 but not over $88,000.	$36,400, plus 63% of excess over $80,000.
Over $88,000 but not over $100,000.	$41,440, plus 64% of excess over $88,000.
Over $100,000 but not over $120,000.	$49,120, plus 66% of excess over $100,000.
Over $120,000 but not over $140,000.	$62,320, plus 67% of excess over $120,000.

If the taxable income is:	The tax is:
Over $140,000 but not over $160,000.	$75,720, plus 68% of excess over $140,000.
Over $160,000 but not over $180,000.	$89,320, plus 69% of excess over $160,000.
Over $180,000	$103,120, plus 70% of excess over $180,000.

(c) Unmarried individuals (other than surviving spouses and heads of households).

There is hereby imposed on the taxable income of every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b) who is not a married individual (as defined in section 143) a tax determined in accordance with the following table:

If the taxable income is:	The tax is:
Not over $500	14% of the taxable income.
Over $500 but not over $1,000.	$70, plus 15% of excess over $500.
Over $1,000 but not over $1,500.	$145, plus 16% of excess over $1,000.
Over $1,500 but not over $2,000.	$225, pius 17% of excess over $1,500.
Over $2,000 but not over $4,000.	$310, plus 19% of excess over $2,000.
Over $4,000 but not over $6,000.	$690, plus 21% of excess over $4,000.
Over $6,000 but not over $8,000.	$1,110 plus 24% of excess over $6,000.
Over $8,000 but not over $10,000.	$1,590, plus 25% of excess over $8,000.
Over $10,000 but not over $12,000.	$2,090, pius 27% of excess over $10,000.
Over $12,000 but not over $14,000.	$2,630, pius 29% of excess over $12,000.
Over $14,000 but not over $16,000.	$3,210, plus 31% of excess over $14,000.
Over $16,000 but not over $18,000.	$3,830, plus 34% of excess over $16,000.
Over $18,000 but not over $20,000.	$4,510, plus 36% of excess over $18,000.
Over $20,000 but not over $22,000.	$5,230, plus 38% of excess over $20,000.
Over $22,000 but not over $26,000.	$5,990, plus 40% of excess over $22,000.
Over $26,000 but not over $32,000.	$7,590, plus 45% of excess over $26,000.
Over $32,000 but not over $38,000.	$10,290, plus 50% of excess over $32,000.
Over $38,000 but not over $44,000.	$13,290, plus 55% of excess over $38,000.
Over $44,000 but not over $50,000.	$16,590, plus 60% of excess over $44,000.
Over $50,000 but not over $60,000.	$20,190, plus 62% of excess over $50,000.
Over $60,000 but not over $70,000.	$26,390, plus 64% of excess over $60,000.
Over $70,000 but not over $80,000.	$32,790, plus 66% of excess over $70,000.
Over $80,000 but not over $90,000.	$39,390, plus 68% of excess over $80,000.
Over $90,000 but not over $100,000.	$46,490, plus 69% of excess over $90,000.
Over $100,000	$53,090, plus 70% of excess over $100,000.

(d) Married individuals filing separate returns; estates and trusts.

There is hereby imposed on the taxable income of every married individual (as defined in section 143) who does not make a single return jointly with his spouse under section 6013, and of every estate and trust taxable under this subsection, a tax determined in accordance with the following table:

If the taxable income is:	The tax is:
Not over $500	14% of the taxable income.
Over $500 but not over $1,000.	$70, plus 15% of excess of $500.
Over $1,000 but not over $1,500.	$145, plus 16% of excess over $1,000.
Over $1,500 but not over $2,000.	$225, plus 17% of excess over $1,500.
Over $2,000 but not over $4,000.	$310, plus 19% of excess over $2,000.
Over $4,000 but not over $6,000.	$690, pius 22% of excess over $4,000.
Over $6,000 but not over $8,000.	$1,130, plus 25% of excess over $6,000.
Over $8,000 but not over $10,000.	$1,630, plus 28% of excess over $8,000.
Over $10,000 but not over $12,000.	$2,190, plus 32% of excess over $10,000.
Over $12,000 but not over $14,000.	$2,830, plus 36% of excess over $12,000.
Over $14,000 but not over $16,000.	$3,550, pius 39% of excess over $14,000.
Over $16,000 but not over $18,000.	$4,330, pius 42% of excess over $16,000.
Over $18,000 but not over $20,000.	$5,170, plus 45% of excess over $18,000.
Over $20,000 but not over $22,000.	$6,070, plus 48% of excess over $20,000.
Over $22,000 but not over $26,000.	$7,030, plus 50% of excess over $22,000.
Over $26,000 but not over $32,000.	$9,030, plus 53% of excess over $26,000.
Over $32,000 but not over $38,000.	$12,210, plus 55% of excess over $32,000.
Over $38,000 but not over $44,000.	$15,510, plus 58% of excess over $38,000.
Over $44,000 but not over $50,000.	$18,990, plus 60% of excess over $44,000.
Over $50,000 but not over $60,000.	$22,590, plus 62% of excess over $50,000.
Over $60,000 but not over $70,000.	$28,790, pius 64% of excess over $60,000.
Over $70,000 but not over $80,000.	$35,190, plus 66% of excess over $70,000.
Over $80,000 but not over $90,000.	$41,790, plus 68% of excess over $80,000.
Over $90,000 but not over $100,000.	$48,590, plus 69% of excess over $90,000.
Over $100,000	$55,490, pius 70% of excess over $100,000.

(Aug. 16, 1954, ch. 736, 68A Stat. 5; Feb. 26, 1964, Pub. L. 88–272, title I, § 111, 78 Stat. 19; Nov. 13, 1966, Pub. L. 89–809, title I, § 103(a)(2), 80 Stat. 1550; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 803(a), 83 Stat. 678.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 substituted a table of rates of tax for married individuals filing joint returns and surviving spouses for the tables of rates of tax on individuals. For rates of taxes on unmarried individuals and married persons filing separate returns, see subsecs. (c) and (d) of this section.

Subsec. (b). Pub. L. 91–172 generally revised the rates of tax of heads of household downwards and struck out provisions defining head of household, determination of status, and limitations. For definition of head of household, determination of status, and limitations, see section 2(b) of this title.

Subsec. (c). Pub. L. 91–172 substituted rates of tax on umarried individuals (other than surviving spouses and heads of household) for special rules explaining the rates of tax imposed under former subsecs. (a) and (b)(1) and prescribing a maximum limit of 87 percent of the taxable year.

Subsec (d). Pub. L. 91–172 substituted a table of rates of tax for married individuals filing separate returns for provision prescribing the applicability of the rates to nonresident aliens. For applicability of rates of tax to nonresident aliens, see section 2(d) of this title.

Subsec. (e). Pub. L. 91–172 struck out cross reference to section 63. Such cross reference is now set out as section 2(e) of this title.

1966—Subsec. (d). Pub. L. 89–809 added subsec. (d) and redesignated former subsec. (d) as (e).

Subsec. (e). Pub. L. 89–809 redesignated former subsec. (d) as (e).

1964—Pub. L. 88–272 amended section generally by splitting the former first bracket which started at $2,000 into four new brackets, the 14 percent bracket representing a 30 percent reduction, the 15 percent bracket a 25 percent cut, and the 16 percent bracket a 20 percent cut, and reducing all other brackets by cuts averaging about 20 percent and effectuated these cuts in two steps, one in 1964, and one in 1965.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 803(f) of Pub. L. 91–172 provided that: "The amendments made by subsections (a) [amending this section], (b) [amending section 2 of this title], and (d) (other than paragraphs (1) and (8)) [amending sections 511(b)(1), 641(a), 632, 1347, 5(b) (1), (5) and 6015(a)(1)] shall apply to taxable years beginning after December 31, 1970, except that section 2(c) of the Internal Revenue Code of 1954 [section 2(c) of this title], as amended by subsection (b), shall also apply to taxable years beginning after December 31, 1969. The amendments made by subsections (c) [amending section 3 of this title], (d)(1) [amending section 6014(a) of this title], and (d)(3) [amending section 1304(b)(1) of this title] shall apply to taxable years beginning after December 31, 1969".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 131 of Pub. L. 88–272 provided that: "Except for purposes of section 21 of the Internal Revenue Code of 1954 (relating to effect of changes in rates during a taxable year), the amendments made by parts I and II of this title [to this section, and sections 2, 11, 37, 141, 144, 242, 821, 871, 963, 6016, 6074, 6154, 6212, 6504 and 6655 of this title] shall apply with respect to taxable years beginning after December 31, 1963."

SHORT TITLE OF 1969 AMENDMENT

Section 1(a) of Pub. L. 91–172 provided that: "This Act [enacting sections 49, 56 to 58, 82, 83, 123, 169, 183, 184 to 187, 249, 278, 279, 385, 585, 586, 596, 636, 638, 664, 844, 1039, 1251 to 1253, 1348, 1379, 1564 and 7463 of this title, amending this section and sections 2 to 5, 11, 12, 21, 46 to 48, 51, 62, 72, 103, 124, 141 to 143, 151, 152, 162, 163, 166, 167, 170, 172, 179, 216, 217, 243, 246, 263, 301, 305, 311, 812, 341, 381, 402 to 407, 443, 451, 453, 481, 501, 511, 535, 537, 545, 563, 582, 593, 613 to 617, 632, 641, 642, 668, 665 to 669, 673, 677, 703, 751, 802, 804, 805, 809, 810, 815, 823, 825, 851, 852, 857, 861, 901, 904, 954, 963, 964, 1001, 1011, 1016, 1031, 1033, 1082, 1201, 1211, 1212, 1221, 1222, 1231, 1232, 1243, 1245, 1248, 1250, 1301 to 1304, 1314, 1347, 1373, 1375, 1378, 1382, 1383, 1441, 1561 to 1563, 2055, 2104, 2106, 2522, 3102, 3121, 3402, 4061, 4065, 4216, 4251, 5684, 6013 to 6015, 6049, 6051, 6212, 6214, 6334, 6401, 6411, 6412, 6501, 6511, 6601, 6611, 6653, 6654, 6656, 7441, 7447, 7448, 7453, 7456, 7471, 7481, 7485, 7487 and 7701 of this title, and sections 401 to 403, 415, 427 and 428 of Title 42, repealing sections 270, 1562, and 4251 to 4254 of this title, and enacting provisions set out as notes under this section and sections 4, 51, 56, 83, 103, 123, 141, 151, 152, 162, 163, 167, 169, 170, 183, 184, 186, 187, 216, 217, 249, 252, 263, 278, 279, 305, 311, 333, 402, 451, 453, 537, 563, 582, 585, 593, 596, 613, 615, 636, 665, 677, 805, 851, 861, 901, 954, 101, 1031, 1033, 1039, 1201, 1211, 1212, 1221, 1231, 1232, 1245, 1251, 1301, 1348, 1379, 1382, 1561, 1562, 3402, 4063, 4216, 6012 to 6015, 6153, 6334, 6601, 6651, 7441, 7443, 7447, 7483, and 7483 of this title and sections 401 to 403, 415 and 427 of Title 42] may be cited as the 'Tax Reform Act of 1969'."

SHORT TITLE

Section 2(a) of Pub. L. 88–272 provided that Pub. L. 88–272, which enacted sections 79, 121, 217, 275, 406, 407, 422—425, 483, 1022, 1250, 1301—1305, 1561—1563, 6039, 6052, amended this section, and sections 2—5, 11, 12, 21, 34, 35, 37, 46, 48, 62, 72, 105, 116, 141, 144, 163—165, 170, 172, 213, 214, 242—244, 246, 264, 265, 269, 272, 274, 301, 312, 316, 331, 333, 341, 368, 381, 401—403, 421, 441, 453, 461, 535, 541—545, 551, 553, 554, 556, 562, 584, 614, 631, 642, 691, 702, 751, 802, 804, 809, 818, 821, 822, 832, 852—857, 871, 901, 903, 904, 911, 963, 1016, 1033, 1034, 1212, 1222, 1231, 1245, 1341, 1361, 1371, 1375, 1402, 1441, 1503, 1551, 1552, 3121, 3401, 3402, 6012, 6014, 6016, 6074, 6154, 6163, 6212, 6323, 6324, 6501, 6504, 6511, 6652, 6655, 6678, and 7701 of this title, and sections 409 and 411 of Title 42, The Public Health and Welfare, omitted sections 1301—1307, and repealed section 181 of this title, and enacted provisions set out as notes under this section, and sections 3, 21, 34, 35, 37, 38, 48, 62, 79, 105, 121, 163—165, 170, 172, 213, 214, 243, 264, 265, 272, 274, 816, 333, 368, 401, 406, 421, 453, 461, 614, 809, 852, 911, 1212, 1250, 1301,' 1371, 1503, 1551, 3402, 6163, and 6323 of this title, may be cited as the "Revenue Act of 1964."

CONGRESSIONAL DECLARATION RELATING TO THE 1964 AMENDMENTS

Section 1 of Pub. L. 88–272 provided that: "It is the sense of Congress that the tax reduction provided by this Act [Pub. L. 88–272; see short title note under this section] through stimulation of the economy, will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt. To further the objective of obtaining balanced budgets in the near future, Congress by this action, recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective."

CROSS REFERENCES

Deductions for individuals,
- Additional itemized allowable, see section 211 et seq. of this title.
- Individuals not eligible for standard deduction, see section 142 of this title.
- Itemized deductions, see section 161 et seq. of this title.
- Personal exemptions, see section 151 et seq. of this title.
- Standard, see section 141 et seq. of this title.

Dependent defined, see section 152 of this title.

Effect of change of rate of tax, see section 21 of this title

Head of household,
- Declaration of estimated tax, see section 6015 of this title.
- Medical expenses, etc., deduction, see section 213 of this title.

Imposition of net income taxes by State on income derived from interstate commerce, see chapter 10B of Title 15, Commerce and Trade.

Income exempt under treaty, see section 894 of this title.

Income tax collected at source, see section 3402 of this title.
Nonresident aliens, see section 871 et seq. of this title.
Optional tax if adjusted gross income is less than $10,000, see section 3 of this title.
Partners subject to income tax in individual capacities, see section 701 of this title.
Rate of tax under Federal Insurance Contributions Act, see section 3101 of this title.
Treaty obligations observed, see section 7852 (d) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 2, 3, 51, 72, 142, 511, 632, 641, 871, 876, 877, 891, 1201, 1347, 1348 of this title.

§ 2. Definitions and special rules.

(a) Definition of surviving spouse.

(1) In general.

For purposes of section 1, the term "surviving spouse" means a taxpayer—

(A) whose spouse died during either of his two taxable years immediately preceding the taxable year, and

(B) who maintains as his home a household which constitutes for the taxable year the principal place of abode (as a member of such household) of a dependent (i) who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer, and (ii) with respect to whom the taxpayer is entitled to a deduction for the taxable year under section 151.

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

(2) Limitations.

Notwithstanding paragraph (1), for purposes of section 1 a taxpayer shall not be considered to be a surviving spouse—

(A) if the taxpayer has remarried at any time before the close of the taxable year, or

(B) unless, for the taxpayer's taxable year during which his spouse died, a joint return could have been made under the provisions of section 6013 (without regard to subsection (a) (3) thereof).

(b) Definition of head of household.

(1) In general.

For purposes of this subtitle, an individual shall be considered a head of a household if, and only if, such individual is not married at the close of his taxable year, is not a surviving spouse (as defined in subsection (a)), and either—

(A) maintains as his home a household which constitutes for such taxable year the principal place of abode, as a member of such household, of—

(i) a son, stepson, daughter, or stepdaughter of the taxpayer, or a descendant of a son or daughter of the taxpayer, but if such son, stepson, daughter, stepdaughter, or descendant is married at the close of the taxpayer's taxable year, only if the taxpayer is entitled to a deduction for the taxable year for such person under section 151, or

(ii) any other person who is a dependent of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such person under section 151, or

(B) maintains a household which constitutes for such taxable year the principal place of abode of the father or mother of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such father or mother under section 151.

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

(2) Determination of status.

For purposes of this subsection—

(A) a legally adopted child of a person shall be considered a child of such person by blood;

(B) an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married;

(C) a taxpayer shall be considered as not married at the close of his taxable year if at any time during the taxable year his spouse is a nonresident alien; and

(D) a taxpayer shall be considered as married at the close of his taxable year if his spouse (other than a spouse described in subparagraph (C)) died during the taxable year.

(3) Limitations.

Notwithstanding paragraph (1), for purposes of this subtitle a taxpayer shall not be considered to be a head of a household—

(A) if at any time during the taxable year he is a nonresident alien; or

(B) by reason of an individual who would not be a dependent for the taxable year but for—

(i) paragraph (9) of section 152(a),

(ii) paragraph (10) of section 152(a), or

(iii) subsection (c) of section 152.

(c) Certain married individuals living apart.

For purposes of this part, an individual who, under section 143(b), is not to be considered as married shall not be considered as married.

(d) Nonresident aliens.

In the case of a nonresident alien individual, the tax imposed by section 1 shall apply only as provided by section 871 or 877.

(e) Cross reference.

For definition of taxable income, see section 63.

(Aug. 16, 1954, ch. 736, 68A Stat. 8; Feb. 26, 1964, Pub. L. 88-272, title I, § 112(b), 78 Stat. 24; Dec. 30, 1969, Pub. L. 91-172, title VIII, § 803(b), 83 Stat. 682.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91-172 redesignated the provisions of former subsec. (b) as subsec. (a). The provisions of former subsec. (a) are now covered by sec. 1(a) of this title.

Subsec. (b). Pub. L. 91-172 redesignated the provisions of former section 1(b)(2)-(4) of this title as subsec. (b). Former subsec. (b) was redesignated, with minor changes, as subsec. (a).

Subsec (c). Pub. L. 91–172 added subsec. (c).

Subsec. (d). Pub. L. 91–172 redesignated as subsec. (d) the provisions of former section 1(d) in this subsec. with minor changes.

Subsec. (e). Pub. L. 91–172 redesignated as subsec. (e) the provisions of former section 1(e).

1964—Subsec. (a). Pub. L. 88–272 inserted the reference to section 141.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1970, except that subsec. (c) is applicable to taxable years beginning after Dec. 31, 1969, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

CROSS REFERENCES

Joint returns of income tax by husband and wife, see section 6013 of this title.

Optional tax if adjusted gross income is less than $10,000, see section 3 of this title.

Rate of tax on individuals, see section 1 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1, 1304, 3402, 6015 of this title.

§ 3. Optional tax tables for individuals.

In lieu of the tax imposed by section 1, there is hereby imposed for each taxable year beginning after December 31, 1969, on the taxable income of every individual whose adjusted gross income for such year is less than $10,000 and who has elected for such year to pay the tax imposed by this section, a tax determined under tables, applicable to such taxable year, which shall be prescribed by the Secretary or his delegate. In the tables so prescribed, the amounts of tax shall be computed on the basis of the taxable income computed by taking the standard deduction and on the basis of the rates prescribed by section 1. (Aug. 16, 1954, ch. 736, 68A Stat. 8; Feb. 26, 1964, Pub. L. 88–272, title III, § 301(a), 78 Stat. 129; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 803(c), 83 Stat. 684.)

AMENDMENTS

1969—Pub.L. 91–172 raised the individual gross income limit of $5,000 to $10,000 for exercising the option and substituted provision that the tax has to be determined under tables to be prescribed by the Secretary or his delegate for tables of tax rates for single persons, heads of household, married persons filing joint returns, married persons filing separate returns with 10 per cent standard deduction and married persons filing separate returns with minimum standard deduction.

1964—Pub. L. 88–272 substituted optional tax tables covering five categories for taxable years beginning on or after Jan. 1, 1964, and before Jan. 1, 1965, and for years beginning after Dec. 31, 1964, for a single general table.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 301(c) of Pub. L. 88–272 provided that: "Except for purposes of section 21 of the Internal Revenue Code of 1954 (relating to effect of changes in rates during a taxable year), the amendments made by this section [to this section and sections 4 and 6014 of this title] shall apply to taxable years beginning after December 31, 1963."

CROSS REFERENCES

Credits not allowed to individuals paying optional tax, see section 36 of this title.

Election of standard deduction, see section 144 of this title.

Income tax return, tax not computed by taxpayer, see section 6014 (a) of this title.

Personal exemptions, see section 151 et seq. of this title.

Rate of tax on individuals, see section 1 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 4, 36, 72, 144, 891, [illegible], 6014 of this title.

§ 4. Rules for optional tax.

(a) Number of exemptions.

For purposes of the tables prescribed by the Secretary or his delegate pursuant to section 3, the term "number of exemptions" means the number of exemptions allowed under section 151 as deductions in computing taxable income.

(b) Manner of election.

The election referred to in section 3 shall be made in the manner provided in regulations prescribed by the Secretary or his delegate.

(c) Husband or wife filing separate return.

(1) A husband or wife may not elect to pay the optional tax imposed by section 3 if the tax of the other spouse is determined under section 1 on the basis of taxable income computed without regard to the standard deduction.

(2) Except as otherwise provided in this subsection, in the case of a husband or wife filing a separate return the tax imposed by section 3 shall be the lesser of the tax shown in—

(A) the table prescribed under section 3 applicable in the case of married persons filing separate returns which applies the percentage standard deduction, or

(B) the table prescribed under section 3 applicable in the case of married persons filing separate returns which applies the low income allowance.

(3) The table referred to in paragraph (2)(B) shall not apply in the case of a husband or wife filing a separate return if the tax of the other spouse is determined with regard to the percentage standard deduction; except that an individual described in section 141(d)(2) may elect (under regulations prescribed by the Secretary of his delegate) to pay the tax shown in the table referred to in paragraph (2)(B) in lieu of the tax shown in the table referred to in paragraph (2)(A). For purposes of this title, an election under the preceding sentence shall be treated as an election made under section 141(d)(2).

(4) For purposes of this subsection, determination of marital status shall be made under section 143.

(d) Certain other taxpayers ineligible.

Section 3 shall not apply to—

(1) a nonresident alien individual;

(2) a citizen of the United States entitled to the benefits of section 931 (relating to income from sources within possessions of the United States);

(3) an individual making a return under section 443 (a) (1) for a period of less than 12 months on account of a change in his accounting period; or

(4) an estate or trust.

(e) Taxable income computed with standard deduction.

Whenever it is necessary to determine the taxable income of a taxpayer who made the election referred to in section 3, the taxable income shall be determined under section 63 (b) (relating to definition of taxable income for individuals electing standard deduction).

(f) Cross references.

(1) For other applicable rules (including rules as to the change of an election under section 3), see section 144.

(2) For disallowance of certain credits against tax, see section 36.

(3) For rule that optional tax is not to apply if individual chooses the benefits of income averaging, see section 1304(b).

(4) For computation of tax by Secretary or his delegate, see section 6014.

(Aug. 16, 1954, ch. 736, 68A Stat. 10; Feb. 26, 1964, Pub. L. 88–272, title II, § 232(f)(1), title III, § 301(b)(1), (3), 78 Stat. 111, 140; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 802(c)(1)—(3), 83 Stat. 677, 678.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 802(c)(1), substituted reference to tables prescribed by the Secretary or his delegate pursuant to section 3, for reference to tables in section 3.

Subsec. (c)(2). Pub. L. 91–172, § 802(c)(2), substituted reference to tables of percentage standard deduction and low income allowance applicable in the case of married persons filing separate returns for reference to Tables IV and V of former section 3(a), (b).

Subsec. (c)(3). Pub. L. 91–172, § 802(c)(2), substituted reference to the table referred to in par. (2)(B) (applicable to low income allowance) for reference to Tables V of section 3 (a), (b) and percentage standard deduction for 10-per cent standard deduction.

Subsec. (f)(4). Pub. L. 91–172, § 802(c)(3), substituted "For computation of tax by Secretary or his delegate, see section 6014" for "For nonapplicability of Table V in section 3(a) and Table V in section 3(b) in case where tax is not computed by taxpayer, see section 6014(a)".

1964—Subsec. (a). Pub. L. 88–272, § 301(b)(3)(A), substituted "tables" for "table."

Subsec. (c). Pub. L. 88–272, § 301(b)(1), designated existing provisions as pars. (1) and (4), and inserted pars. (2) and (3).

Subsec. (f)(3). Pub. L. 88–272, § 232(f)(1), added par. (3).

Subsec. (f)(4). Pub. L. 88–272, § 301(b)(3)(B), added par. (4).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 802(d) of Pub. L. 91–172 provided that: "The amendments made by subsections (a) [amending section 141 of this title], (b) [amending section 143 of this title], and (c) [amending sections 4 (a), (c), (f)(4), 141(d) and 1304(c)(4) of this title] shall apply to taxable years beginning after December 31, 1969."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsecs. (a), (c) and (f)(4) of this section by Pub. L. 88–272 applicable, except for purpose of section 21, to taxable years beginning after Dec. 31, 1963, see section 301(c) set out as a note under section 3 of this title.

Amendment of subsec. (f) of this section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

CROSS REFERENCES

Individuals electing standard deduction, see section 63 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 144 of this title.

§ 5. Cross references relating to tax on individuals.

(a) Other rates of tax on individuals, etc.

(1) For rates of tax on nonresident aliens, see section 871.

(2) For doubling of tax on citizens of certain foreign countries, see section 891.

(3) For alternative tax in case of capital gain, see section 1201 (b).

(4) For rate of withholding in the case of nonresident aliens, see section 1441.

(5) For minimum tax for tax preferences, see section 56.

(b) Special limitations on tax.

(1) For limitation on tax attributable to sales of oil or gas properties, see section 632.

(2) For limitation on tax in case of income of members of Armed Forces on death, see section 692.

(3) For limitation on tax where an individual chooses the benefits of income averaging, see section 1301.

(4) For computation of tax where taxpayer restores substantial amount held under claim of right, see section 1341.

(5) For limitation on tax attributable to claims against the United States involving acquisitions of property, see section 1347.

(Aug. 16, 1954, ch. 736, 68A Stat. 10; Feb. 26, 1964, Pub. L. 88–272, title II, § 232(f)(2), 78 Stat. 111; Dec. 30, 1969, Pub. L. 91–172, title III, § 301(b)(2), title VIII, § 803(d)(6), 83 Stat. 585, 684.)

AMENDMENTS

1969—Subsec. (a)(5). Pub. L. 91–172, § 301(b)(2), added par. (5).

Subsec. (b). Pub. L. 91–172, § 803(d)(6), substituted "tax" for "surtax" in pars. (1) and (5).

1964—Subsec. (b). Pub. L. 88–272 redesignated pars. (2), (3), (4), (7) and (8) as pars. (1)—(5), substituted "where an individual chooses the benefits of income averaging" for "with respect to compensation for long-term services" in par. (3), and eliminated former pars. (1), (5) and (6) which referred to tax attributable to receipt of lump sum under annuity, endowment, or life insurance contract, to income from artistic work or inventions, and to back pay, respectively.

EFFECTIVE DATE OF 1969 AMENDMENT

Subsec. (a)(5) of this section applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

Amendment of subsec. (b)(1), (5) by section 803 (d)(6) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1970, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1933, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

PART II.—TAX ON CORPORATIONS

Sec.
11. Tax imposed.
12. Cross references relating to tax on corporations.

§ 11. Tax imposed.

(a) Corporations in general.

A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

(b) Normal tax.

The normal tax is equal to the following percentage of the taxable income:

(1) 30 percent, in the case of a taxable year beginning before January 1, 1964, and

(2) 22 percent, in the case of a taxable year beginning after December 31, 1963.

(c) Surtax.

The surtax is equal to the following percentage of the amount by which the taxable income exceeds the surtax exemption for the taxable year:

(1) 22 percent, in the case of a taxable year beginning before January 1, 1964,

(2) 28 percent, in the case of a taxable year beginning after December 31, 1963, and before January 1, 1965, and

(3) 26 percent, in the case of a taxable year beginning after December 31, 1964.

(d) Surtax exemption.

For purposes of this subtitle, the surtax exemption for any taxable year is $25,000, except that, with respect to a corporation to which section 1561 or 1564 (relating to surtax exemptions in case of certain controlled corporations) applies for the taxable year, the surtax exemption for the taxable year is the amount determined under such section.

(e) Exceptions.

Subsection (a) shall not apply to a corporation subject to a tax imposed by—

(1) section 594 (relating to mutual savings banks conducting life insurance business),

(2) subchapter L (sec. 801 and following, relating to insurance companies), or

(3) subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts).

(f) Foreign corporations.

In the case of a foreign corporation, the tax imposed by subsection (a) shall apply only as provided by section 882. (Aug. 16, 1954, ch. 736, 68A Stat. 11; Mar. 30, 1955, ch. 18, § 2, 69 Stat. 14; Mar. 29, 1956, ch. 115, § 2, 70 Stat. 66; Mar. 29, 1957, Pub. L. 85–12, § 2, 71 Stat. 9; June 30, 1958, Pub. L. 85–475, § 2, 72 Stat. 259; June 30, 1959, Pub. L. 86–75, § 2, 73 Stat. 157; June 30, 1960, Pub. L. 86–564, title II, § 201, 74 Stat. 290; Sept. 14, 1960, Pub. L. 86–779, § 10(d), 74 Stat. 1009; June 30, 1961, Pub. L. 87–72, § 2, 75 Stat. 193; June 28, 1962, Pub. L. 87–508, § 2, 76 Stat. 114; June 29, 1963, Pub. L. 88–52, § 2, 77 Stat. 72; Feb. 26, 1964, Pub. L. 88–272, title I, § 121, 78 Stat. 25; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(b)(2), 80 Stat. 1557; Dec. 30, 1969, Pub. L. 91–172, title IV, § 401(b)(2)(B), 83 Stat. 602.)

AMENDMENTS

1969—Subsec. (d). Pub. L. 91–172 substituted "section 1561 or 1564" for "section 1561."

1966—Subsec. (e). Pub. L. 89–809, § 104(b)(2)(A), struck out par. (4) which made reference to section 881 (a) (relating to foreign corporations not engaged in business in United States).

Subsec. (f). Pub. L. 89–809, § 104(b)(2)(B), added subsec. (f).

1964—Subsec. (b). Pub. L. 88–272 applied the 30 percent tax to years beginning before Jan. 1, 1964 instead of July 1, 1964 in par. (1), and in par. (2), reduced the rate from 25 percent to 22 percent, and applied it to years beginning after Dec. 31, 1963, instead of June 30, 1964.

Subsec. (c). Pub. L. 88–272 increased the percentage from 22 to 28 for taxable years beginning after Dec. 31, 1963, and before Jan. 1, 1965, and to 26 percent for taxable years beginning after Dec. 31, 1964. The surtax exemption previously carried in subsec. (c), is now stated in subsec. (d).

Subsec. (d). Pub. L. 88–272 added subsec. (d). Former subsec. (d) redesignated (e).

Subsec. (e). Pub. L. 88–272 redesignated former subsec. (d) as (e).

1963—Subsec. (b). Pub. L. 88–52 substituted "July 1, 1964" for "July 1, 1963" and "June 30, 1964" for "June 30, 1963", wherever appearing.

1962—Subsec. (b). Pub. L. 87–508 substituted "July 1, 1963" for "July 1, 1962" and "June 30, 1963" for "June 30, 1962", wherever appearing.

1961—Subsec. (b). Pub. L. 87–72 substituted "July 1, 1962" for "July 1, 1961" and "June 30, 1962" for "June 30, 1961", wherever appearing.

1960—Subsec. (b). Pub. L. 86–564 substituted "July 1, 1961" for "July 1, 1960" and "June 30, 1961" for "June 30, 1960" wherever appearing.

Subsec. (d)(3). Pub. L. 86–779 inserted "and real estate investment trusts" following "regulated investment companies."

1959—Subsec. (b). Pub. L. 86–75 substituted "July 1, 1960" for "July 1, 1959" and "June 30, 1960" for "June 30, 1959" wherever appearing.

1958—Subsec. (b). Pub. L. 85–475 substituted "July 1, 1959" for "July 1, 1958" and "June 30, 1959" for "June 30, 1958" wherever appearing.

1957—Subsec. (b). Pub. L. 85–12 substituted "July 1, 1958" for "April 1, 1957" and "June 30, 1958" for "March 31, 1957" wherever appearing.

1956—Subsec. (b). Act Mar. 29, 1956, substituted "April 1, 1957" for "April 1, 1956" and "March 31, 1957" for "March 31, 1956" wherever appearing.

1955—Subsec. (b). Act Mar. 30, 1955, substituted "April 1, 1956" for "April 1, 1955" and "March 31, 1956" for "March 31, 1955" wherever appearing.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (d) by Pub. L. 91–172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 401(h)(2) of Pub. L. 91–172, set out as a note under section 1561 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 104(n) of Pub. L. 89–809 provided that: "The amendments made by this section (other than subsection (k)) [adding section 6683 to this title and amending this section and sections 245, 301, 512, 542, 543, 545, 819, 821, 822, 831, 832, 841, 842, 881, 882, 884, 952, 953, 1249, 1442, and 6016 of this title] shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by subsection (k) [amending section 1248(d)(4) of this title] shall apply with respect to sales or exchanges occurring after December 31, 1966."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

SHORT TITLE

Section 1 of Pub. L. 88–52 provided: "That this Act [amending this section, sections 821, 4061, 4251, 4261, 5001, 5022, 5041, 5051, 5063, 5701, 5707, and 6412 of this title, section 5(e) of the Tax Rate Extension Act of 1962 (set out as note under section 4261 of this title) and section 497 of the Revenue Act of 1951 (set out as note under section 5701 of this title)] may be cited as the 'Tax Rate Extension Act of 1963'."

Section 1 of Pub. L. 87–508 provided: "That this Act [amending this section and sections 821, 4061, 4251—4253, 4261—4264, 5001, 5002, 5041, 5051, 5063, 5701, 6707, 6412, 6416, and 6421 of this title, enacting provisions set out as notes under section 4261, 6416, and 6421 of this title, and amending provisions set out as a note under section 5701 of this title] may be cited as the 'Tax Rate Extension Act of 1962'."

Section 1 of Pub. L. 87–72 provided: "That this Act [amending this section, sections 821, 4061, 4251, 4261, 5001, 5022, 5041, 5051, 5063, 5701, 5707 and 6412 of this title, and section 497 of the Revenue Act of 1951, which is set out as a note under section 5701 of this title] may be cited as the 'Tax Rate Extension Act of 1961'."

Section 1 of Pub. L. 86–75 provided that Pub. L. 86–75, which amended this section, sections 821, 4061, 4251, 4261, 5001, 5022, 5041, 5051, 5063, 5701, 5707 and 6412 of this title, and section 497 of the Revenue Act of 1951, which is set out as a note under section 5701 of this title, may be cited as the "Tax Rate Extension Act of 1959."

Section 1 of Pub. L. 85–475 provided that Pub. L. 85–475, which amended this section and sections 821, 4061, 4292, 5001, 5022, 5041, 5051, 5063, 5134, 5701, 5707, 6412, 6415, 6416, 7012 and 7272 of this title, repealed sections 4271—4273 and 4281—4283 of this title, and amended section 497 of the Revenue Act of 1951, should be popularly known as the "Tax Rate Extension Act of 1958."

CROSS REFERENCES

Computation of taxable income, see section 61 et seq. of this title.

Corporate distributions and adjustments, see section 301 et seq. of this title.

Declaration of estimated income tax by corporations, see section 6016 of this title.

Deduction for dividends paid, see section 561 et seq. of this title.

Definitions—

Corporation, see section 7701 (a) (3) of this title.

Taxable income, see section 63 of this title.

Effect of change of rate of tax, see section 21 of this title.

Exempt corporations, see section 501 of this title.

Imposition of net income taxes by State on income derived from interstate commerce, see chapter 10B of Title 15, Commerce and Trade.

Special deductions for corporations, see section 241 et seq. of this title.

Tax on—

Foreign corporations not engaged in business in United States, see section 881 of this title.

Resident foreign corporations as provided in this section, see section 882 (a) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 80, 511, 594, 802, 804, 821, 826, 831, 852, 857, 882, 891, 962, 1201, 1351, 1378, 1381, 1551, 1562, 4942, 6016, 6154, 6425, 6655 of this title.

§ 12. Cross references relating to tax on corporations.

(1) For tax on the unrelated business income of certain charitable and other corporations exempt from tax under this chapter, see section 511.

(2) For accumulated earnings tax and personal holding company tax, see parts I and II of subchapter G (sec. 531 and following).

(3) For doubling of tax on corporations of certain foreign countries, see section 891.

(4) For alternative tax in case of capital gains, see section 1201 (a).

(5) For rate of withholding in case of foreign corporations, see section 1442.

(6) For withholding of tax on tax-free covenant bonds, see section 1451.

(7) For limitation on the $25,000 exemption from surtax provided in section 11 (c) see section 1551.

(8) For minimum tax for tax preferences, see section 56.

(Aug. 16, 1954, ch. 736, 68A Stat. 11; Feb. 26, 1964, Pub. L. 88–272, title II, § 234(b)(4), 78 Stat. 115; Dec. 30, 1969, Pub. L. 91–172, title III, § 301(b)(3), 83 Stat. 585.)

AMENDMENTS

1969—Par. (8). Pub. L. 91–172 added par. (8).

1964—Par. (8). Pub. L. 88–272 deleted par. (8) which referred to section 1503 for additional tax for corporations filing consolidated returns.

EFFECTIVE DATE OF 1969 AMENDMENT

Par. (8) of this section applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 234(c) of Pub. L. 88–272, set out as a note under section 1503 of this title.

PART III.—CHANGES IN RATES DURING A TAXABLE YEAR

Sec.

21. Effect of changes.

§ 21. Effect of changes.

(a) General rule.

If any rate of tax imposed by this chapter changes, and if the taxable year includes the effective date of the change (unless that date is the first day of the taxable year), then—

(1) tentative taxes shall be computed by applying the rate for the period before the effective date of the change, and the rate for the period on and after such date, to the taxable income for the entire taxable year; and

(2) the tax for such taxable year shall be the sum of that proportion of each tentative tax which the number of days in each period bears to the number of days in the entire taxable year.

(b) Repeal of tax.

For purposes of subsection (a)—

(1) if a tax is repealed, the repeal shall be considered a change of rate; and

(2) the rate for the period after the repeal shall be zero.

(c) Effective date of change.

For purposes of subsections (a) and (b)—

(1) if the rate changes for taxable years "beginning after" or "ending after" a certain date, the following day shall be considered the effective date of the change; and

(2) if a rate changes for taxable years "beginning on or after" a certain date, that date shall be considered the effective date of the change.

(d) Changes made by Tax Reform Act of 1969 in case of individuals.

In applying subsection (a) to a taxable year of an individual which is not a calendar year, each change made by the Tax Reform Act of 1969 in part I or in the application of part IV or V of subchapter B for purposes of the determination of taxable income shall be treated as a change in a rate of tax. (Aug. 16, 1954, ch. 736, 68A Stat. 12; Feb. 26, 1964, Pub. L. 88–272, title I, § 132, 78 Stat. 30; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 803(e), 83 Stat. 685.)

REFERENCES IN TEXT

Tax Reform Act of 1969, referred to in subsec. (d), is Pub. L. 91–172, Dec. 30, 1969, 83 Stat. 487.

AMENDMENTS

1969—Subsec. (d). Pub. L. 91–172 substituted provisions covering changes made by the Tax Reform Act of 1969 in case of individuals for provisions covering changes made by Revenue Act of 1964.

1964—Subsec. (d). Pub. L. 88–272 amended subsection generally by substituting provisions relating to changes made by the Revenue Act of 1964, for provisions relating to taxable years beginning before Jan. 1, 1954, and ending after Dec. 31, 1953.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 132 of Pub. L. 88–272 provided in part that subsec. (d) of this section was amended by such section 132 effective with respect to taxable years ending after Dec. 31, 1963.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 6013 of this title.

PART IV.—CREDITS AGAINST TAX

Subpart
A. Credits allowable.
B. Rules for computing credit for investment in certain depreciable property.

SUBPART A—CREDITS ALLOWABLE

Sec.
31. Tax withheld on wages.
32. Tax withheld at source on nonresident aliens and foreign corporations and on tax-free covenant bonds.
33. Taxes of foreign countries and possessions of the United States.
35. Partially tax-exempt interest received by individuals.
36. Credits not allowed to individuals paying optional tax or taking standard deduction.
37. Retirement income.
38. Investment in certain depreciable property.
39. Certain uses of gasoline, special fuels, and lubricating oil.
40. Overpayments of tax.

AMENDMENTS

1970—Pub. L. 91–258, title II, § 207(d)(10), May 21, 1970, 84 Stat. 249, inserted ", special fuels," after "gasoline" in item 39.

1965—Pub. L. 89–44, title VIII, § 809(d)(1), June 21, 1965, 79 Stat. 167, added item 39 and redesignated former item 39 as 40.

1964—Pub. L. 88–272, title II, § 201(d)(1), Feb. 26, 1964, 78 Stat. 32, deleted item 34.

1962—Pub. L. 87–834, § 2(g)(1), (2), Oct. 16, 1962, 76 Stat. 972, 973, added the headings of subparts A and B and item 38, and redesignated former item 38 as 39.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in sections 6154, 6425, 6455 of this title.

§ 31. Tax withheld on wages.

(a) Wage withholding for income tax purposes.

(1) In general.

The amount withheld under section 3402 as tax on the wages of any individual shall be allowed to the recipient of the income as a credit against the tax imposed by this subtitle.

(2) Year of credit.

The amount so withheld during any calendar year shall be allowed as a credit for the taxable year beginning in such calendar year. If more than one taxable year begins in a calendar year, such amount shall be allowed as a credit for the last taxable year so beginning.

(b) Credit for special refunds of social security tax.

(1) In general.

The Secretary or his delegate may prescribe regulations providing for the crediting against the tax imposed by this subtitle of the amount determined by the taxpayer or the Secretary (or his delegate) to be allowable under section 6413 (c) as a special refund of tax imposed on wages. The amount allowed as a credit under such regulations shall, for purposes of this subtitle, be considered an amount withheld at source as tax under section 3402.

(2) Year of credit.

Any amount to which paragraph (1) applies shall be allowed as a credit for the taxable year beginning in the calendar year during which the wages were received. If more than one taxable year begins in the calendar year, such amount shall be allowed as a credit for the last taxable year so beginning.

(Aug. 16, 1954, ch. 736; 68A Stat. 12.)

CROSS REFERENCES

Amount allowable as credit under this section exceeding taxes imposed by chapter 1 considered as overpayment, see section 6401 (b) of this title.

Time tax collected at source deemed paid, see section 6513 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 72, 874, 6211, 6401, 6413, 6513, 6654 of this title.

§ 32. Tax withheld at source on nonresident aliens and foreign corporations and on tax-free covenant bonds.

There shall be allowed as credits against the tax imposed by this chapter—

(1) the amount of tax withheld at source under subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and on foreign corporations), and

(2) the amount of tax withheld at source under subchapter B of chapter 3 (relating to interest on tax-free covenant bonds).

(Aug. 16, 1954, ch. 736, 68A Stat. 13.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 36, 37, 874, 882, 6096, 6211 of this title.

§ 33. Taxes of foreign countries and possessions of the United States.

The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by this chapter to the extent provided in section 901. (Aug. 16, 1954, ch. 736, 68A Stat. 13.)

CROSS REFERENCES

Foreign tax credit, see section 901 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 35, 36, 37, 56, 1351, 1851, 6096 of this title.

§ 34. Repealed. Pub. L. 88–272, title II, § 201(b), Feb. 26, 1964, 78 Stat. 31.

Section, acts Aug. 16, 1954, ch. 736, 68A Stat. 13; June 25, 1959, Pub. L. 86–69, § 3(a)(1), 73 Stat. 139; Sept. 14, 1960, Pub. L. 86–779, § 10(e), 74 Stat. 1009; Feb. 26, 1964, Pub. L. 88–272, title II, § 201(a), 78 Stat. 31, related to dividends received by individuals.

EFFECTIVE DATE OF REPEAL

Section 201(b) of Pub. L. 88–272 provided in part that this section is repealed effective with respect to dividends received after Dec. 31, 1964.

§ 35. Partially tax-exempt interest received by individuals.

(a) In general.

There shall be allowed to an individual, as a credit against the tax imposed by this subtitle for the taxable year, an amount equal to 3 percent of the amount received as interest on obligations of the

United States or on obligations of corporations organized under Act of Congress which are instrumentalities of the United States, but only if—

(1) such interest is included in gross income; and

(2) such interest is exempt from normal tax under the Act authorizing the issuance of such obligations.

(b) Limitation on amount of credit.

The credit allowed by subsection (a) shall not exceed whichever of the following is the lesser:

(1) the amount of the tax imposed by this chapter for the taxable year, reduced by the credit allowable under section 33; or

(2) 3 percent of the taxable income for the taxable year.

(c) Certain nonresident aliens ineligible for credit.

No credit shall be allowed under subsection (a) to a nonresident alien individual with respect to whom a tax is imposed for the taxable year under section 871 (a).

(d) Cross reference.

For reduction of credit under this section on account of amortizable bond premium, see section 171.

(Aug 16, 1954, ch. 736, 68A Stat. 14; Sept. 2, 1958, Pub. L. 85–866, title I, § 41(b), 72 Stat. 1639; Feb. 26, 1964, Pub. L. 88–272, title II, § 201(d)(2), 78 Stat. 32.)

AMENDMENTS

1964—Subsec. (b)(1). Pub. L. 88–272 substituted "the credit allowable under section 33" for "the sum of the credits allowable under sections 33 and 34."

1958—Subsec. (c). Pub. L. 85–866 added subsec. (c). Former subsec. (c) redesignated as (d).

Subsec. (d). Pub. L. 85–866 redesignated former subsec. (c) as (d).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 201(e) of Pub. L. 88–272 provided that: "The amendments made by subsection (a) [to section 34 of this title] shall apply with respect to taxable years ending after December 31, 1963. The amendment made by subsection (b) [repealing section 34 of this title] shall apply with respect to taxable years ending after December 31, 1964. The amendment made by subsection (c) [to section 116(a) of this title] shall apply with respect to taxable years beginning after December 31, 1963. The amendments made by subsection (d) [to this section, the analysis preceding section 31, and sections 37, 46, 116(c)(3), 584, 642, 702, 854, 857, 871, 1375 and 6014 of this title] shall apply with respect to dividends received after December 31, 1964, in taxable years ending after such date".

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsecs. (c) and (d) by Pub. L. 85–866 applicable only to taxable years beginning after Dec. 31, 1957, see section 41(c) of Pub. L. 85–866, set out as a note under section 871 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 36, 37, 171, 551, 584, 642, 702, 1402, 6096 of this title.

§ 36. Credits not allowed to individuals paying optional tax or taking standard deduction.

If an individual elects to pay the optional tax imposed by section 3, or if he elects under section 144 to take the standard deduction, the credits provided by sections 32, 33, and 35 shall not be allowed. (Aug. 16, 1954, ch. 736, 68A Stat. 15.)

§ 37. Retirement income.

(a) General rule.

In the case of an individual who has received earned income before the beginning of the taxable year, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 17 percent, in the case of a taxable year beginning in 1964, or 15 percent, in the case of a taxable year beginning after December 31, 1964, of the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d)); but this credit shall not exceed such tax reduced by the credits allowable under section 32(2) (relating to tax withheld at source on tax-free covenant bonds), section 33 (relating to foreign tax credit), and section 35 (relating to partially tax exempt interest).

(b) Individual who has received earned income.

For purposes of subsection (a), an individual shall be considered to have received earned income if he has received, in each of any 10 calendar years before the taxable year, earned income (as defined in subsection (g)) in excess of $600. A widow or widower whose spouse had received such earned income shall be considered to have received earned income.

(c) Retirement income.

For purposes of subsection (a), the term "retirement income" means—

(1) in the case of an individual who has attained the age of 65 before the close of the taxable year, income from—

(A) pensions and annuities (including in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1), distributions by a trust described in section 401(a) which is exempt from tax under section 501(a)),

(B) interest,

(C) rents,

(D) dividends, and

(E) bonds described in section 405(b)(1) which are received under a qualified bond purchase plan described in section 405(a) or in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a), or

(2) in the case of an individual who has not attained the age of 65 before the close of the taxable year, income from pensions and annuities under a public retirement system (as defined in subsection (f)),

to the extent included in gross income without reference to this section, but only to the extent such income does not represent compensation for personal services rendered during the taxable year.

(d) Limitation on retirement income.

For purposes of subsection (a), the amount of retirement income shall not exceed $1,524 less—

(1) in the case of any individual, any amount received by the individual as a pension or annuity—

(A) under title II of the Social Security Act,

(B) under the Railroad Retirement Acts of 1935 or 1937, or

(C) otherwise excluded from gross income, and

(2) in the case of any individual who has not attained age 72 before the close of the taxable year—

(A) if such individual has not attained age 62 before the close of the taxable year, any amount of earned income (as defined in subsection (g) in excess of $900 received by such individual in the taxable year, or

(B) if such individual has attained age 62 before the close of the taxable year, the sum of (i) one-half the amount of earned income received by such individual in the taxable year in excess of $1,200 but not in excess of $1,700, and (ii) the amount of earned income so received in excess of $1,700.

(e) Rule for application of subsection (d) (1).

Subsection (d) (1) shall not apply to any amount excluded from gross income under section 72 (relating to annuities), 101 (relating to life insurance proceeds), 104 (relating to compensation for injuries or sickness), 105 (relating to amounts received under accident and health plans), 402 (relating to taxability of beneficiary of employees' trust), or 403 (relating to taxation of employee annuities).

(f) Public retirement system defined.

For purposes of subsection (c) (2), the term "public retirement system" means a pension, annuity, retirement, or similar fund or system established by the United States, a State, a Territory, a possession of the United States, any political subdivision of any of the foregoing, or the District of Columbia.

(g) Earned income defined.

For purposes of subsections (b) and (d) (2), the term "earned income" has the meaning assigned to such term in section 911 (b), except that such term does not include any amount received as a pension or annuity.

(h) Nonresident alien ineligible for credit.

No credit shall be allowed under subsection (a) to any nonresident alien.

(i) Special rules for certain married couples.

(1) Election.

A husband and wife who make a joint return for the taxable year and both of whom have attained the age of 65 before the close of the taxable year may elect (at such time and in such manner as the Secretary or his delegate by regulations prescribes) to determine the amount of the credit allowed by subsection (a) by applying the provisions of paragraph (2).

(2) Special rules.

If an election is made under paragraph (1) for the taxable year, for purposes of subsection (a)—

(A) if either spouse is an individual who has received earned income within the meaning of subsection (b), the other spouse shall be considered to be an individual who has received earned income within the meaning of such subsection; and

(B) subsection (d) shall be considered as providing that the amount of the combined retirement income of both spouses shall not exceed $2,286, less the sum of the amounts specified in paragraphs (1) and (2) of subsection (d) for each spouse.

(j) Cross reference.

For disallowance of credit where tax is computed by Secretary or his delegate, see section 6014 (a).

(Aug. 16, 1954, ch. 736, 68A Stat. 15; Aug. 9, 1955, ch. 659, § 1, 69 Stat. 591; Jan. 28, 1956, ch. 17, § 1, 70 Stat. 8; Oct. 10, 1962, Pub. L. 87–792; § 7(a), 76 Stat. 828; Oct. 24, 1962, Pub. L. 87–876, § 1, 76 Stat. 1199; Feb. 26, 1964, Pub. L. 88–272, title I, § 113(a), title II, §§ 201(d)(3), 202(a), 78 Stat. 24, 32, 33.)

REFERENCES IN TEXT

Title II of the Social Security Act, referred to in subsec. (d), is classified to section 401 et seq. of Title 42, The Public Health and Welfare.

The Railroad Retirement Act of 1935, referred to in subsec. (d), was classified to former sections 215—228 of Title 45, Railroads, and was amended by, and incorporated in, the Railroad Retirement Act of 1937.

The Railroad Retirement Act of 1937, referred to in subsec. (d), is classified to section 228a et seq. of Title 45, Railroads.

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272, §§ 113(a), 201(d)(3), substituted "an amount equal to 17 percent, in the case of a taxable year beginning in 1964, or 15 percent, in the case of a taxable year beginning after December 31, 1964, of the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d));" for "an amount equal to the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d)), multiplied by the rate provided in section 1 for the first $2,000 of taxable income;", and eliminated "section 34 (relating to credit for dividends received by individuals)", preceding "and section 35."

Subsec. (i). Pub. L. 88–272, § 202(a), added subsec. (i). Former subsec. (i) redesignated (j).

Subsec. (j). Pub. L. 88–272, § 202(a), redesignated former subsec. (i) as (j).

1962—Subsec. (c)(1). Pub. L. 87–792 inserted provisions in subpar. (A) requiring inclusion, in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1), distributions by a trust described in section 401(a) which is exempt from tax under section 501(a), and added subpar. (E).

Subsec. (d). Pub. L. 87–876 increased the limit on retirement income from $1,200 to $1,524, lowered the age requirement in par. (2)(A) from 65 to 62, and substituted provisions in par. (2)(B) which reduce the amount of retirement income for individuals who reach age 62, by one-half the amount of earned income in excess of $1,200 but not in excess of $1,700, and by the amount received over $1,700, for provisions which reduced such income by the amount earned over $1,200 by persons having reached age 65, and which defined income as in subsec. (g) of this section.

1956—Subsec. (d)(2). Act Jan. 28, 1956, reduced from 75 to 72 the age at which there will be no limitation on earned income and increased from $900 to $1,200 the amount that an individual over 65 can earn without reducing the $1,200 on which the retirement credit is computed.

1955—Subsec. (f). Act Aug. 9, 1955, extended the retirement income tax credit to members of the Armed Forces.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (a) by section 113(a) of Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

Amendment of subsec. (a) by section 201(d)(3) of Pub. L. 88–272 applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272 set out as a note under section 35 of this title.

Section 202(b) of Pub. L. 88–272 provided that: "The amendments made by subsection (a) [to this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENTS

Section 2 of Pub. L. 87–876 provided that: "The amendment made by the first section of this Act [to subsec. (d) of this section] shall apply only to taxable years ending after the date of the enactment of this Act [Oct. 24, 1962]."

Section 8 of Pub. L. 87–792 provided that: "The amendments made by this Act [enacting sections 405 and 6047 of this title, and amending this section and sections 62, 72, 101, 104, 105, 172, 401—404, 503, 805, 1361, 2039, 2517, 3306, 3401 and 7207 of this title] shall apply to taxable years beginning after December 31, 1962."

EFFECTIVE DATE OF 1956 AMENDMENT

Section 2 of act Jan. 28, 1956, provided that: "The amendment made by the first section of this Act [to subsec. (d) (2)] shall apply only with respect to taxable years beginning after December 31, 1955."

EFFECTIVE DATE OF 1955 AMENDMENT

Section 2 of act Aug. 9, 1955, provided that: "The amendment made by this Act [to subsec. (f)] shall be applicable to taxable years beginning after December 31, 1954."

CROSS REFERENCES

Dividends received credit not allowed on distributions of electing small business corporations, see section 1375 of this title.

Disallowance of credit where tax is computed by Secretary or his delegate, see section 6014 (a) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 56, 1375, 6014, 6096 of this title.

§ 38. Investment in certain depreciable property.

(a) General rule.

There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B. (Added Pub. L. 87–834, § 2(a), Oct. 16, 1962, 76 Stat. 962.)

EFFECTIVE DATE

Section 2(h) of Pub. L. 87–834 provided that: "The amendments made by this section [adding this section and sections 46—48 and 181 of this title, amending sections 381, 1016, 6501, 6511, 6601 and 6611 of this title, and redesignating former section 38 as section 39 of this title] shall apply with respect to taxable years ending after December 31, 1961."

SHORT TITLE

Section 1(a) of Pub. L. 87–834 provided that: "This Act [adding this section and sections 46—48, 78, 181, 182, 274, 595, 669, 823—826, 951—964, 970—972, 1245—1249, 1381—1383, 1385, 1388, 6048, 6049 and 6677—6679 of this title, amending sections 72, 162, 167, 170, 179, 216, 245, 263, 301, 312, 318, 341, 381, 453, 501, 521, 535, 545, 591, 593, 613, 642, 643, 665, 666, 668, 751, 821, 822, 831, 832, 841, 861, 901, 902, 904, 911, 1016, 1201, 1223, 1307, 2031, 2033—2038, 2040, 2041, 4382, 6038, 6041, 6042, 6044, 6046, 6072, 6501, 6511, 6601, 6611, 6652 and 7701 of this title, and section 1464 of Title 12, Banks and Banking, redesignating section 38 as section 39 of this title and section 823 as section 822(f) of this title, repealing section 522 of this title, enacting provisions set out as notes under this section and sections 72, 162, 170, 216, 301, 593, 595, 643, 821, 902, 904, 911, 951, 1245, 1246, 1248, 1249, 1307, 1371, 1374, 1381, 2031, 4382, 6038, 6042, 6046, 7701 and 7852 of this title and under section 1984 of Title 50, Appendix, War and National Defense, and amending section 188 of the Internal Revenue Code of 1939] may be cited as the 'Revenue Act of 1962'."

TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES

Pub. L. 88–272, title II, § 203(e), Feb. 26, 1964, 78 Stat. 35, provided that:

"It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use—

"(1) in the case of public utility property (as defined in section 46(c)(3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by section 38 of such Code, or

"(2) in the case of any other property, any credit against tax allowed by section 38 of such Code,

to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 47, 48, 49, 51, 56, 167, 169, 185, 381, 1016, 1351, 6096, 6601 of this title.

§ 39. Certain uses of gasoline, special fuels, and lubricating oil.

(a) General rule.

There shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to the sum of the amounts payable to the taxpayer—

(1) under section 6420 with respect to gasoline used during the taxable year on a farm for farming purposes (determined without regard to section 6420(h)),

(2) under section 6421 with respect to gasoline used during the taxable year (A) otherwise than as a fuel in a highway vehicle or (B) in vehicles while engaged in furnishing certain public passenger land transportation service (determined without regard to section 6421(i)),

(3) under section 6424 with respect to lubricating oil used during the taxable year otherwise than in a highway motor vehicle (determined without regard to section 6424(g)), and

(4) under section 6427 with respect to fuels used for nontaxable purposes or resold during the taxable year (determined without regard to section 6427(f)).

(b) Transitional rules.

For purposes of paragraphs (1) and (2) of subsection (a), a taxpayer's first taxable year beginning after June 30, 1965, shall include the period after June 30, 1965, and before the beginning of such first taxable year. For purposes of paragraph (3) of subsection (a), a taxpayer's first taxable year beginning after December 31, 1965, shall include the period after December 31, 1965, and before the beginning of such first taxable year.

(c) Exception.

Credit shall not be allowed under subsection (a) for any amount payable under section 6421, 6424, or 6427, if a claim for such amount is timely filed, and

under section 6421(i), 6424(g), or 6427(f) is payable, under such section. (Added Pub. L. 89–44, title VIII, § 809(c), June 21, 1965, 79 Stat. 167, and amended Pub. L. 91–258, title II, § 207(c), May 21, 1970, 84 Stat. 248.)

AMENDMENTS

1970—Pub. L. 91–258, § 207(c)(1), inserted reference to special fuels in the catchline.

Subsec. (a). Pub. L. 91–258, § 207(c)(2), added par. (4).

Subsec. (c). Pub. L. 91–258, § 207(c)(3), (4), inserted references to sections 6427 and 6427(f), respectively.

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91–258 applicable with respect to taxable years ending after June 30, 1970, see section 211(b) of Pub. L. 91–258, set out as a note under section 4041 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning on or after July 1, 1965, see section 809(f) of Pub. L. 89–44, set out as a note under section 6420 of this title.

SHORT TITLE

Section 1(a) of Pub. L. 89–44 provided that: "This Act [adding this section and sections 4094 and 6424 of this title, amending sections 72, 874, 1314, 1481, 4041, 4055, 4057, 4061, 4063, 4082, 4091, 4101, 4161, 4216, 4218, 4221, 4222, 4227, 4251, 4252, 4253, 4254, 4261, 4261 note, 4262, 4291, 4361, 4371, 4374, 4402, 4461, 4462, 4901, 4905, 4914, 5001, 5002, 5004, 5008, 5022, 5025, 5041, 5051, 5053, 5062, 5083, 5215, 5223, 5234, 5382, 5383, 5384, 5385, 5392, 5608, 5701, 5701 note, 5702, 5704, 5705, 5711, 5741, 5753, 5762, 5763, 6011, 6040, 6103, 6201, 6206, 6211, 6213, 6334, 6401, 6412, 6415, 6416, 6420, 6421, 6501, 6675, 6802, 6806, 6803, 7012, 7103, 7210, 7232, 7272, 7326, 7603, 7604, 7605, and 7652 of this title and section 120 note of Title 23, redesignating section 39 of this title as section 40 and subchapters E, F, and G of chapter 52 of this title as subchapters D, E, and F respectively, repealing sections 4001—4003, 4011—4013, 4021, 4022, 4031, 4051—4053, 4111, 4121, 4131, 4141—4143, 4151, 4171—4173, 4191, 4192, 4201, 4211, 4224, 4231—4234, 4241—4243, 4286, 4287, 4301—4305, 4311—4315, 4321—4324, 4331—4333, 4341—4346, 4351—4354, 4381, 4451—4457, 4712—4474, 5063, 5707, 5731, 5732, and 7275 of this title, and enacting provisions set out as notes under sections 501, 4041, 4061, 4063, 4082, 4251, 4261, 4262, 4287, 4291, 4361, 4374, 4402, 4461, 4905, 5002, 5008, 5025, 5041, 5383, 5701, 5702, 5705, 6103, 6334, 6412, 6420, and 6501 of this title] may be cited as the 'Excise Tax Reduction Act of 1965'."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 72, 874, 882, 1378, 6201, 6211, 6401 of this title.

§ 40. Overpayments of tax.

For credit against the tax imposed by this subtitle for overpayments of tax, see section 6401.

(Aug. 16, 1954, ch. 736, 68A Stat. 16, § 40, formerly § 38, renumbered § 39, Oct. 16, 1962, Pub. L. 87–834, § 2(a), 76 Stat. 962; renumbered § 40, June 21, 1965, Pub. L. 89–44, title VIII, § 809(c), 79 Stat. 167.)

SUBPART B—RULES FOR COMPUTING CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY

Sec.
46. Amount of credit.
47. Certain dispositions, etc., of section 38 property.
48. Definitions; special rules.
49. Termination of credit.

AMENDMENTS

1969—Pub. L. 91–172, title VII, § 703(d), Dec. 30, 1969, 83 Stat. 667, added item 49.

1962—Pub. L. 87–834, § 2(b), Oct. 16, 1962, 76 Stat. 963, added subpart B.

§ 46. Amount of credit.

(a) Determination of amount.

(1) General rule.

The amount of the credit allowed by section 38 for the taxable year shall be equal to 7 percent of the qualified investment (as defined in subsection (c)).

(2) Limitation based on amount of tax.

Notwithstanding paragraph (1), the credit allowed by section 38 for the taxable year shall not exceed—

(A) so much of the liability for tax for the taxable year as does not exceed $25,000, plus

(B) for taxable years ending on or before the last day of the suspension period (as defined in section 48(j)), 25 percent of so much of the liability for tax for the taxable year as exceeds $25,000, or

(C) for taxable years ending after the last day of such suspension period, 50 percent of so much of the liability for tax for the taxable year as exceeds $25,000.

In applying subparagraph (C) to a taxable year beginning on or before the last day of such suspension period and ending after the last day of such suspension period, the percent referred to in such subparagraph shall be the sum of 25 percent plus the percent which bears the same ratio to 25 percent as the number of days in such year after the last day of the suspension period bears to the total number of days in such year. The amount otherwise determined under this paragraph shall be reduced (but not below zero) by the credit which would have been allowable under paragraph (1) for such taxable year with respect to suspension period property but for the application of section 48(h)(1).

(3) Liability for tax.

For purposes of paragraph (2), the liability for tax for the taxable year shall be the tax imposed by this chapter for such year, reduced by the sum of the credits allowable under—

(A) section 33 (relating to foreign tax credit),

(B) section 35 (relating to partially tax-exempt interest), and

(C) section 37 (relating to retirement income).

For purposes of this paragraph, any tax imposed for the taxable year by section 56 (relating to minimum tax for tax preferences), section 531 (relating to accumulated earnings tax), section 541 (relating to personal holding company tax) and any additional tax imposed for the taxable year by section 1351(d)(1) (relating to recoveries of foreign expropriation losses), or section 1378 (relating to tax on certain capital gains of subchapter S corporation), and shall not be considered tax imposed by this chapter for such year.

(4) Married individuals.

In the case of a husband or wife who files a separate return, the amount specified under subparagraphs (A) and (B) of paragraph (2) shall be $12,500 in lieu of $25,000. This paragraph shall

not apply if the spouse of the taxpayer has no qualified investment for, and no unused credit carryback or carryover to, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

(5) Controlled groups.

In the case of a controlled group, the $25,000 amount specified under paragraph (2) shall be reduced for each component member of such group by apportioning $25,000 among the component members of such group in such manner as the Secretary or his delegate shall by regulations prescribe. For purposes of the preceding sentence, the term "controlled group" has the meaning assigned to such term by section 1563(a).

(b) Carryback and carryover of unused credits.

(1) Allowance of credit.

If the amount of the credit determined under subsection (a)(1) for any taxable year exceeds the limitation provided by subsection (a)(2) for such taxable year (hereinafter in this subsection referred to as "unused credit year"), such excess shall be—

(A) an investment credit carryback to each of the 3 taxable years preceding the unused credit year, and

(B) an investment credit carryover to each of the 7 taxable years following the unused credit year,

and shall be added to the amount allowable as a credit by section 38 for such years, except that such excess may be a carryback only to a taxable year ending after December 31, 1961. The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 10 taxable years to which (by reason of subparagraphs (A) and (B)) such credit may be carried, and then to each of the other 9 taxable years to the extent that, because of the limitation contained in paragraph (2), such unused credit may not be added for a prior taxable year to which such unused credit may be carried.

(2) Limitation.

The amount of the unused credit which may be added under paragraph (1) for any preceding or succeeding taxable year shall not exceed the amount by which the limitation provided by subsection (a)(2) for such taxable year exceeds the sum of—

(A) the credit allowable under subsection (a)(1) for such taxable year, and

(B) the amounts which, by reason of this subsection, are added to the amount allowable for such taxable year and attributable to taxable years preceding the unused credit year.

(3) Repealed. Pnb. L. 90-225, § 2(a), Dec. 27, 1967, 81 Stat. 731.

(4) Taxable year beginning before January 1, 1962.

For purposes of determining the amount of an investment credit carryback that may be added under paragraph (1) for a taxable year beginning before January 1, 1962, and ending after December 31, 1961, the amount of the limitation provided by subsection (a)(2) is the amount which bears the same ratio to such limitation as the number of days in such year after December 31, 1961, bears to the total number of days in such year.

(5) Taxable years beginning after December 31, 1968, and ending after April 18, 1969.

The amount which may be added under this subsection for any taxable year beginning after December 31, 1968, and ending after April 18, 1969, shall not exceed 20 percent of the higher of—

(A) the aggregate of the investment credit carrybacks and investment credit carryovers to the taxable year, or

(B) the highest amount computed under subparagraph (A) for any preceding taxable year which began after December 31, 1968, and ended after April 18, 1969.

(6) Additional 3-year carryover period in certain cases.

Any portion of an investment credit carryback or carryover to any taxable year beginning after December 31, 1968, and ending after April 18, 1969, which—

(A) may be added under this subsection under the limitations provided by paragraph (2), and

(B) may not be added under the limitation provided by paragraph (5),

shall be an investment credit carryover to each of the 3 taxable years following the last taxable year for which such portion may be added under paragraph (1), and shall (subject to the provisions of paragraphs (1), (2), and (5)) be added to the amount allowable as a credit by section 38 for such years.

(c) Qualified investment.

(1) In general.

For purposes of this subpart, the term "qualified investment" means, with respect to any taxable year, the aggregate of—

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year, plus

(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48(c)(1)) placed in service by the taxpayer during such taxable year.

(2) Applicable percentage.

For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

If the useful life is—	The applicable percentage is—
4 years or more but less than 6 years	33⅓
6 years or more but less than 8 years	66⅔
8 years or more	100

For purposes of this paragraph, the useful life of any property shall be determined as of the time such property is placed in service by the taxpayer.

(3) Public utility property.

(A) In the case of section 38 property which is public utility property, the amount of the qualified investment shall be 3/7 of the amount determined under paragraph (1)

(B) For purposes of subparagraph (A), the term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—

(i) electrical energy, water, or sewage disposal services,

(ii) gas through a local distribution system,

(iii) telephone service, or

(iv) telegraph service by means of domestic telegraph operations (as defined in section 222(a)(5) of the Communications Act of 1934, as amended; 47 U.S.C., sec. 222(a)(5)),

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

(4) Certain replacement property.

For purposes of paragraph (1), if section 38 property is placed in service by the taxpayer to replace property which was—

(A) destroyed or damaged by fire, storm, shipwreck, or other casualty, or

(B) stolen,

the basis of such section 38 property (in the case of new section 38 property), or the cost of such section 38 property (in the case of used section 38 property), which (but for this paragraph) would be taken into account under paragraph (1) shall be reduced by an amount equal to the amount received by the taxpayer as compensation, by insurance or otherwise, for the property so destroyed, damaged, or stolen, or to the adjusted basis of such property, whichever is the lesser. No reduction in basis or cost shall be made under the preceding sentence in any case in which the reduction in qualified investment attributable to the substitution required by section 47(a)(1) with respect to the property so destroyed, damaged, or stolen (determined without regard to section 47(a)(4)) is greater than the reduction described in the preceding sentence.

(d) Limitations with respect to certain persons.

(1) In general.

In the case of—

(A) an organization to which section 593 applies,

(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (sec. 851 and following), and

(C) a cooperative organization described in section 1381(a),

the qualified investment and the $25,000 amount specified under subparagraphs (A) and (B) of subsection (a)(2) shall equal such person's ratable share of such items.

(2) Ratable share.

For purposes of paragraph (1), the ratable share of any person for any taxable year of the items described therein shall be—

(A) in the case of an organization referred to in paragraph (1)(A), 50 percent thereof,

(B) in the case of a regulated investment company or a real estate investment trust, the ratio (i) the numerator of which is its taxable income and (ii) the denominator of which is its taxable income computed without regard to the deduction for dividends paid provided by section 852(b)(2)(D) or 857(b)(2)(C), as the case may be, and

(C) in the case of a cooperative organization, the ratio (i) the numerator of which is its taxable income and (ii) the denominator of which is its taxable income increased by amounts to which section 1382(b) or (c) applies and similar amounts the tax treatment of which is determined without regard to subchapter T (sec. 1381 and following).

For purposes of subparagraph (B) of the preceding sentence, the term "taxable income" means in the case of a regulated investment company its investment company taxable income (within the meaning of section 852(b)(2)), and in the case of a real estate investment trust its real estate investment trust taxable income (within the meaning of section 857(b)(2)).

(Added Pub. L. 87–834, § 2(b), Oct. 16, 1962, 76 Stat. 963, and amended Pub. L. 88–272, title II, § 201(d)(4), Feb. 26, 1964, 78 Stat. 32; Pub. L. 89–384, § 1(c)(1), Apr. 8, 1966, 80 Stat. 102; Pub. L. 89–389, § 2(b)(5), Apr. 14, 1966, 80 Stat. 114; Pub. L. 89–800, § 3, Nov. 8, 1966, 80 Stat. 1514; Pub. L. 90–225, § 2(a), Dec. 27, 1967, 81 Stat. 731; Pub. L. 91–172, title III, § 301(b)(4), title IV, § 401(e)(1), title VII, § 703(b), Dec. 30, 1969, 83 Stat. 585, 603, 666.)

AMENDMENTS

1969—Subsec. (a)(3). Pub. L. 91–172, § 301(b)(4), inserted reference to "section 56 (relating to minimum tax for tax preference),".

Subsec. (a)(5). Pub. L. 91–172, § 401(e)(1), reenacted subsection with minor changes and substituted reference to section 1563(a) for reference to section 1504.

Subsec. (b). Pub. L. 91–172, § 703(b), added pars. (5) and (6).

1967—Subsec. (b). Pub. L. 90–225 struck out par. (3), which provided that to the extent that the excess described in par. (1) of this subsection arises by reason of net operating loss carryback, subpar. (A) of par. (1) of this subsection shall not apply.

1966—Subsec. (a)(2). Pub. L. 89–800, § 3(a), added "for taxable years ending on or before the last day of the suspension period (as defined in section 48(j))," at the beginning of subpar. (B), and added subpar. (C) and the provisions following subpar. (C) covering the application of subpar. (C) and the reduction of the amount otherwise determined under par. (2) by the credit allowable but for the application of section 48(h)(1).

Subsec. (a)(3). Pub. L. 89–389 inserted reference to tax imposed for the taxable year by section 1378 (relating to tax on certain capital gains of subchapter S corporations) in the list of taxes not to be considered tax imposed by this chapter for purposes of par. (3).

Pub. L. 89–384 added any additional tax imposed for the taxable year by section 1351 (relating to recoveries of foreign expropriation losses) to the list of taxes not to be considered a tax imposed by this chapter for purposes of par. (3).

Subsec. (b)(1). Pub. L. 89-800, § 3(b), substituted "7 taxable years" for "5 taxable years" in subpar. (B) and "10 taxable years" and "other 9 taxable years" for "8 taxable years" and "other 7 taxable years" respectively in the material following subpar. (B).

1964—Subsec. (a)(3). Pub. L. 88-272 deleted subpar. (B) relating to section 34, and redesignated subpars. (C) and (D) as (B) and (C), respectively.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a)(3) of this section by section 301(b)(4) of Pub. L. 91-172 applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91-172, set out as a note under section 56 of this title.

Amendment of subsec. (a)(5) of this section by section 401(e)(1) of Pub. L. 91-172 applicable with respect to taxable years ending on or after Dec. 31, 1970, see section 401(h)(3) of Pub. L. 91-172, set out as a note under section 1561 of this title.

EFFECTIVE DATE OF 1967 AMENDMENT

Section 2(g) of Pub. L. 90-225 provided that: "The amendments made by this section [amending subsec. (b)(3) of this section and sections 6411(a), 6501(j), 6511(d)(4)(A), 6601(e)(2), and 6611(f)(2) of this title] shall apply with respect to investment credit carrybacks attributable to net operating loss carrybacks from taxable years ending after July 31, 1967."

EFFECTIVE DATE OF 1966 AMENDMENTS

Section 4 of Pub. L. 89-800 provided that: "The amendments made by this Act [amending subsec. (a)(2) of this section and sections 48 and 167 of this title] shall apply to taxable years ending after October 9, 1966, except that the amendments made by section 3(b) [amending subsec. (b)(1) of this section] shall apply only if the fifth taxable year following the unused credit year ends after December 31, 1966."

Amendment of subsec. (a)(3) of this section by Pub. L. 89-389 applicable with respect to taxable years of electing small business corporations beginning after April 14, 1966, but not applicable with respect to sales or exchanges occurring before February 24, 1966, see section 2(c) of Pub. L. 89-389, set out as a note under section 1378 of this title.

Amendment of subsec. (a)(3) by Pub. L. 89-384 applicable with respect to amounts received after December 31, 1964, in respect of foreign expropriation losses (as defined in section 1351(b) of this title) sustained after December 31, 1958, see section 2 of Pub. L. 89-384, set out as a note under section 1351 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88-272 applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88-272, set out as a note under section 35 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years ending after Dec. 31, 1961, see section 2(h) of Pub. L. 87-834, set out as a note under section 38 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 47, 48, 6411 of this title.

§ 47. Certain dispositions, etc., of section 38 property.

(a) General rule.

Under regulations prescribed by the Secretary or his delegate—

(1) Early disposition, etc.

If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

(2) Property becomes public utility property.

If during any taxable year any property taken into account in determining qualified investment becomes public utility property (within the meaning of section 46(c)(3)(B)), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from treating the property, for purposes of determining qualified investment, as public utility property (after giving due regard to the period before such change in use). If the application of this paragraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

(3) Carrybacks and carryovers adjusted.

In the case of any cessation described in paragraph (1) or any change in use described in paragraph (2), the carrybacks and carryovers under section 46(b) shall be adjusted by reason of such cessation (or change in use).

(4) Property destroyed by casualty, etc.

No increase shall be made under paragraph (1) and no adjustment shall be made under paragraph (3) in any case in which—

(A) any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, on account of its destruction or damage by fire, storm, shipwreck, or other casualty, or by reason of its theft,

(B) section 38 property is placed in service by the taxpayer to replace the property described in subparagraph (A), and

(C) the reduction in basis or cost of such section 38 property described in the first sentence of section 46(c)(4) is equal to or; greater than the reduction in qualified investment which (but for this paragraph) would be made by reason of the substitution required by paragraph (1) with respect to the property described in subparagraph (A).

Subparagraphs (B) and (C) shall not apply with respect to any casualty or theft occurring after April 18, 1969.

(5) Certain property replaced after April 18, 1969.

In any case in which—

(A) section 38 property is disposed of, and

(B) property which would be section 38 property but for section 49 is placed in service by the taxpayer to replace the property disposed of,

the increase under paragraph (1) and the adjustment under paragraph (3) shall not be greater than the increase or adjustment which would result if the qualified investment of the property described in subparagraph (B) (determined as if

such property were section 38 property) were substituted for the qualified investment of the property disposed of (as determined under paragraph (1)). Except in the case of a disposition by reason of a casualty or theft occurring before April 19, 1969, the preceding sentence shall apply only if the section 38 property disposed of is replaced within 6 months after the date of such disposition.

(6) Aircraft used outside the United States after April 18, 1969.

(A) General rule.—

Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used outside the United States under a qualifying lease or leases shall be treated as not ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 4 years in total. For purposes of the preceding sentence, the registration of such aircraft under the laws of a foreign country shall be treated as use outside the United States.

(B) Computation of qualified investment.—

If an aircraft described in subparagraph (A) is disposed of or otherwise ceases to be section 38 property, the increase under paragraph (1) and the adjustment under paragraph (3) shall not be greater than the increase or adjustment which would result if the qualified investment of such aircraft were based upon a useful life equal to the lesser of (i) the actual useful life of such aircraft with respect to the taxpayer, or (ii) twice the number of full calendar months during which such aircraft was registered by the Administrator of the Federal Aviation Agency and was used in the United States, operated to and from the United States, or operated under contract with the United States. For purposes of the preceding sentence, an aircraft shall be treated as used in the United States for any calendar month beginning after such aircraft was placed in service, if such month is included in a taxable year ending before January 1, 1971, for which such aircraft was section 38 property (determined without regard to this paragraph).

(C) Qualifying lease defined.—

For purposes of subparagraph (A) the term "qualifying lease" means a lease from an air carrier (as defined in section 101 of the Federal Aviation Act of 1958, as amended (49 U.S.C. 1301)) which complies with the provisions of the Federal Aviation Act of 1958, as amended, and the rules and regulations promulgated by the Civil Aeronautics Board thereunder, but only if such lease was executed after April 18, 1969.

(b) Section not to apply in certain cases.

Subsection (a) shall not apply to—

(1) a transfer by reason of death, or

(2) a transaction to which section 381(a) applies.

For purposes of subsection (a), property shall not be treated as ceasing to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

(c) Special rule.

Any increase in tax under subsection (a) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A. (Added Pub. L. 87–834, § 2(b), Oct. 16, 1962, 76 Stat. 966, and amended Pub. L. 91–172, title VII, § 703(c), Dec. 30, 1969, 83 Stat. 666; Pub. L. 91–676, § 1, Jan. 12, 1971, 84 Stat. 2060.)

AMENDMENTS

1971—Subsec. (a). Pub. L. 91–676 added par. (6).

1969—Subsec. (a). Pub. L. 91–172, § 703(c)(2), added par. (5).

Subsec. (a)(4). Pub. L. 91–172, § 703(c)(1), added provision making subpars. (B) and (C) inapplicable to any casualty or theft occurring after April 18, 1969.

EFFECTIVE DATE OF 1971 AMENDMENT

Section 2 of Pub. L. 91–676 provided that: "The amendment made by the first section of this Act [enacting subsec. (a)(6) of this section] shall apply to taxable years ending after April 18, 1969."

EFFECTIVE DATE

Section applicable with respect to taxable years ending after Dec. 31, 1961, see section 2(h) of Pub. L. 87–834, set out as a note under section 38 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 48, 49, 51 of this title.

§ 48. Definitions; special rules.

(a) Section 38 property.

(1) In general.

Except as provided in this subsection, the term "section 38 property" means—

(A) tangible personal property, or

(B) other tangible property (not including a building and its structural components) but only if such property—

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research or storage facility used in connection with any of the activities referred to in clause (i), or

(C) elevators and escalators, but only if—

(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

(ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date.

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 4 years or more.

(2) Property used outside the United States.

(A) In general.

Except as provided in subparagraph (B), the term "section 38 property" does not include property which is used predominantly outside the United States.

(B) Exceptions.

Subparagraph (A) shall not apply to—

(i) any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated to and from the United States or is operated under contract with the United States;

(ii) rolling stock, of a domestic railroad corporation subject to part I of the Interstate Commerce Act, which is used within and without the United States;

(iii) any vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States;

(iv) any motor vehicle of a United States person (as defined in section 7701(a)(30)) which is operated to and from the United States;

(v) any container of a United States person which is used in the transportation of property to and from the United States;

(vi) any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; 43 U.S.C., sec. 1331); and

(vii) any property which is owned by a domestic corporation (other than a corporation entitled to the benefits of section 931 or 934(b)) or by a United States citizen (other than a citizen entitled to the benefits of section 931, 932, 933, or 934(c)) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States.

(3) Property used for lodging.

Property which is used predominantly to furnish lodging or in connection with the furnishing of lodging shall not be treated as section 38 property. The preceding sentence shall not apply to—

(A) nonlodging commercial facilities which are available to persons not using the lodging facilities on the same basis as they are available to persons using the lodging facilities, and

(B) property used by a hotel or motel in connection with the trade or business of furnishing lodging where the predominant portion of the accommodations is used by transients.

(4) Property used by certain tax-exempt organizations.

Property used by an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter shall be treated as section 38 property only if such property is used predominantly in an unrelated trade or business the income of which is subject to tax under section 511. If the property is debt-financed property (as defined in section 514(c)), the basis or cost of such property for purposes of computing qualified investment under section 46(c) shall include only that percentage of the basis or cost which is the same percentage as is used under section 514(b), for the year the property is placed in service, in computing the amount of gross income to be taken into account during such taxable year with respect to such property.

(5) Property used by governmental units.

Property used by the United States, any State or political subdivision thereof, any international organization, or any agency or instrumentality of any of the foregoing shall not be treated as section 38 property.

(6) Livestock.

Livestock shall not be treated as section 38 property.

(b) New section 38 property.

For purposes of this subpart, the term "new section 38 property" means section 38 property—

(1) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

In applying section 46(c)(1)(A) in the case of property described in paragraph (1), there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961.

(c) Used section 38 property.

(1) In general.

For purposes of this subpart, the term "used section 38 property" means section 38 property acquired by purchase after December 31, 1961, which is not new section 38 property. Property shall not be treated as "used section 38 property" if, after its acquisition by the taxpayer, it is used by a person who used such property before such acquisition (or by a person who bears a relationship described in section 179(d)(2)(A) or (B) to a person who used such property before such acquisition).

(2) Dollar limitation.

(A) In general.

The cost of used section 38 property taken into account under section 46(c)(1)(B) for any taxable year shall not exceed $50,000. If such cost exceeds $50,000, the taxpayer shall select (at such time and in such manner as the Secretary or his delegate shall by regulations prescribe) the items to be taken into account, but only to the extent of an aggregate cost of $50,000. Such a selection, once made, may be changed only in the manner, and to the extent, provided by such regulations.

(B) Married individuals.

In the case of a husband or wife who files a separato return, the limitation under subparagraph (A) shall be $25,000 in lieu of $50,000. This subparagraph shall not apply if the spouse of the taxpayer has no used section 38 property which may be taken into account as qualified

investment for the taxable year of such spouse which ends within or with the taxpayer's taxable year.

(C) Controlled groups.

In the case of a controlled group, the $50,000 amount specified under subparagraph (A) shall be reduced for each component member of the group by apportioning $50,000 among the component members of such group in accordance with their respective amounts of used section 38 property which may be taken into account.

(D) Partnerships.

In the case of a partnership, the limitation contained in subparagraph (A) shall apply with respect to the partnership and with respect to each partner.

(3) Definitions.

For purposes of this subsection—

(A) Purchase.

The term "purchase" has the meaning assigned to such term by section 179(d) (2).

(B) Cost.

The cost of used section 38 property does not include so much of the basis of such property as is determined by reference to the adjusted basis of other property held at any time by the person acquiring such property. If property is disposed of (other than by reason of its destruction or damage by fire, storm, shipwreck, or other casualty, or its theft) and used section 38 property similar or related in service or use is acquired as a replacement therefor in a transaction to which the preceding sentence does not apply, the cost of the used section 38 property acquired shall be its basis reduced by the adjusted basis of the property replaced. The cost of used section 38 property shall not be reduced with respect to the adjusted basis of any property disposed of if, by reason of section 47, such disposition involved an increase of tax or a reduction of the unused credit carrybacks or carryovers described in section 46(b).

(C) Controlled group.

The term "controlled group" has the meaning assigned to such term by section 1563(a), except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

(d) Certain leased property.

A person (other than a person referred to in section 46(d)) who is a lessor of property may (at such time, in such manner, and subject to such conditions as are provided by regulations prescribed by the Secretary or his delegate) elect with respect to any new section 38 property to treat the lessee as having acquired such property for an amount equal to—

(1) except as provided in paragraph (2), the fair market value of such property, or

(2) if such property is leased by a corporation which is a component member of a controlled group (within the meaning of section 46(a)(5)) to another corporation which is a component member of the same controlled group, the basis of such property to the lessor.

The election provided by the preceding sentence may be made only with respect to property which would be new section 38 property if acquired by the lessee. For purposes of the preceding sentence and section 46(c), the useful life of property in the hands of the lessee is the useful life of such property in the hands of the lessor. If a lessor makes the election provided by this subsection with respect to any property, the lessee shall be treated for all purposes of this subpart as having acquired such property. In the case of suspension period property which is leased and is property of a kind which the lessor ordinarily leases to one lessee for a substantial portion of the useful life of the property, the lessor of the property shall be deemed to have elected to treat the first such lessee as having acquired such property for purposes of applying the last sentence of section 46(a)(2). In the case of section 38 property which (i) is leased after October 9, 1966 (other than pursuant to a binding contract to lease entered into before October 10, 1966), (ii) is not suspension period property with respect to the lessor but is suspension period property if acquired by the lessee, and (iii) is property of the same kind which the lessor ordinarily sold to customers before Octeber 10, 1966, or ordinarily leased before such date and made an election under this subsection, the lessor of such property shall be deemed to have made an election under this subsection with respect to such property.

(e) Subchapter S corporations.

In the case of an electing small business corporation (as defined in section 1371)—

(1) the qualified investment for each taxable year shall be apportioned pro rata among the persons who are shareholders of such corporation on the last day of such taxable year; and

(2) any person to whom any investment has been apportioned under paragraph (1) shall be treated (for purposes of this subpart) as the taxpayer with respect to such investment, and such investment shall not (by reason of such apportionment) lose its character as an investment in new section 38 property or used section 38 property, as the case may be.

(f) Estates and trusts.

In the case of an estate or trust—

(1) the qualified investment for any taxable year shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each,

(2) any beneficiary to whom any investment has been apportioned under paragraph (1) shall be treated (for purposes of this subpart) as the taxpayer with respect to such investment, and such investment shall not (by reason of such apportionment) lose its character as an investment in new section 38 property or used section 38 property, as the case may be, and

(3) the $25,000 amount specified under subparagraphs (A) and (B) of section 46(a)(2) applicable to such estate or trust shall be reduced

to an amount which bears the same ratio to $25,000 as the amount of the qualified investment allocated to the estate or trust under paragraph (1) bears to the entire amount of the qualified investment.

(g) Repealed. Pub. L. 88–272, title II, § 203(a)(1), Feb. 26, 1964, 78 Stat. 33.

(h) Suspension of investment credit.

For purposes of this subpart—

(1) General rule.

Section 38 property which is suspension period property shall not be treated as new or used section 38 property.

(2) Suspension period property defined.

Except as otherwise provided in this subsection and subsection (i), the term "suspension period property" means section 38 property—

(A) the physical construction, reconstruction, or erection of which (i) is begun during the suspension period, or (ii) is begun, pursuant to an order placed during such period, before May 24, 1967, or

(B) which (i) is acquired by the taxpayer during the suspension period, or (ii) is acquired by the taxpayer, pursuant to an order placed during such period, before May 24, 1967.

In applying subparagraph (A) to any section 38 property, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection before May 24, 1967.

(3) Binding contracts.

To the extent that any property is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on October 9, 1966, and at all times thereafter, binding on the taxpayer, such property shall not be deemed to be suspension period property.

(4) Equipped building rule.

If—

(A) pursuant to a plan of the taxpayer in existence on October 9, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the equipped building in service), the taxpayer has constructed, reconstructed, erected, or acquired a building and the machinery and equipment necessary to the planned use of the building by the taxpayer, and

(B) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such building as so equipped is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date,

then all section 38 property comprising such building as so equipped (and any incidental section 38 property adjacent to such building which is necessary to the planned use of the building) shall be treated as section 38 property which is not suspension period property. For purposes of subparagraph (B) of the preceding sentence, the rules of paragraphs (3) and (6) shall be applied. For purposes of this paragraph, a special purpose structure shall be treated as a building.

(5) Plant facility rule.

(A) General rule.

If—

(i) pursuant to a plan of the taxpayer in existence on October 9, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the plant facility in service), the taxpayer has constructed, reconstructed, or erected a plant facility, and either

(ii) the construction, reconstruction, or erection of such plant facility was commenced by the taxpayer before October 10, 1966, or

(iii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facility is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date.

then all section 38 property comprising such plant facility shall be treated as section 38 property which is not suspension period property. For purposes of clause (iii) of the preceding sentence, the rules of paragraphs (3) and (6) shall be applied.

(B) Plant facility defined.

For purposes of this paragraph, the term "plant facility" means a facility which does not include any building (or of which buildings constitute an insignificant portion) and which is—

(i) a self-contained, single operating unit or processing operation,

(ii) located on a single site, and

(iii) identified, on October 9, 1966, in the purchasing and internal financial plans of the taxpayer as a single unitary project.

(C) Special rule.

For purposes of this subsection, if—

(i) a certificate of convenience and necessity has been issued before October 10, 1966, by a Federal regulatory agency with respect to two or more plant facilities which are included under a single plan of the taxpayer to construct, reconstruct, or erect such plant facilities, and

(ii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facilities is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date,

such plant facilities shall be treated as a single plant facility.

(D) Commencement of construction

For purposes of subparagraph (A)(ii), the construction, reconstruction, or erection of a plant facility shall not be considered to have commenced until construction, reconstruction,

or erection has commenced at the site of such plant facility. The preceding sentence shall not apply if the site of such plant facility is not located on land.

(6) Machinery or equipment rule.

Any piece of machinery or equipment—

(A) more than 50 percent of the parts and components of which (determined on the basis of cost) were held by the taxpayer on October 9, 1966, or are acquired by the taxpayer pursuant to a binding contract which was in effect on such date, for inclusion or use in such piece of machinery or equipment, and

(B) the cost of the parts and components of which is not an insignificant portion of the total cost,

shall be treated as property which is not suspension period property.

(7) Certain lease-back transactions, etc.

Where a person who is a party to a binding contract described in paragraph (3) transfers rights in such contract (or in the property to which such contract relates) to another person but a party to such contract retains a right to use the property under a lease with such other person, then to the extent of the transferred rights such other person shall, for purposes of paragraph (3), succeed to the position of the transferor with respect to such binding contract and such property. The preceding sentence shall apply, in any case in which the lessor does not make an election under subsection (d), only if a party to such contract retains a right to use the property under a long-term lease.

(8) Certain lease and contract obligations.

Where, pursuant to a binding lease or contract to a binding lease or contract in effect on October 9, 1966, a lessor or lessee is obligated to construct, reconstruct, erect, or acquire property specified in such lease or contract, any property so constructed, reconstructed, erected, or acquired by the lessor or lessee which is section 38 property shall be treated as property which is not suspension period property. In the case of any project which includes property other than the property to be leased to such lessee, the preceding sentence shall be applied, in the case of the lessor, to such other property only if the binding leases and contracts with all lessees in effect on October 9, 1966, cover real property constituting 25 percent or more of the project (determined on the basis of rental value). For purposes of the preceding sentences of this paragraph, in the case of any project where one or more vendor-vendee relationships exist, such vendors and vendees shall be treated as lessors and lessees. Where, pursuant to a binding contract in effect on October 9, 1966, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, to be used to produce one or more products, and (ii) the other party is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, then such property shall be treated is property which is not suspension period property. Clause (ii) of the preceding sentence shall not apply if a political subdivision of a State is the other party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer.

(9) Certain transfers to be disregarded.

(A) If property or rights under a contract are transferred in—

(i) a transfer by reason of death, or

(ii) a transaction as a result of which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of sections 332, 351, 371(a), 374(a), 721, or 731,

and such property (or the property acquired under such contract) would not be treated as suspension period property in the hands of the decedent or the transferor, such property shall not be treated as suspension period property in the hands of the transferee.

(B) If—

(i) property or rights under a contract are acquired in a transaction to which section 334(b)(2) applies,

(ii) the stock of the distributing corporation was acquired before October 10, 1966, or pursuant to a binding contract in effect October 9, 1966, and

(iii) such property (or the property acquired under such contract) would not be treated as suspension period property in the hands of the distributing corporation,

such property shall not be treated as suspension period property in the hands of the distributee.

(10) Property acquired from affiliated corporation.

For purposes of this subsection, in the case of property acquired by a corporation which is a member of an affiliated group from another member of the same group—

(A) such corporation shall be treated as having acquired such property on the date on which it was acquired by such other member,

(B) such corporation shall be treated as having entered into a binding contract for the construction, reconstruction, erection, or acquisition of such property on the date on which such other member entered into a contract for the construction, reconstruction, erection, or acquisition of such property, and

(C) such corporation shall be treated as having commenced the construction, reconstruction, or erection of such property on the date on which such other member commenced such construction, reconstruction, or erection.

For purposes of the preceding sentence, the term "affiliated group" has the meaning assigned to it by section 1504(a), except that all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

(11) Certain tangible property constructed during suspension period and leased new thereafter.

Tangible personal property constructed or reconstructed by a person shall not be suspension period property if—

(A) such person leases such property after the close of the suspension period and the original use of such property commences after the close of such period,

(B) such construction or reconstruction, and such lease transaction, was not pursuant to an order placed during the suspension period, and

(C) an election is made under subsection (d) with respect to such property which satisfies the requirements of such subsection.

(12) Water and air pollution control facilities.

(A) In general.

Any water pollution control facility or air pollution control facility shall be treated as property which is not suspension period property.

(B) Water pollution control facility.

For purposes of subparagraph (A), the term "water pollution control facility" means any section 38 property which—

(i) is used primarily to control water pollution by removing, altering, or disposing of wastes, including the necessary intercepting sewers, outfall sewers, pumping, power, and other equipment, and their appurtenances; and

(ii) is certified by the State water pollution control agency (as defined in section 13(a) of the Federal Water Pollution Control Act) as being in conformity with the State program or requirements for control of water pollution and is certified by the Secretary of Interior as being in compliance with the applicable regulations of Federal agencies and the general policies of the United States for cooperation with the States in the prevention and abatement of water pollution under the Federal Water Pollution Control Act.

(C) Air pollution control facility.

For purposes of subparagraph (A), the term "air pollution control facility" means any section 38 property which—

(i) is used primarily to control atmospheric pollution or contamination by removing, altering, or disposing of atmospheric pollutants or contaminants; and

(ii) is certified by the State air pollution control agency (as defined in section 302(b) of the Clean Air Act) as being in conformity with the State program or requirements for control of air pollution and is certified by the Secretary of Health, Education, and Welfare as being in compliance with the applicable regulations of Federal agencies and the general policies of the United States for cooperation with the States in the prevention and abatement of air pollution under the Clean Air Act.

(D) Standards for facility.

Subparagraph (A) shall apply in the case of any facility only if the taxpayer constructs, reconstructs, erects, or acquires such facility in furtherance of Federal, State, or local standards for the control of water pollution or atmospheric pollution or contaminants.

(13) Certain replacement property.

Section 38 property constructed, reconstructed, erected, or acquired by the taxpayer shall be treated as property which is not suspension period property to the extent such property is placed in service to replace property which was—

(A) destroyed or damaged by fire, storm, shipwreck, or other casualty, or

(B) stolen,

but only to the extent the basis (in the case of new section 38 property) or cost (in the case of used section 38 property) of such section 38 property does not exceed the adjusted basis of the property destroyed, damaged, or stolen.

(i) Exemption from snspension of $20,000 of investment.

(1) In general.

In the case of property acquired by the taxpayer by purchase for use in his trade or business which would (but for this subsection) be suspension period property, the taxpayer may select items to which this subsection applies, to the extent of an aggregate cost, for the suspension period, of $20,000. Any item so selected shall be treated as property which is not suspension period property for purposes of this subpart (other than for purposes of paragraphs (4), (5), (6), (7), (8), (9), and (10) of subsection (h)).

(2) Applicable rules.

Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (2) and (3) of subsection (c) shall be applied for purposes of this subsection. Subsection (d) shall not apply with respect to any item to which this subsection applies.

(j) Suspension period.

For purposes of this subpart, the term "suspension period" means the period beginning on October 10, 1966, and ending on March 9, 1967.

(k) Cross reference.

For application of this suhpart to certain acquiring corporations, see section 381(c)(23).

(Added Pub. L. 87-834, § 2(b), Oct. 16, 1962, 76 Stat. 967, and amended Pub. L. 88-272, title II, § 203(a)(1), (3) (A), (b), (c), Feb. 26, 1964, 78 Stat. 33, 34; Pub. L. 89-800, § 1 Nov. 8, 1966, 80 Stat. 1508; Pub. L. 89-809, title II, § 201(a), Nov. 13, 1966, 80

Stat. 1575; Pub. L. 90–26, §§ 1, 2(a), 3, June 13, 1967, 81 Stat. 57, 58; Pub. L. 91–172, title I, § 121(d)(2)(A), title IV, § 401(e)(2)–(4), Dec. 30, 1969, 83 Stat. 547, 603.)

REFERENCES IN TEXT

Part I of the Interstate Commerce Act, referred to in subsec. (a)(2), is classified to chapter 1 of Title 49, Transportation.

The Federal Water Pollution Control Act, referred to in subsec. (h)(12)(B)(ii), is classified to section 1151 et seq. of Title 33, Navigation and Navigable Waters, and section 13(a) of the Act is classified to section 1163 of Title 33.

The Clean Air Act, referred to in subsec. (h)(12)(C)(ii), is classified to chapter 15B of Title 42, Public Health and Welfare, and section 302(b) of the Act is classified to section 1857h(b) of Title 42.

AMENDMENTS

1969—Subsec. (a)(4). Pub. L. 91–172, § 121(d)(2)(A), added provision relating to the percentage of the basis or cost of debt-financed property that may be considered in computing qualified investment under section 46(c) of this title.

Subsec. (c)(2)(C). Pub. L. 91–172, § 401(e)(2), reenacted subsection with minor changes and substituted reference to controlled group for reference to affiliated group.

Subsec. (c)(3)(C). Pub. L. 91–172, § 401(e)(3), substituted definition of controlled group for definition of affiliated group.

Subsec. (d)(2). Pub. L. 91–172, § 401(e)(4), substituted reference to a component member of a controlled group for reference to a member of an affiliated group.

1967—Subsec. (a)(2)(B)(i). Pub. L. 90–26, § 3, added "or is operated under contract with the United States" following "the United States".

Subsec. (h)(2). Pub. L. 90–26, § 2(a), limited the definition of suspension period property to section 38 property where the physical construction, reconstruction or erection was begun before May 24, 1967, pursuant to an order placed during the suspension period, subject to the proviso that in applying the definition to property the physical construction, reconstruction or erection of which was begun before May 24, 1967, only that portion of the basis properly attributable to construction, reconstruction or erection before May 24, 1967 be taken into account.

Subsec. (j). Pub. L. 90–26, § 1, substituted "March 9, 1967" for "December 31, 1967."

1966—Subsec. (a)(2)(B). Pub. L. 89–809 added clause (vii).

Subsec. (d). Pub. L. 89–800, § 1(b), added provisions covering the treatment of suspension period property, and the elections to be deemed made in connection therewith.

Subsec. (h). Pub. L. 89–800, § 1(a), added subsec. (h). Former subsec. (h) redesignated as subsec. (k).

Subsecs. (i), (j). Pub. L. 89–800, § 1(a), added subsecs. (i) and (j).

Subsec. (k). Pub. L. 89–800, § 1(a), redesignated former subsec. (h) as subsec. (k).

1964—Subsec. (a)(1)(C). Pub. L. 88–272, § 203(c)(2), added subpar. (C).

Subsec. (d). Pub. L. 88–272, § 203(a)(3)(A), (b), substituted "except as provided in paragraph (2)" for "if such property was constructed by the lessor (or by a corporation which controls or is controlled by the lessor within the meaning of section 368(c))" in par. (1), "if such property is leased by a corporation which is a member of an affiliated group (within the meaning of section 46(a)(5) to another corporation which is a member of the same affiliated group" for "if paragraph (1) does not apply" in par. (2), and deleted provisions which stated that if a lessor made an election under this subsection, subsec. (g) would not apply with respect to such property, and deductions otherwise allowable under section 162 to the lessee for amounts paid the lessor would be adjusted consistent with subsec. (g).

Subsec. (g). Pub. L. 88–272, § 203(a)(1), repealed subsec. (g) which required that the basis of section 38 property be reduced by 7 percent of the qualified investment.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a)(4) by section 121(d)(2)(A) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

Amendment of subsecs. (c)(2)(C), (c)(3)(C) and (d)(2) of this section by section 401(e)(2)–(4) of Pub. L. 91–172 applicable with respect to taxable years ending on or after Dec. 31, 1970, see section 401(h)(3) of Pub. L. 91–172, set out as a note under section 1561 of this title.

EFFECTIVE DATE OF 1967 AMENDMENT

Section 4 of Pub. L. 90–26 provided that: "The amendments made by the first three sections of this Act [amending subsecs. (a)(2), (h)(2), and (j) of this section, and subsecs. (i)(1) and (l)(3) of section 167 of this title] shall apply to taxable years ending after March 9, 1967."

EFFECTIVE DATE OF 1966 AMENDMENTS

Section 201(b) of Pub. L. 89–809 provided that: "The amendments made by subsection (a) [adding subsec. (a)(2)(B)(vii) of this section] shall apply to taxable years ending after December 31, 1965, but only with respect to property placed in service after such date. In applying section 46(b) of the Internal Revenue Code of 1954 (relating to carryback and carryover of unused credits) [section 46(b) of this title], the amount of any investment credit carryback to any taxable year ending on or before December 31, 1965, shall be determined without regard to the amendments made by this section."

Amendment of this section by Pub. L. 89–800 applicable to taxable years ending after Oct. 9, 1966, see section 4 of Pub. L. 89–800, set out as a note under section 46 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 203(a)(4) of Pub. L. 88–272 provided that:

"Paragraphs (1) [repealing subsec. (g) of this section] and (3) [amending subsec. (d) of this section, the analysis preceding section 161, and section 1016 of this title and repealing section 181 of this title] of this subsection shall apply—

"(A) in the case of property placed in service after December 31, 1963, with respect to taxable years ending after such date, and

"(B) in the case of property placed in service before January 1, 1964, with respect to taxable years beginning after December 31, 1963."

Section 203(f) of Pub. L. 88–272 provided that:

"(1) The amendments made by subsection (b) [to subsec. (d)(1)(2) of this section] shall apply with respect to property possession of which is transferred to a lessee on or after the date of enactment of this Act [Feb. 26, 1964].

"(2) The amendments made by subsection (c) [to subsec. (a)(1)(c) of this section] shall apply with respect to taxable years ending after June 30, 1963.

"(3) The amendments made by subsection (d) [to section 1245 of this title] shall apply with respect to dispositions after December 31, 1963, in taxable years ending after such date."

EFFECTIVE DATE

Section applicable with respect to taxable years ending after Dec. 31, 1961, see section 2(h) of Pub. L. 87–834, set out as a note under section 38 of this title.

INCREASE IN BASIS OF PROPERTY PLACED IN SERVICE BEFORE JANUARY 1, 1964

Section 203(a)(2) of Pub. L. 88–272 provided that:

"(A) The basis of any section 38 property (as defined in section 48(a) of the Internal Revenue Code of 1954) placed in service before January 1, 1964, shall be increased, under regulations prescribed by the Secretary of the

Treasury or his delegate, by an amount equal to 7 percent of the qualified investment with respect to such property under section 46(c) of the Internal Revenue Code of 1954. If there has been any increase with respect to such property under section 48(g)(2) of such Code, the increase under the preceding sentence shall be appropriately reduced therefor.

"(B) If a lessor made the election provided by section 48(d) of the Internal Revenue Code of 1954 with respect to property placed in service before January 1, 1964—

"(i) subparagraph (A) shall not apply with respect to such property, but

"(ii) under regulations prescribed by the Secretary of the Treasury or his delegate, the deductions otherwise allowable under section 162 of such Code to the lessee for amounts paid to the lessor under the lease (or, if such lessee has purchased such property, the basis of such property) shall be adjusted in a manner consistent with subparagraph (A).

"(C) The adjustments under this paragraph shall be made as of the first day of the taxpayer's first taxable year which begins after December 31, 1963."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 49, 167, 169, 185, 1016, 4914, 4915, 4920, 4931 of this title.

§ 49. Termination of credit.

(a) General rule.

For purposes of this subpart, the term "section 38 property" does not include property—

(1) the physical construction, reconstruction, or erection of which is begun after April 19, 1969, or

(2) which is acquired by the taxpayer after April 18, 1969, other than pre-termination property.

(b) Pre-termination property.

For purposes of this section—

(1) Binding contracts.

Any property shall be treated as pre-termination property to the extent that such property is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on April 18, 1969, and at all times thereafter, binding on the taxpayer.

(2) Equipped building rule.

If—

(A) pursuant to a plan of the taxpayer in existence on April 18, 1969 (which plan was not substantially modified at any time after such date and before the taxpayer placed the equipped building in service), the taxpayer has constructed, reconstructed, erected, or acquired a building and the machinery and equipment necessary te the planned use of the building by the taxpayer, and

(B) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such building as so equipped is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before April 19, 1969, or property the acquisition of which by the taxpayer occurred before such date,

then all property comprising such building as so equipped (and any incidental property adjacent to such building which is necessary to the planned use of the building) shall be pre-termination property. For purposes of subparagraph (B) of the preceding sentence, the rules of paragraphs (1) and (4) shall be applied. For purposes of this paragraph, a special purpose structure shall be treated as a building.

(3) Plant facility rule.

(A) General rule.

If—

(i) pursuant to a plan of the taxpayer in existence on April 18, 1969 (which plan was not substantially modified at any time after such date and before the taxpayer placed the plant facility in service), the taxpayer has constructed, reconstructed, or erected a plant facility, and either

(ii) the construction, reconstruction, or erection of such plant facility was commenced by the taxpayer before April 19, 1969, or

(iii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facility is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before April 19, 1969, or property the acquisition of which by the taxpayer occurred before such date,

then all property comprising such plant facility shall be pre-termination property. For purposes of clause (iii) of the preceding sentence, the rules of paragraphs (1) and (4) shall be applied.

(B) Plant facility defined.

For purposes of this paragraph, the term "plant facility" means a facility which does not include any building (or of which buildings constitute an insignificant portion) and which is—

(i) a self-contained, single operating unit or processing operation,

(ii) located on a single site, and

(iii) identified, on April 18, 1969, in the purchasing and internal financial plans of the taxpayer as a single unitary project.

(C) Special rule.

For purposes of this subsection, if—

(i) a certificate of convenience and necessity has been issued before April 19, 1969, by a Federal regulatory agency with respect to two or moro plant facilities which are included under a single plan of the taxpayer to construct, reconstruct, or erect such plant facilities, and

(ii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facilities is attributable to either property the construction, reconstruction, or erection of which was begun

by the taxpayer before April 19, 1969, or property the acquisition of which by the taxpayer occurred before such date,

such plant facilities shall be treated as a single plant facility.

(D) Commencement of construction.

For purposes of subparagraph (A)(ii), the construction, reconstruction, or erection of a plant facility shall not be considered to have commenced until construction, reconstruction, or erection has commenced at the site of such plant facility. The preceding sentence shall not apply if the site of such plant facility is not located on land.

(4) Machinery or equipment rule.

Any piece of machinery or equipment—

(A) more than 50 percent of the parts and components of which (determined on the basis of cost) were held by the taxpayer on April 18, 1969, or are acquired by the taxpayer pursuant to a binding contract which was in effect on such date, for inclusion or use in such piece of machinery or equipment, and

(B) the cost of the parts and components of which is not an insignificant portion of the total cost,

shall be treated as property which is pre-termination property.

(5) Certain lease-back transactions, etc.

(A) Where a person who is a party to a binding contract described in paragraph (1) transfers rights in such contract (or in the property to which such contract relates) to another person but a party to such contract retains a right to use the property under a lease with such other person, then to the extent of the transferred rights such other person shall, for purposes of paragraph (1), succeed to the position of the transferor with respect to such binding contract and such property. In any case in which the lessor does not make an election under section 48(d)—

(i) the preceding sentence shall apply only if a party to the contract retains the right to use the property under a lease for a term of at least 1 year; and

(ii) if such use is retained (other than under a long-term lease), the lessor shall be deemed for the purposes of section 47 as having made a disposition of the property at such time as the lessee loses the right to use the property.

For purposes of clause (ii), if the lessee transfers the lease in a transfer described in paragraph (7), the lessee shall be considered as having the right to use of the property so long as the transferee has such use.

(B) For purposes of subparagraph (A)—

(i) a person who holds property (or rights in property) which is pre-termination property by reason of the application of paragraph (4) shall, with respect to such property, be treated as a party to a binding contract described in paragraph (1), and

(ii) a corporation which is a member of the same affiliated group (as defined in paragraph (8)) as the transferor described in subparagraph (A) and which simultaneously with the transfer of property to another person acquires a right to use such property under a lease with such other person shall be treated as the transferor and as a party to the contract.

(6) Certain lease and contract obligations.

(A) Where, pursuant to a binding lease or contract to lease in effect on April 18, 1969, a lessor or lessee is obligated to construct, reconstruct, erect, or acquire property specified in such lease or contract or in a related document filed before April 19, 1969, with a Federal regulatory agency or property the specifications of which are readily ascertainable from the terms of such lease or contract or from such related document, any property so constructed, reconstructed, erected, or acquired by the lessor or lessee shall be pre-termination property. In the case of any project which includes property other than the property to be leased to such lessee, the preceding sentence shall be applied, in the case of the lessor, to such other property only if the binding leases and contracts with all lessees in effect on April 18, 1969, cover real property constituting 25 percent or more of the project (determined on the basis of rental value). For purposes of the preceding sentences of this paragraph, in the case of any project where one or more vendor-vendee relationships exist, such vendors and vendees shall be treated as lessors and lessees.

(B) Where in order to perform a binding contract or contracts in effect on April 18, 1969, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in any order of a Federal regulatory agency for which application was filed before April 19, 1969, (ii) the property is to be used to transport one or more products under such contract or contracts, and (iii) one or more parties to the contract or contracts are required to take or to provide more than 50 percent of the products to be transported over a substantial portion of the expected useful life of the property, then such property shall be pre-termination property.

(C) Where, in order to perform a binding contract in effect on April 18, 1969, the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract to be used to produce one or more products and (unless the other party to the contract is a State or a political subdivision of a State which is required by the contract to make substantial expenditures which benefit the taxpayer) the other party to the contract is required to take substantially all of the products to be produced over

a substantial portion of the expected useful life of the property, then such property shall be pre-termination property. For purposes of applying the preceding sentence in the case of a contract for the extraction of minerals, property shall be treated as specified in the contract if (i) the specifications for such property are readily ascertainable from the location and characteristics of the mineral properties specified in such contract from which the minerals are to be extracted; (ii) such property is necessary for and is to be used solely in the extraction of minerals under such contract; (iii) the physical construction, reconstruction, or erection of such property is begun by the taxpayer before April 19, 1970, such property is acquired by the taxpayer before April 19, 1970, or such property is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on April 18, 1970, and at all times thereafter, binding on the taxpayer; (iv) such property is placed in service on or before December 31, 1972; (v) such contract is a fixed price contract (except for provisions for price changes under which the loss of the credit allowed by section 38 would not result in a price change); and (vi) such property is not placed in service to replace other property used in extracting minerals under such contract.

(7) Certain transfers to be disregarded.

(A) If property or rights under a contract are transferred in—

(i) a transfer by reason of death,

(ii) a transaction as a result of which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731, or

(iii) a sale of substantially all of the assets of the transferor pursuant to the terms of a contract, which was on April 18, 1969, and at all times thereafter, binding on the transferee,

and such property (or the property acquired under such contract) would be treated as pre-termination property in the hands of the decedent or the transferor, such property shall be treated as pre-termination property in the hands of the transferee.

(B) If—

(i) property or rights under a contract are acquired in a transaction to which section 334(b)(2) applies,

(ii) the stock of the distributing corporation was acquired before April 19, 1969, or pursuant to a binding contract in effect April 18, 1969, and

(iii) such property (or the property acquired under such contract) would be treated as pre-termination property in the hands of the distributing corporation,

such property shall be treated as pre-termination property in the hands of the distributee.

(8) Property acquired from affiliated corporation.

In the case of property acquired by a corporation which is a member of an affiliated group from another member of the same group—

(A) such corporation shall be treated as having acquired such property on the date on which it was acquired by such other member,

(B) such corporation shall be treated as having entered into a binding contract for the construction, reconstruction, erection, or acquisition of such property on the date on which such other member entered into a contract for the construction, reconstruction, erection, or acquisition of such property, and

(C) such corporation shall be treated as having commenced the construction, reconstruction, or erection of such property on the date on which such other member commenced such construction, reconstruction, or erection.

For the purposes of this subsection and subsection (c), a contract between two corporations which are members of the same affiliated group shall not be treated as a binding contract as between such corporations, unless, at all times after June 30, 1969, and prior to the completion of performance of such contract, such corporations are not members of the same affiliated group. For purposes of the preceding sentences, the term "affiliated group" has the meaning assigned to it by section 1504(a), except that all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

(9) Barges for ocean-going vessels.

Barges specifically designed and constructed, reconstructed, erected, or acquired for use with ocean-going vessels which are designed to carry barges and which are pre-termination property, but not in excess of—

(A) the number to be used with such vessels specified in applications for mortgage or construction loan insurance filed with the Secretary of Commerce on or before April 18, 1969, under title XI of the Merchant Marine Act, 1936, or

(B) if subparagraph (A) does not apply and if more than 50 percent of the barges which the taxpayer establishes as necessary to the initial planned use of such vessels are pre-termination property (determined without regard to this paragraph), the number which the taxpayer establishes as so necessary,

together with the machinery and equipment to be installed on such barges and necessary for their planned use, shall be treated as pre-termination property.

(10) Certain new-design products.

Where—

(A) on April 18, 1969, the taxpayer had undertaken a project to produce a product of a new design pursuant to binding contracts in effect on such date which—

(i) were fixed-price contracts (except for provisions requiring or permitting price changes resulting from changes in rates of pay or costs of materials), and

(ii) covered more than 50 percent of the entire production of such design to be delivered by the taxpayer before January 1, 1973, and

(B) on or before April 18, 1969, more than 50 percent of the aggregate adjusted basis of all property of a character subject to the allowance for depreciation required to carry out such binding contracts was property the construction, reconstruction, or erection of which had been begun by the taxpayer, or had been acquired by the taxpayer (or was under a binding contract for such construction, reconstruction, erection, or acquisition),

then all tangible personal property placed in service by the taxpayer before January 1, 1972, which is required to carry out such binding contracts shall be deemed to be pre-termination property. For purposes of subparagraph (B) of the preceding sentence, jigs, dies, templates, and similar items which can be used only for the manufacture or assembly of the production under the project and which were described in written engineering and internal financial plans of the taxpayer in existence on April 18, 1969, shall be treated as property which on such date was under a binding contract for construction.

(c) Leased property.

In the case of property which is leased after April 18, 1969 (other than pursuant to a binding contract to lease entered into before April 19, 1969), which is section 38 property with respect to the lessor but is property which would not be section 38 property because of the application of subsection (a) if acquired by the lessee, and which is property of the same kind which the lessor ordinarily sold to customers before April 19, 1969, or ordinarily leased before such date and made an election under section 48(d), such property shall not be section 38 property with respect to either the lessor or the lessee.

(d) Property placed in service after 1975.

For purposes of this subpart, the term "section 38 property" does not include any property placed in service after December 31, 1975. (Added Pub. L. 91–172, title VII, § 703(a), Dec. 30, 1969, 83 Stat 660.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 47 of this title.

PART V.—TAX SURCHARGE

Sec.
51. Tax surcharge.

AMENDMENTS

1968—Pub. L. 90–364, title I, § 102(a), June 28, 1968, 82 Stat. 252, added the heading of Part V and item 51.

§ 51. Tax surcharge.

(a) Imposition of tax.

(1) Calendar years.

(A) Individuals (other than estates and trusts).

In addition to the other taxes imposed by this chapter, there is hereby imposed on the income of every individual (other than an estate or trust) whose taxable year is the calendar year a tax as follows:

CALENDAR YEAR 1968

TABLE 1.—*Single person (other than head of household) and married person filing separate return*

If the adjusted tax is: At least	But less than	The tax is—	If the adjusted tax is: At least	But less than	The tax is—
0	$148	0	$380	$393	$29
$148	155	$1	393	407	30
155	162	2	407	420	31
162	168	3	420	433	32
168	175	4	433	447	33
175	182	5	447	460	34
182	188	6	460	473	35
188	195	7	473	487	36
195	202	8	487	500	37
202	208	9	500	513	38
208	215	10	513	527	39
215	222	11	527	540	40
222	228	12	540	553	41
228	235	13	553	567	42
235	242	14	567	580	43
242	248	15	580	593	44
248	255	16	593	607	45
255	262	17	607	620	40
262	268	18	620	633	47
268	275	19	633	647	48
275	282	20	647	660	49
282	288	21	660	673	50
288	298	22	673	687	51
298	313	23	687	700	52
313	327	24	700	713	53
327	340	25	713	727	54
340	353	26	727	734	55
353	367	27	734 and over, 7.5% of the adjusted tax.		
367	380	28			

TABLE 2.—*Head of household*

If the adjusted tax is: At least	But less than	The tax is—	If the adjusted tax is: At least	But less than	The tax is—
0	$223	0	$410	$417	$29
$228	230	$1	417	423	30
230	237	2	423	430	31
237	243	3	430	437	32
243	250	4	437	447	33
250	257	5	447	460	34
257	263	6	460	473	35
263	270	7	473	487	36
270	277	8	487	500	37
277	283	9	500	513	38
283	290	10	513	527	39
290	297	11	527	540	40
297	303	12	540	553	41
303	310	13	553	567	42
310	317	14	567	580	43
317	323	15	580	593	44
323	330	16	593	607	45
330	337	17	607	620	46
337	343	18	620	633	47
343	350	19	633	647	48
350	357	20	647	660	49
357	363	21	660	673	50
363	370	22	673	687	51
370	377	23	687	700	62
377	383	24	700	713	53
383	390	25	713	727	54
390	397	26	727	734	55
397	403	27	734 and over, 7.5% of the adjusted tax.		
403	410	28			

TABLE 3.—*Married persons or surviving spouse filing joint return*

If the adjusted tax is: At least	But less than	The tax is—	If the adjusted tax is: At least	But less than	The tax is—
0	$293	0	$420	$427	$20
$293	300	$1	427	433	21
300	307	2	433	440	22
307	313	3	440	447	23
313	320	4	447	453	24
320	327	5	453	460	25
327	333	6	460	467	26
333	340	7	467	473	27
340	347	8	473	480	28
347	353	9	480	487	29
353	360	10	487	493	30
360	367	11	493	500	31
367	373	12	500	507	32
373	380	13	507	513	33
380	387	14	513	520	34
387	393	15	520	527	35
393	400	16	527	533	36
400	407	17	533	540	37
407	413	18	540	547	38
413	420	19	547	553	39

TABLE 3.—*Married persons or surviving spouse filing joint return*—Con.

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than	
$553	$560	$40	$647	$660	$49
560	567	41	660	673	50
567	573	42	673	687	51
573	580	43	687	700	52
580	593	44	700	713	53
593	607	45	713	727	54
607	620	46	727	734	55
620	633	47	734 and over, 7.5% of the adjusted tax.		
633	647	48			

CALENDAR YEAR 1969

TABLE 1.—*Single person (other than head of household) and married person filing separate return*

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than	
0	$148	0	$375	$385	$38
$148	153	$1	385	395	39
153	158	2	395	405	40
158	163	3	405	415	41
163	168	4	415	425	42
168	173	5	425	435	43
173	178	6	435	445	44
178	183	7	445	455	45
183	188	8	455	465	46
188	193	9	465	475	47
193	198	10	475	485	48
198	203	11	485	495	49
293	208	12	495	505	50
208	213	13	505	515	51
213	218	14	515	525	52
218	223	15	525	535	53
223	228	16	535	545	54
223	233	17	545	555	55
233	238	18	555	565	56
238	243	19	565	575	57
243	248	20	575	585	58
248	253	21	585	595	59
253	258	22	595	005	60
258	263	23	605	615	61
263	268	24	615	625	62
268	273	25	625	635	63
273	278	26	635	645	64
278	283	27	545	655	65
283	288	28	655	665	66
283	295	29	665	675	67
295	305	30	675	685	68
305	315	31	685	695	69
315	325	32	695	705	70
325	335	33	705	715	71
335	345	34	715	725	72
345	355	35	725	735	73
355	365	36	735 and over, 10% of the adjusted tax		
365	375	37			

TABLE 2.—*Head of household*

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than	
0	$223	0	$363	$368	$29
$223	228	$1	368	373	30
228	233	2	373	378	31
233	238	3	378	383	32
238	243	4	383	388	33
243	248	5	383	393	34
248	253	6	393	398	35
253	258	7	398	403	36
258	263	8	403	408	37
263	268	9	408	413	38
268	273	10	413	418	39
273	278	11	418	423	40
278	283	12	423	428	41
283	288	13	428	433	42
283	293	14	433	438	43
293	298	15	438	445	44
298	303	16	445	455	45
303	308	17	455	465	46
308	313	18	465	475	47
313	318	19	475	485	48
318	323	20	485	495	49
323	328	21	495	505	50
328	333	22	505	515	51
333	333	23	515	525	52
338	343	24	525	535	53
343	348	25	535	545	54
348	353	26	545	555	55
353	353	27	555	565	56
358	303	28	565	575	57

TABLE 2.—*Head of household*—Continued

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than	
$575	$585	$58	$665	$675	$67
585	595	59	675	685	68
595	605	60	685	695	69
605	615	61	695	705	70
615	625	62	705	715	71
625	635	63	715	725	72
635	645	64	725	735	73
645	655	05	735 and over, 10% of the adjusted tax		
655	665	66			

TABLE 3.—*Married persons or surviving spouse filing joint return*

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least	But less than		At least	But less than	
0	$293	0	$478	$483	$38
$293	298	$1	483	488	39
298	303	2	488	493	40
303	308	3	493	498	41
308	313	4	498	503	42
313	318	5	503	508	43
318	323	6	508	513	44
323	328	7	513	518	45
328	333	8	518	523	46
333	338	9	523	528	47
338	343	10	528	533	48
343	348	11	533	538	49
348	353	12	538	543	50
353	358	13	543	548	51
358	363	14	548	553	52
363	368	15	553	558	53
368	373	16	558	563	54
373	378	17	563	563	55
378	383	18	568	573	56
383	383	19	573	578	57
388	393	20	578	585	58
393	398	21	585	595	59
398	403	22	595	605	60
403	408	23	005	615	61
408	413	24	615	625	62
413	418	25	625	635	63
418	423	26	635	645	64
423	438	27	645	655	65
428	433	28	655	665	66
433	438	29	665	675	67
438	443	30	675	685	68
443	448	31	685	695	69
448	453	32	695	705	70
453	458	33	705	715	71
458	463	34	715	725	72
453	468	35	725	735	73
468	473	36	735 and over, 10% of the adjusted tax		
473	478	37			

CALENDAR YEAR 1970

TABLE 1.—*Single person (other than head of household) and married persons filing separate returns*

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least—	But less than—		At least—	But less than—	
0	$155	0	$1,060	$1,100	$27
$155	175	$1	1,100	1,140	28
175	195	2	1,140	1,180	29
195	215	3	1,180	1,220	30
215	235	4	1,220	1,260	31
235	255	5	1,200	1,300	32
255	275	6	1,300	1,340	33
275	300	7	1,340	1,380	34
300	340	8	1,380	1,420	35
340	380	9	1,420	1,460	36
380	420	10	1,460	1,500	37
420	460	11	1,500	1,540	38
460	500	12	1,540	1,580	39
500	540	13	1,580	1,620	40
540	580	14	1,620	1,660	41
580	620	15	1,660	1,700	42
620	660	16	1,760	1,740	43
660	700	17	1,740	1,780	44
700	740	18	1,780	1,820	45
740	780	19	1,820	1,800	46
780	820	20	1,860	1,900	47
820	860	21	1,900	1,940	48
860	900	22	1,940	1,980	49
900	940	23	1,980	2,020	50
940	980	24	2,620 and over, 2.5% of the adjusted tax.		
980	1,020	25			
1,020	1,060	26			

TABLE 2.—*Head of household*

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least—	But less than—		At least—	But less than—	
0	$230	0	$1,060	$1,100	$27
$230	250	$1	1,100	1,140	28
250	270	2	1,140	1,180	29
270	290	3	1,180	1,220	30
290	310	4	1,220	1,260	31
310	330	5	1,260	1,300	32
330	350	6	1,300	1,340	33
350	370	7	1,340	1,380	34
370	390	8	1,380	1,420	35
390	410	9	1,420	1,460	36
410	430	10	1,460	1,500	37
430	460	11	1,500	1,540	38
460	500	12	1,540	1,580	39
500	540	13	1,580	1,620	40
540	580	14	1,620	1,660	41
580	620	15	1,660	1,700	42
620	660	16	1,700	1,740	43
660	700	17	1,740	1,780	44
700	740	18	1,780	1,820	45
740	780	19	1,820	1,860	46
780	820	20	1,860	1,900	47
820	860	21	1,900	1,940	48
860	900	22	1,940	1,980	49
900	940	23	1,980	2,020	50
940	980	24	2,020 and over, 2.5% of the adjusted tax.		
980	1,020	25			
1,020	1,060	26			

TABLE 3.—*Married persons or surviving spouse filing joint return*

If the adjusted tax is:		The tax is—	If the adjusted tax is:		The tax is—
At least—	But less than—		At least—	But less than—	
0	$300	0	$1,060	$1,100	$27
$300	320	$1	1,100	1,140	28
320	340	2	1,140	1,180	29
340	360	3	1,180	1,220	30
360	380	4	1,220	1,260	31
380	400	5	1,200	1,300	32
400	420	6	1,300	1,340	33
420	440	7	1,340	1,380	34
440	460	8	1,380	1,420	35
460	480	9	1,420	1,460	36
480	500	10	1,460	1,500	37
500	520	11	1,500	1,540	38
520	540	12	1,540	1,580	39
540	560	13	1,580	1,620	40
560	580	14	1,620	1,660	41
580	620	15	1,660	1,700	42
620	060	16	1,700	1,740	43
660	700	17	1,740	1,780	44
700	740	18	1,780	1,820	45
740	780	19	1,820	1,860	46
780	820	20	1,860	1,900	47
820	860	21	1,900	1,940	48
860	900	22	1,940	1,980	49
900	940	23	1,980	2,020	50
940	980	24	2,020 and over, 2.5% of the adjusted tax.		
980	1,020	25			
1,020	1,060	26			

(B) Other persons.

In addition to the other taxes imposed by this chapter, there is hereby imposed on the income of every corporation, and on the income of every estate and trust, whose taxable year is the calendar year, a tax equal to the percent of the adjusted tax (as defined in subsection (b)) for the taxable year specified in the following table:

Calendar year	Percent	
	Estates and trusts	Corporations
1968	7.5	10.0
1969	10.0	10.0
1970	2.5	2.5

(2) Fiscal and short taxable years.

(A) In general.

In addition to the other taxes imposed by this chapter and except as provided in subparagraph (B), in the case of taxable years ending on or after the effective date of the surcharge and beginning before July 1, 1970, there is hereby imposed on the income of every person whose taxable year is other than the calendar year, a tax equal to—

(i) 10 percent of the adjusted tax for the taxable year, multiplied by

(ii) a fraction, the numerator of which is the sum of the number of days in the taxable year occurring on and after the effective date of the surcharge and before January 1, 1970, plus one-half times the number of days in the taxable year occurring after December 31, 1969, and before July 1, 1970, and the denominator of which is the number of days in the entire taxable year.

(B) Limitation.

In the case of—

(i) a husband and wife (or surviving spouse) who file a joint return under section 6013 and whose adjusted tax for the taxable year is less than $580,

(ii) an individual who is a head of a household to whom section 1(b) applies and whose adjusted tax for the taxable year is less than $440, and

(iii) any other individual (other than an estate or trust) whose adjusted tax for the taxable year is less than $290,

the tax imposed by subparagraph (A) shall not be greater than an amount equal to twice the tax which would be imposed by subparagraph (A) if the tax were imposed on the amount by which the adjusted tax exceeds $290, $220, or $145, respectively.

(C) Effective date defined.

For the purposes of subparagraph (A), the term "effective date of the surcharge" means—

(i) January 1, 1968, in the case of a corporation, and

(ii) April 1, 1968, in the case of any other taxpayer.

(b) Adjusted tax defined.

For purposes of this section, the term "adjusted tax" means, with respect to any taxable year, the tax imposed by this chapter for such taxable year, determined without regard to—

(1) the taxes impesed by this section, section 56, section 871(a), and section 881; and

(2) any increases in tax under section 47(a) (relating to certain dispositions, etc., of section 38 property) or section 614(c)(4)(C) (relating to increase in tax for deductions under section 615(a) prior to aggregation),

and reduced by an amount equal to the amount of any credit which would be allowable under section 37 (relating to retirement income) if no tax were imposed by this section for such taxable year.

(c) Estimated tax.

For purposes of applying the provisions of this title with respect to declarations, amended declarations, and payments of estimated tax the time prescribed for filing or payment of which is on or after—

(1) in the case of an individual, September 15, 1968, or

(2) in the case of a corporation, June 15, 1968,

sections 6654(d)(1) and 6655(d)(1) shall not apply with respect to any taxable year for which a tax is imposed by this section.

(d) Western Hemisphere trade corporations and dividends on certain preferred stock.

In computing, for a taxable year of a corporation, the fraction described in—

(1) section 244(a)(2), relating to deduction with respect to dividends received on the preferred stock of a public utility,

(2) section 247(a)(2), relating to deduction with respect to certain dividends paid by a public utility, or

(3) section 922(2), relating to special deduction for Western Hemisphere trade corporations,

the denominator shall, under regulations prescribed by the Secretary or his delegate, be increased to reflect the rate at which tax is imposed under subsection (a) for such taxable year.

(e) Shareholders of regulated investment companies.

In computing the amount of tax deemed paid under section 852(b)(3)(D)(ii) and the adjustment to basis described in section 852(b)(3)(D)(iii), the percentages set forth therein shall be adjusted under regulations prescribed by the Secretary or his delegate to reflect the rate at which tax is imposed under subsection (a).

(f) Special rule.

For purposes of this title, to the extent the tax imposed by this section is attributable (under regulations prescribed by the Secretary or his delegate) to a tax imposed by another section of this chapter, such tax shall be deemed to be imposed by such other section. (Added Pub. L. 90–364, title I, § 102(a), June 28, 1968, 82 Stat. 252, and amended Pub. L. 91–53, § 5(a), Aug. 7, 1969, 83 Stat. 93; Pub. L. 91–172, title III, § 301(b)(5), title VII, § 701(a), Dec. 30, 1969, 83 Stat. 585, 657.)

AMENDMENTS

1969—Subsec. (a)(1)(A). Pub. L. 91–172, § 701(a)(1), added tables 1, 2 and 3 for calendar year 1970.

Subsec. (a)(1)(A). Pub. L. 91–53, § 5(a)(1), revised generally tables 1, 2, and 3 for calendar year 1969, substituting a range in the tax surcharge from zero to $73 and 10% of the adjusted tax when $735 and over for prior range from zero to $36 and 5% of the adjusted tax when $730 and over.

Subsec. (a)(1)(B). Pub. L. 91–172, § 701(a)(2), added provision for the imposition of a 2.5 percent surcharge on estates and trusts and on corporations for calendar year 1970.

Subsec. (a)(1)(B). Pub. L. 91–53, § 5(a)(2), substituted in the table for calendar year 1969 10 percent for 5 percent as applicable to income of estates and trusts and corporations.

Subsec. (a)(2)(A). Pub. L. 91–172, § 701(a)(3), substituted "July 1, 1970" for "January 1, 1970" in provisions preceding cl. (i).

Subsec. (a)(2)(A). Pub. L. 91–53, § 5(a)(3), substituted "January 1, 1970" for "July 1, 1969", in two instances.

Subsec. (a)(2)(A)(ii). Pub. L. 91–172, § 701(a)(4), added provision requiring the addition of one-half the number of days in the taxable year occurring after Dec. 31, 1969 and before July 1, 1970, for the purposes of determining the number of days in the taxable year occurring on or after the effective date of the surcharge and before Jan. 1, 1970.

Subsec. (b)(1). Pub. L. 91–172, § 301(b)(5), inserted reference to section 56.

EFFECTIVE DATE OF 1969 AMENDMENTS

Section 5(c) of Pub. L. 91–53 provided that:

"(1) In general.—The amendments made by subsections (a) and (b) [to subsec. (a)(1)(A), (B), (2)(A) of this section and section 963 (b) of this title] shall apply to taxable years ending after June 30, 1969, and beginning before January 1, 1970.

"(2) Declarations of estimated tax.—If any taxpayer is required to make a declaration or amended declaration of estimated tax, or to pay any amount or additional amount of estimated tax, by reason of the amendments made by this section [Aug. 7, 1969], such amount or additional amount shall be paid ratably on or before each of the remaining installment dates for the taxable year beginning with the first installment date on or after the 30th day after the date of enactment of this Act [this title]. With respect to any declaration or payment of estimated tax before such first installment date, sections 6015, 6154, 6654, and 6655 of the Internal Revenue Code of 1954 [this title] shall be applied without regard to the amendments made by this section [to subsec. (a)(1)(A), (B), (2)(A) of this section and section 963(b) of this title]. For purposes of this paragraph, the term installment date means any date on which, under section 6153 or 6154 of such Code (whichever is applicable), and installment payment of estimated tax is required to be made by the taxpayer."

Section 701(c) of Pub. L. 91–172 provided that: "The amendments made by subsections (a) and (b) [amending this section and section 963 of this title] shall apply to taxable years ending after December 31, 1969, and beginning before July 1, 1970."

Amendment of subsec. (b)(1) of this section by section 301(b)(5) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

EFFECTIVE DATE

Section 102(e) of Pub. L. 90–364 provided that:

"Except as provided by section 104 [set out as notes under this section and section 6154 of this title], the amendments made by this (other than subsection (c)) [enacting this section and amending section 963 of this title], shall apply—

"(1) Insofar as they relate to taxpayers other than corporations, to taxable years ending after March 31, 1968, and beginning before July 1, 1969.

"(2) Insofar as they relate to corporations, to taxable years ending after December 31, 1967, and beginning before July 1, 1969."

SHORT TITLE

Section 1(a) of Pub. L. 90–364 provided that: "This Act [enacting this section and section 6425 of this title, amending sections 103, 243, 276, 501, 963, 3402, 4061, 4251, 6020, 6154, 6412, 6651, 6655, 7203, 7502, and 7701 of this title and sections 603, 607, and 1396b of Title 42, The Public Health and Welfare, repealing sections 6016, 6074, and 4251—4254 of this title, enacting provisions set out as notes under this section, sections 103, 276, 501, 4061, 6154, and 7502 of this title, section 3101 of Title 5, Government Organization and Employees, sections 11 and 757b of Title 31, Money and Finance, and section 1396b of Title 42, Public Health and Welfare, and amending notes under section 1396b of Title 42, The Public Health and Welfare] may be cited as the 'Revenue and Expenditure Control Act of 1968'."

PAYMENT OF TAX SURCHARGE FOR TAXABLE YEARS ENDING BEFORE JUNE 28, 1968

Section 104(b) of Pub. L. 90–364 provided that: "In the case of a taxable year ending before the date of the enactment of this Act [June 28, 1968], the time prescribed for payment of the tax imposed by section 51 of the Internal Revenue Code of 1954 [this section] shall not expire before September 15, 1968."

PART VI—MINIMUM TAX FOR TAX PREFERENCES

Sec.
56. Imposition of tax.
57. Items of tax preference.
58. Rules for application of this part.

AMENDMENTS

1969—Pub. L. 91–172, title III, § 301(a), Dec. 30, 1969, 83 Stat. 530, added Part VI and items 56 to 58.

§ 56. Imposition of tax.

(a) In general.

In addition to the other taxes imposed by this chapter, there is hereby imposed for each taxable year, with respect to the income of every person, a tax equal to 10 percent of the amount (if any) by which—

(1) the sum of the items of tax preference in excess of $30,000, is greater than

(2) the sum of—

(A) the taxes imposed by this chapter for the taxable year (computed without regard to this part and without regard to the taxes imposed by sections 531 and 541) reduced by the sum of the credits allowable under—

(i) section 33 (relating to foreign tax credit),

(ii) section 37 (relating to retirement income), and

(iii) section 38 (relating to investment credit); and

(B) the tax carry overs to the taxable year.

(b) Deferral of tax liability in case of certain net operating losses.

(1) In general.

If for any taxable year a person—

(A) has a net operating loss any portion of which (under section 172) remains as a net operating loss carryover to a succeeding taxable year, and

(B) has items of tax preference in excess of $30,000,

then an amount equal to the lesser of the tax imposed by subsection (a) or 10 percent of the amount of the net operating loss carryover described in subparagraph (A) shall be treated as tax liability not imposed for the taxable year, but as imposed for the succeeding taxable year or years pursuant to paragraph (2).

(2) Year of liability.

In any taxable year in which any portion of the net operating loss carryover attributable to the excess described in paragraph (1)(B) reduces taxable income, the amount of tax liability described in paragraph (1) shall be treated as tax liability imposed in such taxable year in an amount equal to 10 percent of such reduction.

(3) Priority of application.

For purposes of paragraph (2), if any portion of the net operating loss carryover described in paragraph (1)(A) is not attributable to the excess described in paragraph (1)(B), such portion shall be considered as being applied in reducing taxable income before such other portion.

(c) Tax carry overs.

If for any taxable year—

(1) the taxes imposed by this chapter (computed without regard to this part and without regard to the taxes imposed by sections 531 and 541) reduced by the sum of the credits allowable under—

(A) section 33 (relating to foreign tax credit),

(B) section 37 (relating to retirement income), and

(C) section 38 (relating to investment credit), exceed.

(2) the sum of the items of tax preference in excess of $30,000.

then the excess of the taxes described in paragraph (1) over the sum described in paragraph (2) shall be a tax carry over to each of the 7 taxable years following such year. The entire amount of the excess for a taxable year shall be carried to the first of such 7 taxable years, and then to each of the other such taxable years to the extent that such excess is not used to reduce the amount subject to tax under subsection (a) for a prior taxable year to which excess may be carried. (Added Pub. L. 91–172, title III, § 301(a), Dec. 30, 1969, 83 Stat. 580, and amended Pub. L. 91–614, title V, § 501(a), Dec. 31, 1970, 84 Stat. 1846.)

AMENDMENTS

1970—Subsec. (a)(2). Pub. L. 91–614, § 501(a)(1), substituted the sum of the taxes imposed by this chapter reduced by the sum of the credits allowable under sections 33, 37, and 38 of this title plus the tax carry overs to the taxable year for the taxes imposed by this chapter reduced by the sum of the credits allowable under sections 33, 37, and 38 of this title.

Subsec. (c). Pub. L. 91–614, § 501(a)(2), added subsec. (c).

EFFECTIVE DATE OF 1970 AMENDMENT; DETERMINATION OF EXCESS REFERRED TO IN SUBSEC. (c) OF THIS SECTION IN THE CASE OF A TAXABLE YEAR BEGINNING IN 1969 AND ENDING IN 1970

Section 501(b) of Pub. L. 91–614 provided that:

"The amendments made by subsection (a) [amending this section] shall apply to taxable years ending after December 31, 1969. In the case of a taxable year beginning in 1969 and ending in 1970, the excess referred to in section 56(c) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall be an amount equal to the excess determined under such section (without regard to the sentence) multiplied by a fraction—

"(1) the numerator of which is the number of days in the taxable year occurring after December 31, 1969, and

"(2) the denominator of which is the number of days in the entire taxable year."

EFFECTIVE DATE

Section 301(c) of Pub. L. 91–172 provided that:

"The amendments made by this section [enacting sections 5(a)(5), 12(3), 56 to 58, 443(d), and 511(d), and amending sections 46(a)(3), 51(b)(1), 453(c)(3), 901(a), 1373(c), 1375(a)(3), 6015(c)(1), and 6654(f)(1) of this title] shall apply to taxable years ending after December 31, 1969. In the case of a taxable year beginning in 1969 and ending in 1970, the tax imposed by section 56 of the Internal Revenue Code of 1954 [this section] (as added by subsection (a)) shall be an amount equal to the tax imposed by such section (determined without regard to this sentence) multiplied by a fraction—

"(1) the numerator of which is the number of days in the taxable year occurring after December 31, 1969, and

"(2) the denominator of which is the number of days in the entire taxable year."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 5, 12, 46, 51, 58, 453, 511, 901, 1373, 1375, 6015, 6654 of this title.

§ 57. Items of tax preference.

(a) In general.

For purposes of this part, the items of tax preference are—

(1) Excess investment interest.

The amount of the excess investment interest for the taxable year (as determined under subsection (b)).

(2) Accelerated depreciation on real property.

With respect to each section 1250 property (as defined in section 1250(c)), the amount by which the deduction allowable for the taxable year for exhaustion, wear and tear, obsolescence, or amortization exceeds the depreciation deduction which would have been allowable for the taxable year had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life (determined without regard to section 167(k)) for which the taxpayer has held the property.

(3) Accelerated depreciation on personal property subject to a net lease.

With respect to each item of section 1245 property (as defined in section 1245(a)(3)) which is the subject of a net lease, the amount by which the deduction allowable for the taxable year for exhaustion, wear and tear, obsolescence, or amortization exceeds the depreciation deduction which would have been allowable for the taxable year had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life for which the taxpayer has held the property.

(4) Amortization of certified pollution control facilities.

With respect to each certified pollution control facility for which an election is in effect under section 169, the amount by which the deduction allowable for the taxable year under such section exceeds the depreciation deduction which would otherwise be allowable under section 167.

(5) Amortization of railroad rolling stock.

With respect to each unit of railroad rolling stock for which an election is in effect under section 184, the amount by which the deduction allowable for the taxable year under such section exceeds the depreciation deduction which would otherwise be allowable under section 167.

(6) Stock options.

With respect to the transfer of a share of stock pursuant to the exercise of a qualified stock option (as defined in section 422(b)) or a restricted stock option (as defined in section 424(b)), the amount by which the fair market value of the share at the time of exercise exceeds the option price.

(7) Reserves for losses on bad debts of financial institutions.

In the case of a financial institution to which section 585 or 593 applies, the amount by which the deduction allowable for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allowable had the institution maintained its bad debt reserve for all taxable years on the basis of actual experience.

(8) Depletion.

With respect to each property (as defined in section 614), the excess of the deduction for depletion allowable under section 611 for the taxable year over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year).

(9) Capital gains.

(A) Individuals.

In the case of a taxpayer other than a corporation, an amount equal to one-half of the amount by which the net long-term capital gain exceeds the net short-term capital ioss for the taxable year.

(B) Corporations.

In the case of a corporation, if the net long-term capital gain exceeds the net short-term capital loss for the taxable year, an amount equal to the product obtained by multiplying such excess by a fraction the numerator of which is the sum of the normal tax rate and the surtax rate under section 11, minus the alternative tax rate under section 1201(a), for the taxable year, and the denominator of which is the sum of the normal tax rate and the surtax rate under section 11 for the taxable year. In the case of a corporation to which section 1201 (a) does not apply, the amount under this subparagraph shall be determined under regulations prescribed by the Secretary or his delegate in a manner consistent with the preceding sentence.

Paragraph (1) shall apply only to taxable years beginning before January 1, 1972. Paragraphs (1) and (3) shall not apply to a corporation other than an electing small business corporation (as defined in section 1371(b)) and a personal holding company (as defined in section 542).

(b) Excess investment interest.

(1) In general.

For purposes of paragraph (1) of subsection (a), the excess investment interest for any taxable year is the amount by which the investment interest expense for the taxable year exceeds the net investment income for the taxable year.

(2) Definitions.

For purposes of this subsection—

(A) Net investment income.

The term "net investment income" means the excess of investment income over investment expenses.

(B) Investment income.

The term "investment income" means—

(i) the gross income from interest, dividends, rents, and royalties,

(ii) the net short-term capital gain attributable to the dispesition of property held for investment, and

(iii) amounts treated under sections 1245 and 1250 as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231,

but only to the extent such income, gain, and amounts are not derived from the conduct of a trade or business.

(C) Investment expenses.

The term "investment expenses" means the deductions allowable under sections 164(a) (1) or (2), 166, 167, 171, 212, 243, 244, 245, or 611 directly connected with the production of investment income. For purposes of this subparagraph, the deduction allowable under section 167 with respect to any property may be treated as the amount which would have been allowable had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life for which the taxpayer has held the property, and the deduction allowable under section 611 with respect to any property may be treated as the amount which would have been allowable had the taxpayer determined the deduction under section 611 without regard to section 613 for each taxable year for which the taxpayer has held the property.

(D) Investment interest expense.

The term "investment interest expense" means interest paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment. For purposes of the preceding sentence, interest paid or accrued on indebtedness incurred or continued in the construction of property to be used in a trade or business shall not be treated as an investment interest expense.

(3) Property subject to net lease.

For purposes of this subsection, property which is subject to a net lease entered into after October 9, 1969, shall be treated as property held for investment, and not as property used in a trade or business.

(c) Net leases.

For purposes of this section, property shall be considered to be subject to a net lease for a taxable year if—

(1) for such taxable year the sum of the deductions with respect to such property which are allowable solely by reason of section 162 is less than 15 percent of the rental income produced by such property, or

(2) the lessor is either guaranteed a specified return or is guaranteed in whole or in part against loss of income.

(Added Pub. L. 91–172, title III, § 301(a), Dec. 30, 1969, 83 Stat. 581.)

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 58, 163, 1348 of this title.

§ 58. Rules for application of this part.

(a) Husband and wife.

In the case of a husband or wife who files a separate return for the taxable year, the $30,000 amount specified in section 56 shall be $15,000.

(h) Members of controlled groups.

In the case of a controlled group of corporations (as defined in section 1563(a)), the $30,000 amount specified in section 56 shall be divided equally among the component members of such group unless all component members consent (at such time and in such manner as the Secretary of his delegate prescribes by regulations) to an apportionment plan providing for an unequal allocation of such amount.

(c) Estates and trusts.

In the case of an estate or trust—

(1) the sum of the items of tax preference for any taxable year of the estate or trust shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each, and

(2) the $30,000 amount specified in section 56 applicable to such estate or trust shall be reduced to an amount which bears the same ratio to $30,000 as the portion of the sum of the items of tax preference allocated to the estate or trust under paragraph (1) bears to such sum.

(d) Electing small business corporations and their shareholders.

(1) In general.

Except as provided in paragraph (2), the items of tax preference of an electing small business corporation (as defined in section 1371(b)) for each taxable year of the corporation shall be treated as items of tax preference of the shareholders of such corporation, and, except as provided in paragraph (2), shall not be treated as items of tax preference of such corporation. The sum of the items so treated shall be apportioned pro rata among such shareholders in a manner consistent with section 1374(c)(1). For purposes of this paragraph, this part shall be treated as applying to such corporation.

(2) Certain capital gains.

If for a taxable year of an electing small business corporation a tax is imposed on the income of such corporation under section 1378, such corporation shall, notwithstanding the provisions of section 1371(b)(1), be subject to the tax imposed by section 56, but computed only with reference to the item of tax preference set forth in section 57(a)(9)(B) to the extent attributable to gains subject to the tax imposed by section 1378.

(e) Participants in a common trust fund.

The items of tax preference of a common trust fund (as defined in section 584(a)) for each taxable year of the fund shall be treated as items of tax preference of the participants of such fund and shall be apportioned pro rata among such participants. For purposes of this subsection, this part shall be treated as applying to such fund.

(f) Regulated investment companies, etc.

In the case of a regulated investment company to which part I of subchapter M applies or a real estate investment trust to which part II of subpart M applies—

(1) the item of tax preference set forth in section 57(a)(9) shall not be treated as an item of tax preference of such company or such trust for each taxable year to the extent that such item is attributable to amounts taken into account as income by the shareholders of such company under section 852(b)(3), or by the shareholders or holders of beneficial interests of such trust under section 857(b)(3), and

(2) the items of tax preference of such company or such trust for each taxable year (other than the item of tax preference set forth in section 57(a)(9) and, in the case of a real estate investment trust, the item of tax preference set forth in section 57(a)(2)) shall be treated as items of tax preference of the shareholders of such company, or the shareholders or holders of beneficial interests of such trust (and not as item or tax preference of such company or such trust), in the same proportion that the dividends (other than capital gain dividends) paid to each such shareholder, or holder of beneficial interest, bears to the taxable income of such company or such trust determined without regard to the deduction for dividends paid.

(g) Tax preferences attributable to foreign sources.

(1) In general.

For purposes of section 56, the items of tax preference set forth in section 57(a) (other than in paragraphs (6) and (9) of such section) which are attributable to sources within any foreign country or possession of the United States shall be taken into account only to the extent that such items reduce the tax imposed by this chapter (other than the tax imposed by section 56) on income derived from sources within the United States. For purposes of the preceding sentence, items of tax preference shall be treated as reducing the tax imposed by this chapter before items which are not items of tax preference.

(2) Capital gains and stock options.

For purposes of section 56, the items of tax preference set forth in paragraphs (6) and (9) of section 57(a) which are attributable to sources within any foreign country or possession of the United States shall not be taken into account if, under the tax laws of such country or possession—

(A) in the case of the item set forth in paragraph (6) of section 57(a), preferential treatment is not accorded transfers of shares of stock pursuant to stock options described in such paragraph, and

(B) in the case of the item set forth in paragraph (9) of section 57(a), preferential treatment is not accorded gain from the sale or exchange of capital assets (or property treated as capital assets).

(Added Pub. L. 91–172, title III, § 301(a), Dec. 30, 1969, 83 Stat. 583.)

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 443 of this title.

Subchapter B.—Computation of Taxable Income

Part

I. Definition of gross income, adjusted gross income, and taxable income.
II. Items specifically included in gross income.
III. Items specifically excluded from gross income.
IV. Standard deduction for individuals.
V. Deductions for personal exemptions.
VI. Itemized deductions for individuals and corporations.
VII. Additional itemized deductions for individuals.
VIII. Special deductions for corporations.
IX. Items not deductible.
X. Terminal railroad corporations and their shareholders.

AMENDMENTS

1962—Pub. L. 87–870, § 1(b), Oct. 23, 1962, 76 Stat. 1160, added part X.

PART I.—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, AND TAXABLE INCOME

Sec.

61. Gross income defined.
62. Adjusted gross income defined.
63. Taxable income defined.

§ 61. Gross income defined.

(a) General definition.

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

(b) Cross references.

For items specifically included in gross income, see part II (sec. 71 and following). For items specifically excluded from gross income, see part III (sec. 101 and following).

(Aug. 16, 1954, ch. 736, 68A Stat. 17.)

REIMBURSEMENT OF MOVING EXPENSES OF EMPLOYEES OF CERTAIN CORPORATIONS EXCLUDED FROM GROSS INCOME; CLAIM FOR REFUND OR CREDIT; LIMITATIONS; INTEREST

Pub. L. 86–780, § 5, Sept. 14, 1960, 74 Stat. 1013, provided that:

"Any amount received after December 31, 1949, and before October 1, 1955, from a corporation which—

"(1) was formed exclusively for the purpose of, and was engaged exclusively in, operating without profit a scientific laboratory for the Atomic Energy Commission, and

"(2) operated solely on funds appropriated to the Atomic Energy Commission,

by an individual as reimbursement for moving himself and his immediate family, household goods, and personal effects to a new place of residence in order to accept employment with such corporation shall, for Federal income tax purposes, be treated as an amount which was not includible in the gross income of the individual, to the extent that such amount did not exceed the actual expenses paid or incurred by the individual for such purposes, if the individual was advised, at the time of his employment, by an authorized officer, employee, or agent of such corporation that the amount of such reimbursement would not be includible in gross income. If refund or credit of any overpayment resulting from the application of this section is prevented on the date of enactment of this Act [Sept. 14, 1960], or within six months after such date, by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises, and the corresponding provisions of prior law), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefore is filed within six months after such date. No interest shall be paid or allowed on any overpayment resulting from the application of the preceding sentence."

CROSS REFERENCES

Capital gains and losses, see section 1201 et seq. of this title.

Guaranteed payments to partner for services or use of capital considered as made to one not member of partnership for purposes of this section, see section 707 of this title.

Income from sources—

Within the United States, see section 861 of this title.

Without the United States, see section 862 of this title.

Items specifically excluded from gross income—

Certain death benefits, see section 101 of this title.

Income from discharge of indebtedness, see section 108 of this title.

Items specifically included in gross income—

Alimony and separate maintenance payments, see section 71 of this title.

Annuities; certain proceeds of endowment and life insurance contracts, see section 72 of this title.

Recipients of income in respect of decedents, see section 691 of this title.

Trust income attributable to grantors and others as substantial owners includible in gross income, see section 671 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 671, 707 of this title.

§ 62. Adjusted gross income defined.

For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

(1) Trade and business deductions.

The deductions allowed by this chapter (other than by part VII of this subchapter) which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.

(2) Trade and business deductions of employees.

(A) Reimbursed expenses.

The deductions allowed by part VI (sec. 161 and following) which consist of expenses paid or incurred by the taxpayer, in connection with the performance by him of services as an employee, under a reimbursement or other expense allowance arrangement with his employer.

(B) Expenses for travel away from home.

The deductions allowed by part VI (sec. 161 and following) which consist of expenses of travel, meals, and lodging while away from home, paid or incurred by the taxpayer in connection with the performance by him of services as an employee.

(C) Transportation expenses.

The deductions allowed by part VI (sec. 161 and following) which consist of expenses of transportation paid or incurred by the taxpayer in connection with the performance by him of services as an employee.

(D) Outside salesmen.

The deductions allowed by part VI (sec. 161 and following) which are attributable to a trade or business carried on by the taxpayer, if such trade or business consists of the performance of services by the taxpayer as an employee and if such trade or business is to solicit, away from the employer's place of business, business for the employer.

(3) Long-term capital gains.

The deduction allowed by section 1202.

(4) Losses from sale or exchange of property.

The deductions allowed by part VI (sec. 161 and following) as losses from the sale or exchange of property.

(5) Deductions attributable to rents and royalties.

The deductions allowed by part VI (sec. 161 and following), by section 212 (relating to expenses for production of income), and by section 611 (relating to depletion) which are attributable to property held for the production of rents or royalties.

(6) Certain deductions of life tenants and income beneficiaries of property.

In the case of a life tenant of property, or an income beneficiary of property held in trust, or an heir, legatee, or devisee of an estate, the deduction for depreciation allowed by section 167 and the deduction allowed by section 611.

(7) Pension, profit-sharing, annuity, and bond purchase plans of self-employed individuals.

In the case of an individual who is an employee within the meaning of section 401(c)(1), the deductions allowed by section 404 and section 405(c) to the extent attributable to contributions made on behalf of such individual.

(8) Moving expense deduction.

The deduction allowed by section 217.

(9) Pension, etc., plans of electing small business corporations.

The deduction allowed by section 1379(b)(3).

Nothing in this section shall permit the same item to be deducted more than once. (Aug. 16, 1954, ch.

736, 68A Stat. 17; Oct. 10, 1962, Pub. L. 87-792, § 7 (b), 76 Stat. 828; Feb. 26, 1964, Pub. L. 88-272, title II, § 213(b), 78 Stat. 52; Dec. 30, 1969, Pub. L. 91-172, title V, § 531(b), 83 Stat. 655.)

AMENDMENTS

1969—Par. (9). Pub. L. 91-172 added par. (9).
1964—Par. (8). Pub. L. 88-272 added par. (8).
1962—Par. (7). Pub. L. 87-792 added par. (7).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable with respect to taxable years of electing small business corporations beginning after Dec. 31, 1970, see section 531(d) of Pub. L. 91-172, set out as a note under section 1379 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 213(d) of Pub. L. 88-272 provided that: "The amendments made by subsections (a) [adding section 217, redesignating former section 217 as 218, and amending analysis preceding section 211 of this title] and (b) [to this section] shall apply to expenses incurred after December 31, 1963, in taxable years ending after such date. The amendment made by subsection (c) [to section 3401 of this title] shall apply with respect to remuneration paid after the seventh day following the date of the enactment of this Act [Feb. 26, 1964]."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87-792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87-792, set out as a note under section 37 of this title.

CROSS REFERENCES

Lessee, coal disposed with retained economic interest, see section 631 of this title.
Optional tax, individuals, see section 3 of this title.
Percentage allowed for charitable, etc., contributions, see section 170 of this title.
Standard deduction—
Generally, see section 141 of this title.
Election, see section 144 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1348, 3402 of this title; title 18 section 3575; title 21 section 849.

§ 63. Taxable income defined.

(a) General rule.

Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

(b) Individuals electing standard deduction.

In the case of an individual electing under section 144 to use the standard deduction provided in part IV (sec. 141 and following), for purposes of this subtitle the term "taxable income" means adjusted gross income, minus—

(1) such standard deduction, and

(2) the deductions for personal exemptions provided in section 151.

(Aug. 16, 1954, ch. 736, 68A Stat. 18.)

CROSS REFERENCES

Deductions—
Additional itemized deductions for individuals, see section 211 et seq. of this title.
Deductions for personal exemptions, see section 151 et seq. of this title.
Itemized deductions for individuals and corporations, see section 161 et seq. of this title.
Special deductions for corporations, see section 241 et seq. of this title.
Standard deduction, computation with, see section 4 of this title.
Standard deduction referred to in this section, amount of, see section 141 of this title.
Gross income—
Defined, see section 61 of this title.
Items specifically included in gross income, see section 71 et seq. of this title.
Recomputation where limitation on deductions allowable to individuals in certain cases, see section 270 of this title.
Sale or exchange of residence, see section 1034 of this title.
Tax imposed, see section 1 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 4, 72, 161, 211, 1034 of this title.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

Sec.
71. Allmony and separate maintenance payments.
72. Annuities; certain proceeds of endowment and life insurance contracts.
73. Services of child.
74. Prizes and awards.
75. Dealers in tax-exempt securities.
76. Mortgages made or obligations issued by joint-stock land banks.
77. Commodity credit loans.
78. Dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit.
79. Group-term life insurance purchased for employees.
80. Restoration of value of certain securities.
81. Increases in suspense account under section 166(g).
82. Reimbursement of moving expenses.
83. Property transferred in connection with performance of services.

AMENDMENTS

1969—Pub. L. 91-172, title II, § 231(c)(1), title III, § 321(c), Dec. 30, 1969, 83 Stat. 579, 591, added items 82, 83.
1966—Pub. L. 89-722, § 1(b)(2), Nov. 2, 1966, 80 Stat. 1152, inserted item 81.
Pub. L. 89-384, § 1(b)(2), Apr. 8, 1966, 80 Stat. 102, added item 80.
1964—Pub. L. 88-272, title II, § 204(a)(2), Feb. 26, 1964, 78 Stat. 36, added item 79.
1962—Pub. L. 87-834, § 9(d)(1), Oct. 16, 1962, 76 Stat. 1001, added item 78.

§ 71. Alimony and separate maintenance payments.

(a) General rule.

(1) Decree of divorce or separate maintenance.

If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

(2) Written separation agreement.

If a wife is separated from her husband and there is a written separation agreement executed after the date of the enactment of this title, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such agreement is executed which are made under such agreement and because of the marital or family relationship (or which are attributable to property transferred, in trust or otherwise, under such agreement and because of

such relationship). This paragraph shall not apply if the husband and wife make a single return jointly.

(3) Decree for support.

If a wife is separated from her husband, the wife's gross income includes periodic payments (whether or not made at regular intervals) received by her after the date of the enactment of this title from her husband under a decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance. This paragraph shall not apply if the husband and wife make a single return jointly.

(b) Payments to support minor children.

Subsection (a) shall not apply to that part of any payment which the terms of the decree, instrument, or agreement fix, in terms of an amount of money or a part of the payment, as a sum which is payable for the support of minor children of the husband. For purposes of the preceding sentence, if any payment is less than the amount specified in the decree, instrument, or agreement, then so much of such payment as does not exceed the sum payable for support shall be considered a payment for such support.

(c) Principal sum paid in installments.

(1) General rule.

For purposes of subsection (a), installment payments discharging a part of an obligation the principal sum of which is, either in terms of money or property, specified in the decree, instrument, or agreement shall not be treated as periodic payments.

(2) Where period for payment is more than 10 years.

If, by the terms of the decree, instrument, or agreement, the principal sum referred to in paragraph (1) is to be paid or may be paid over a period ending more than 10 years from the date of such decree, instrument, or agreement, then (notwithstanding paragraph (1)) the installment payments shall be treated as periodic payments for purposes of subsection (a), but (in the case of any one taxable year of the wife) only to the extent of 10 percent of the principal sum. For purposes of the preceding sentence, the part of any principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be treated as an installment payment for the taxable year in which it is received.

(d) Rule for husband in case of transferred property.

The husband's gross income does not include amounts received which, under subsection (a), are (1) includible in the gross income of the wife, and (2) attributable to transferred property.

(e) Cross references.

(1) For definitions of "husband" and "wife", see section 7701 (a) (17).

(2) For deduction by husband of periodic payments not attributable to transferred property, see section 215.

(3) For taxable status of income of an estate or trust in case of divorce, etc., see section 682.

(Aug. 16, 1954, ch. 736, 68A Stat. 19.)

REFERENCES IN TEXT

Date of the enactment of this title, referred to in subsec. (a) (2), (3), is Aug. 16, 1954.

CROSS REFERENCES

Alimony, etc., payments, as not subject to death benefits provisions, see section 101 of this title.

Gross income as including alimony and separate maintenance payments, see section 61 of this title.

Husband and wife, definition of, see section 7701 (a) (17) of this title.

Payment includible in gross income of wife under this section not treated as payment by husband for support of dependent, see section 152 of this title.

Payments in discharge of alimony as not subject to annuity provisions, see section 72 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 72, 101, 152, 215, 682, 7701 of this title.

§ 72. Annuities; certain proceeds of endowment and life insurance contracts.

(a) General rule for annuities.

Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

(b) Exclusion ratio.

Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). This subsection shall not apply to any amount to which subsection (d) (1) (relating to certain employee annuities) applies.

(c) Definitions.

(1) Investment in the contract.

For purposes of subsection (b), the investment in the contract as of the annuity starting date is—

(A) the aggregate amount of premiums or other consideration paid for the contract, minus

(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

(2) Adjustment in investment where there is refund feature.

If—

(A) the expected return under the contract depends in whole or in part on the life expectancy of one or more individuals;

(B) the contract provides for payments to be made to a beneficiary (or to the estate of an annuitant) on or after the death of the annuitant or annuitants; and

(C) such payments are in the nature of a refund of the consideration paid,

then the value (computed without discount for interest) of such payments on the annuity starting date shall be subtracted from the amount determined under paragraph (1). Such value shall be computed in accordance with actuarial tables prescribed by the Secretary or his delegate. For purposes of this paragraph and of subsection (e) (2) (A), the term "refund of the consideration paid" includes amounts payable after the death of an annuitant by reason of a provision in the contract for a life annuity with minimum period of payments certain, but (if part of the consideration

was contributed by an employer) does not include that part of any payment to a beneficiary (or to the estate of the annuitant) which is not attributable to the consideration paid by the employee for the contract as determined under paragraph (1) (A).

(3) Expected return.

For purposes of subsection (b), the expected return under the contract shall be determined as follows:

(A) Life expectancy.

If the expected return under the contract, for the period on and after the annuity starting date, depends in whole or in part on the life expectancy of one or more individuals, the expected return shall be computed with reference to actuarial tables prescribed by the Secretary or his delegate.

(B) Installment payments.

If subparagraph (A) does not apply, the expected return is the aggregate of the amounts receivable under the contract as an annuity.

(4) Annuity starting date.

For purposes of this section, the annuity starting date in the case of any contract is the first day of the first period for which an amount is received as an annuity under the contract; except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954.

(d) Employees' annuities.

(1) Employee's contributions recoverable in 3 years.

Where—

(A) part of the consideration for an annuity, endowment, or life insurance contract is contributed by the employer, and

(B) during the 3-year period beginning on the date (whether or not before January 1, 1954) on which an amount is first received under the contract as an annuity, the aggregate amount receivable by the employee under the terms of the contract is equal to or greater than the consideration for the contract contributed by the employee,

then all amounts received as an annuity under the contract shall be excluded from gross income until there has been so excluded (under this paragraph and prior income tax laws) an amount equal to the consideration for the contract contributed by the employee. Thereafter all amounts so received under the contract shall be included in gross income.

(2) Special rules for application of paragraph (1).

For purposes of paragraph (1)—

(A) if the employee died before any amount was received as an annuity under the contract, the words "receivable by the employee" shall be read as "receivable by a beneficiary of the employee"; and

(B) any contribution made with respect to the contract while the employee is an employee within the meaning of section 401(c)(1) which is not allowed as a deduction under section 404 shall be treated as consideration for the contract contributed by the employee.

(3) Cross reference.

For certain rules for determining whether amounts contributed by employer are includible in the gross income of the employee, see part I of subchapter D (sec. 401 and following, relating to pension, profit-sharing, and stock bonus plans, etc.).

(e) Amounts not received as annuities.

(1) General rule.

If any amount is received under an annuity, endowment, or life insurance contract, if such amount is not received as an annuity, and if no other provision of this subtitle applies, then such amount—

(A) if received on or after the annuity starting date, shall be included in gross income; or

(B) if subparagraph (A) does not apply, shall be included in gross income, but only to the extent that it (when added to amounts previously received under the contract which were excludable from gross income under this subtitle or prior income tax laws) exceeds the aggregate premiums or other consideration paid.

For purposes of this section, any amount received which is in the nature of a dividend or similar distribution shall be treated as an amount not received as an annuity.

(2) Special rules for application of paragraph (1).

For purposes of paragraph (1), the following shall be treated as amounts not received as an annuity:

(A) any amount received, whether in a single sum or otherwise, under a contract in full discharge of the obligation under the contract which is in the nature of a refund of the consideration paid for the contract; and

(B) any amount received under a contract on its surrender, redemption, or maturity.

In the case of any amount to which the preceding sentence applies, the rule of paragraph (1) (B) shall apply (and the rule of paragraph (1) (A) shall not apply).

(f) Special rules for computing employees' contributions.

In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d) (1), the consideration for the contract contributed by the employee, and for purposes of subsection (e) (1) (B), the aggregate premiums or other consideration paid, amounts contributed by the employer shall be included, but only to the extent that—

(1) such amounts were includible in the gross income of the employee under this subtitle or prior income tax laws; or

(2) if such amounts had been paid directly to the employee at the time they were contributed, they would not have been includible in the gross income of the employee under the law applicable at the time of such contribution.

Paragraph (2) shall not apply to amounts which were contributed by the employer after December 31, 1962, and which would not have been includible in the gross income of the employee by reason of the application of section 911 if such amounts had been paid directly to the employee at the time of contribution. The preceding sentence shall not apply

to amounts which were contributed by the employer, as determined under regulations prescribed by the Secretary or his delegate, to provide pension or annuity credits, to the extent such credits are attributable to services performed before January 1, 1963, and are provided pursuant to pension or annuity plan provisions in existence on March 12, 1962, and on that date applicable to such services.

(g) Rules for transferee where transfer was for value.

Where any contract (or any interest therein) is transferred (by assignment or otherwise) for a valuable consideration, to the extent that the contract (or interest therein) does not, in the hands of the transferee, have a basis which is determined by reference to the basis in the hands of the transferor, then—

(1) for purposes of this section, only the actual value of such consideration, plus the amount of the premiums and other consideration paid by the transferee after the transfer, shall be taken into account in computing the aggregate amount of the premiums or other consideration paid for the contract;

(2) for purposes of subsection (c) (1) (B), there shall be taken into account only the aggregate amount received under the contract by the transferee before the annuity starting date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws; and

(3) the annuity starting date is January 1, 1954, or the first day of the first period for which the transferee received an amount under the contract as an annuity, whichever is the later.

For purposes of this subsection, the term "transferee" includes a beneficiary of, or the estate of, the transferee.

(h) Optiou to receive annuity in lieu of lump sum.

If—

(1) a contract provides for payment of a lump sum in full discharge of an obligation under the contract, subject to an option to receive an annuity in lieu of such lump sum;

(2) the option is exercised within 60 days after the day on which such lump sum first became payable; and

(3) part or all of such lump sum would (but for this subsection) be includible in gross income by reason of subsection (e) (1),

then, for purposes of this subtitle, no part of such lump sum shall be considered as includible in gross income at the time such lump sum first became payable.

(i) Joint and survivor annuities where first annuitant died in 1951, 1952, or 1953.

Where an annuitant died after December 31, 1950, and before January 1, 1954, and the basis of a surviving annuitant's interest in the joint and survivor annuity contract was determinable under section 113 (a) (5) of the Internal Revenue Code of 1939, then—

(1) subsection (d) shall not apply with respect to such contract;

(2) for purposes of this section, the aggregate amount of premiums or other consideration paid for the contract is the basis of the contract determined under such section 113 (a) (5);

(3) for purposes of subsection (c) (1) (B), there shall be taken into account only the aggregate amount received by the surviving annuitant under the contract before the annuity starting date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws; and

(4) the annuity starting date is January 1, 1954, or the first day of the first period for which the surviving annuitant received an amount under the contract as an annuity, whichever is the later.

(j) Iuterest.

Notwithstanding any other provision of this section, if any amount is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

(k) Payments in discharge of alimony.

(1) In general.

This section shall not apply to so much of any payment under an annuity, endowment, or life insurance contract (or any interest therein) as is includible in the gross income of the wife under section 71 or section 682 (relating to income of an estate or trust in case of divorce, etc.).

(2) Cross reference.

For definition of "wife", see section 7701 (a) (17).

(*l*) Face-amount certificates.

For purposes of this section, the term "endowment contract" includes a face-amount certificate, as defined in section 2 (a) (15) of the Investment Company Act of 1940 (15 U. S. C., sec. 80a–2), issued after December 31, 1954.

(m) Special rules applicable to employee annuities and distributions under employee plans.

(1) Certain amounts received before annuity starting date.

Any amounts received under an annuity, endowment, or life insurance contract before the annuity starting date which are not received as an annuity (within the meaning of subsection (e) (2)) shall be included in the recipient's gross income for the taxable year in which received to the extent that—

(A) such amounts, plus all amounts theretofore received under the contract and includible in gross income under this paragraph, do not exceed

(B) the aggregate premiums or other consideration paid for the contract while the employee was an owner-employee which were allowed as deductions under section 404 for the taxable year and all prior taxable years.

Any such amounts so received which are not includible in gross income under this paragraph shall be subject to the provisions of subsection (e).

(2) Computation of consideration paid by the employee.

In computing—

(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract),

(B) the consideration for the contract contributed by the employee for purposes of subsection (d)(1) (relating to employee's contributions recoverable in 3 years), and

(C) the aggregate premiums or other consideration paid for purposes of subsection (e)(1)(B) (relating to certain amounts not received as an annuity),

any amount allowed as a deduction with respect to the contract under section 404 which was paid while the employee was an employee within the meaning of section 401(c)(1) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the employee was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary or his delegate) to the cost of life, accident, health, or other insurance.

(3) Life insurance contracts.

(A) This paragraph shall apply to any life insurance contract—

(i) purchased as a part of a plan described in section 403(a), or

(ii) purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

(B) Any contribution to a plan described in subparagraph (A)(i) or a trust described in subparagraph (A)(ii) which is allowed as a deduction under section 404, and any income of a trust described in subparagraph (A)(ii), which is determined in accordance with regulations prescribed by the Secretary or his delegate to have been applied to purchase the life insurance protection under a contract described in subparagraph (A), is includible in the gross income of the participant for the taxable year when so applied.

(C) In the case of the death of an individual insured under a contract described in subparagraph (A), an amount equal to the cash surrender value of the contract immediately before the death of the insured shall be treated as a payment under such plan or a distribution by such trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under this section and shall be treated as provided in section 101.

(4) Amounts constructively received.

(A) Assignments or pledges.

If during any taxable year an owner-employee assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a trust described in section 401(a) which is exempt from tax under section 501(a) or any portion of the value of a contract purchased as part of a plan described in section 403(a), such portion shall be treated as having been received by such owner-employee as a distribution from such trust or as an amount received under the contract.

(B) Loans on contracts.

If during any taxable year, an owner-employee receives, directly or indirectly, any amount from any insurance company as a loan under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as part of a plan described in section 403(a), and issued by such insurance company, such amount shall be treated as an amount received under the contract.

(5) Penalties applicable to certain amounts received by owner-employees.

(A) This paragraph shall apply—

(i) to amounts (other than any amount received by an individual in his capacity as a policyholder of an annuity, endowment, or life insurance contract which is in the nature of a dividend or similar distribution) which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) and which are received by an individual, who is, or has been, an owner-employee, before such individual attains the age of 59½ years, for any reason other than the individual's becoming disabled (within the meaning of paragraph (7) of this subsection), but only to the extent that such amounts are attributable to contributions paid on behalf of such individual (whether or not paid by him) while he was an owner-employee,

(ii) to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, an owner-employee, or by the successor of such individual, but only to the extent that such amounts are determined, under regulations prescribed by the Secretary or his delegate, to exceed the benefits provided for such individual under the plan formula, and

(iii) to amounts which are received, by an individual who is, or has been, an owner-employee, by reason of the distribution under the provisions of section 401(e)(2)(E) of his entire interest in all qualified trusts described in section 401(a) and in all plans described in section 403(a).

(B)(i) If the aggregate of the amounts to which this paragraph applies received by any person in his taxable year equals or exceeds $2,500, the increase in his tax for the taxable year in which such amounts are received and attributable to such amounts shall not be less than 110 percent of the aggregate increase in taxes, for the taxable year and the 4 immediately preceding taxable years, which would have resulted if such amounts had been included in such person's gross income ratably over such taxable years.

(ii) If deductions have been allowed under section 404 for contributions paid on behalf of the individual while he is an owner-employee for a number of prior taxable years less than 4, clause (i) shall be applied by taking into account a number of taxable years immediately preceding the taxable year in which the amount was so received equal to such lesser number.

(C) If subparagraph (B) does not apply to a person for the taxable year, the increase in tax of such person for the taxable year attributable to the amounts to which this paragraph applies shall be 110 percent of such increase (computed without regard to this subparagraph).

(D) Subparagraph (A)(ii) of this paragraph shall not apply to any amount to which section 402(a)(2) or 403(a)(2) applies.

(E) For special rules for computation of taxable income for taxable years to which this paragraph applies, see subsection (n)(3).

(6) Owner-employee defined.

For purposes of this subsection, the term "owner-employee" has the meaning assigned to it by section 401(c)(3).

(7) Meaning of disabled.

For purposes of this section, an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary or his delegate may require.

(n) Treatment of total distributions.

(1) Application of subsection.

(A) General rule.

This subsection shall apply to amounts—

(i) distributed to a distributee, in the case of an employees' trust described in section 401(a) which is exempt from tax under section 501(a), or

(ii) paid to a payee, in the case of an annuity plan described in section 403(a),

if the total distributions or amounts payable to the distributee or payee with respect to an employee (including an individual who is an employee within the meaning of section 401(c)(1)) are paid to the distributee or payee within one taxable year of the distributee or payee, but only to the extent that section 402(a)(2) or 403(a)(2)(A) does not apply to such amounts.

(B) Distributions to which applicable.

This subsection shall apply only to distributions or amounts paid—

(i) on account of the employee's death,

(ii) with respect to an individual who is an employee without regard to section 401(c)(1), on account of his separation from the service,

(iii) with respect to an employee within the meaning of section 401(c)(1), after he has attained the age of 59½ years, or

(iv) with respect to an employee within the meaning of section 401(c)(1), after he has become disabled (within the meaning of subsection (m)(7)).

(C) Minimum period of service.

This subsection shall apply to amounts distributed or paid to an employee from or under a plan only if he has been a participant in the plan for 5 or more taxable years prior to the taxable year in which such amounts are distributed or paid.

(D) Amounts subject to penalty.

This subsection shall not apply to amounts described in clauses (ii) and (iii) of subparagraph (A) of subsection (m)(5) (but, in the case of amounts described in clause (ii) of such subparagraph, only to the extent that subsection (m)(5) applies to such amounts).

(2) Limitation of tax.

In any case to which this subsection applies, the tax attributable to the amounts to which this subsection applies for the taxable year in which such amounts are received shall not exceed whichever of the following is the greater:

(A) 5 times the increase in tax which would result from the inclusion in gross income of the recipient of 20 percent of so much of the amount so received as is includible in gross income, or

(B) 5 times the increase in tax which would result if the taxable income of the recipient for such taxable year equaled 20 percent of the amount of the taxable income of the recipient for such taxable year determined under paragraph (3)(A).

(3) Determination of taxable income.

Notwithstanding section 63 (relating to definition of taxable income), for purposes only of computing the tax under this chapter attributable to amounts to which this subsection or subsection (m)(5) applies and which are includible in gross income—

(A) the taxable income of the recipient for the taxable year of receipt shall be treated as being not less than the amount by which (i) the aggregate of such amounts so includible in gross income exceeds (ii) the amount of the deductions allowed for such taxable year under section 151 (relating to deductions for personal exemptions); and

(B) in making ratable inclusion computations under paragraph (5)(B) of subsection (m), the taxable income of the recipient for each taxable year involved in such ratable inclusion shall be treated as being not less than the amount required by such paragraph (5)(B) to be treated as includible in gross income for such taxable year.

In any case in which the preceding sentence results in an increase in taxable income for any taxable year, the resulting increase in the taxes imposed by section 1 or 3 for such taxable year shall not be reduced by any credit under part IV

of subchapter A (other than sections 31 and 39 thereof) which, but for this sentence, would be allowable.

(4) Special rule for employees without regard to section 401(c)(1).

In the case of amounts to which this subsection applies which are distributed or paid with respect to an individual who is an employee without regard to section 401(c)(1), paragraph (2) shall be applied with the following modifications:

(A) "7 times" shall be substituted for "5 times", and "14⅔ percent" shall be substituted for "20 percent".

(B) Any amount which is received during the taxable year by the employee as compensation (other than as deferred compensation within the meaning of section 404) for personal services performed for the employer in respect of whom the amounts distributed or paid are received shall not be taken into account.

(C) No portion of the total distributions or amounts payable (of which the amounts distributed or paid are a part) to which section 402(a)(2) or 403(a)(2)(A) applies shall be taken into account.

Subparagraph (B) shall not apply if the employee has not attained the age of 59½ years, unless he has died or become disabled (within the meaning of subsection (m)(7)).

(o) Annuities under retired serviceman's family protection plan.

Subsections (b) and (d) shall not apply in the case of amounts received after December 31, 1965, as an annuity under chapter 73 of title 10 of the United States Code, but all such amounts shall be excluded from gross income until there has been so excluded (under section 122(b)(1) or this section, including amounts excluded before January 1, 1966) an amount equal to the consideration for the contract (as defined by section 122(b)(2)), plus any amount treated pursuant to section 101(b)(2)(D) as additional consideration paid by the employee. Thereafter all amounts so received shall be included in gross income.

(p) Cross reference.

For limitation on adjustments to basis of annuity contracts sold, see section 1021.

(Aug. 16, 1954, ch. 736, 68A Stat. 20; Oct. 10, 1962, Pub. L. 87-792, § 4(a), (b), 76 Stat. 821; Oct. 16, 1962, Pub. L. 87-834, § 11(b), 76 Stat. 1005; Feb. 26, 1964, Pub. L. 88-272, title II, § 232(b), 78 Stat. 110; June 21, 1965, Pub. L. 89-44, title VIII, § 809(d)(2), 79 Stat. 167; July 30, 1965, Pub. L. 89-97, title I, § 106(d)(2), 79 Stat. 337; Mar. 8, 1966, Pub. L. 89-365, § 1(b), 80 Stat. 32; Dec. 30, 1969, Pub. L. 91-172, title V, § 515(b), 83 Stat. 644.)

AMENDMENTS

1969—Subsec. (n)(1). Pub. L. 91-172, § 515(b)(1), altered section to accommodate the insertion into sections 402 and 403 of provisions under which employer contributions to qualified pension, profit sharing, stock bonus, and annuity plans for plan years beginning after 1969 are to be treated as ordinary income when received in a lump sum distribution, but with such amounts to be eligible for a special averaging procedure.

Subsec. (n)(4). Pub. L. 91-172, § 515(b)(2), added subsec. (n)(4).

1966—Subsec. (o). Pub. L. 89-365 added subsec. (o). Former subsec. (o) redesignated (p).

Subsec. (p). Pub. L. 89-365 redesignated former subsec. (o) as (p).

1965—Subsec. (m)(5)(A)(i). Pub. L. 89-97, § 106(d)(2)(A), substituted "paragraph (7) of this subsection" for "section 213(g)(3)".

Subsec. (m)(7). Pub. L. 89-97, § 106(d)(2)(B), added par. (7).

Subsec. (n)(1). Pub. L. 89-97, § 106(d)(2)(C), substituted in subpars. (A)(iii) and (B)(iii) "subsection (m)(7)" for "section 213(g)(3)".

Subsec. (n)(3). Pub. L. 89-44 struck out "section 31" in the sentence following subpar. (B) and inserted in lieu thereof "sections 31 and 39."

1964—Subsec. (e)(3). Pub. L. 88-272 eliminated par. (3) which provided for a limit on the tax attributable to the receipt of a lump sum.

1962—Subsec. (d)(2). Pub. L. 87-792, § 4(a), designated existing provisions as cl. (A) and added cl. (B).

Subsec. (f). Pub. L. 87-834 inserted sentence providing that par. (2) shall not apply to amounts which were contributed by the employer after Dec. 31, 1962, and which would not have been includible in the gross income of the employee by reason of the application of Section 911 if such amounts had been paid directly to the employee at the time of contribution, and making such sentence inapplicable to amounts which were contributed by the employer, as determined under regulations, to provide pension or annuity credits, to the extent such credits are attributable to services performed before Jan. 1, 1963, and are provided pursuant to pension or annuity plan provisions in existence on Mar. 12, 1962, and on that date applicable to such services.

Subsec. (m). Pub. L. 87-792, § 4(b), added subsec. (m) and redesignated former subsec. (m) as (o).

Subsec. (n). Pub. L. 87-792, § 4(b), added subsec. (n).

Subsec. (o). Pub. L. 87-792, § 4(b), redesignated former subsec. (m) as (o).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable to taxable years ending after Dec. 31, 1969, see section 515(d) of Pub. L. 91-172, set out as a note under section 402 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Addition of subsec. (o) and redesignation of subsec. (o) as subsec. (p) by Pub. L. 89-365 applicable with respect to taxable years ending after Dec. 31, 1965, see section 1(d) of Pub. L. 89-365, set out as a note under section 122 of this title.

EFFECTIVE DATE OF 1965 AMENDMENTS

Amendment of this section by Pub. L. 89-97 applicable to taxable years beginning after Dec. 31, 1966, see section 106(e) of Pub. L. 89-97, set out as a note under section 213 of this title.

Amendment of subsec. (n)(3) by Pub. L. 89-44 applicable to taxable years beginning on or after July 1, 1965, see section 809(f) of Pub. L. 89-44, set out as a note under section 6420 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (e)(3) by Pub. L. 88-272 applicable to taxable years beginning after Dec. 31, 1968, see section 232(g) of Pub. L. 88-272, set out as a note under section 1301 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Section 11(c)(2) of Pub. L. 87-834 provided that: "The amendment made by subsection (b) [to subsec. (f) of this section] shall apply to taxable years ending after December 31, 1962."

Amendment of section by Pub. L. 87-792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87-792, set out as a note under section 37 of this title.

CROSS REFERENCES

Amounts received by surviving annuitant under joint and survivor annuity contract in respect of decedents' income, see section 691 of this title.

Basis of property acquired from decedent, certain provisions inapplicable to annuities, see section 1014 of this title.

Beneficiary of employees' trust, taxability of, see section 402 of this title.

Employee annuities, taxation of, see section 403 of this title.

Employees' death benefits, see section 101 of this title.

Retirement income, see section 37 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 79, 101, 122, 401, 402, 403, 404, 405, 406, 407, 483, 691, 1014, 1302, 1304, 1348, 1379 of this title.

§ 73. Services of child.

(a) Treatmeut of amounts received.

Amounts received in respect of the services of a child shall be included in his gross income and not in the gross income of the parent, even though such amounts are not received by the child.

(b) Treatment of expenditures.

All expenditures by the parent or the child attributable to amounts which are includible in the gross income of the child (and not of the parent) solely by reason of subsection (a) shall be treated as paid or incurred by the child.

(c) Pareut defined.

For purposes of this section, the term "parent" includes an individual who is entitled to the services of a child by reason of having parental rights and duties in respect of the child.

(d) Cross reference.

For assessment of tax against parent in certain cases, see section 6201 (c).

(Aug. 16, 1954, ch. 736, 68A Stat. 24.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 6201 of this title.

§ 74. Prizes and awards.

(a) General rule.

Except as provided in subsection (b) and in section 117 (relating to scholarships and fellowship grants), gross income includes amounts received as prizes and awards.

(b) Exception.

Gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if—

(1) the recipient was selected without any action on his part to enter the contest or proceeding; and

(2) the recipient is not required to render substantial future services as a condition to receiving the prize or award.

(Aug. 16, 1954, ch. 736, 68A Stat. 24.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 4941, 4945 of this title.

§ 75. Dealers in tax-exempt securities.

(a) Adjustment for bond premium.

In computing the gross income of a taxpayer who holds during the taxable year a short-term municipal bond (as defined in subsection (b) (1)) primarily for sale to customers in the ordinary course of his trade or business—

(1) if the gross income of the taxpayer from such trade or business is computed by the use of inventories and his inventories are valued on any basis other than cost, the cost of securities sold (as defined in subsection (b) (2)) during such year shall be reduced by an amount equal to the amortizable bond premium which would be disallowed as a deduction for such year by section 171 (a) (2) (relating to deduction for amortizable bond premium) if the definition in section 171 (d) of the term "bond" did not exclude such municipal bond; or

(2) if the gross income of the taxpayer from such trade or business is computed without the use of inventories, or by use of inventories valued at cost, and the municipal bond is sold or otherwise disposed of during such year, the adjusted basis (computed without regard to this paragraph) of the municipal bond shall be reduced by the amount of the adjustment which would be required under section 1016 (a) (5) (relating to adjustment to basis for amortizable bond premium) if the definition in section 171 (d) of the term "bond" did not exclude such municipal bond.

Notwithstanding the provisions of paragraph (1), no reduction to the cost of securities sold during the taxable year shall be made in respect of any obligation described in subsection (b) (1) (A) (ii) which is held by the taxpayer at the close of the taxable year; but in the taxable year in which any such obligation is sold or otherwise disposed of, if such obligation is a municipal bond (as defined in subsection (b) (1)), the cost of securities sold during such year shall be reduced by an amount equal to the adjustment described in paragraph (2), without regard to the fact that the taxpayer values his inventories on any basis other than cost.

(b) Definitions.

For purposes of subsection (a)—

(1) The term "municipal bond" means any obligation issued by a government or political subdivision thereof if the interest on such obligation is excludable from gross income; but such term does not include such an obligation if—

(A) (i) it is sold or otherwise disposed of by the taxpayer within 30 days after the date of its acquisition by him, or

(ii) its earliest maturity or call date is a date more than 5 years from the date on which it was acquired by the taxpayer; and

(B) when it is sold or otherwise disposed of by the taxpayer—

(i) in the case of a sale, the amount reallzed, or

(il) in the case of any other disposition, its falr market value at the time of such disposition,

is higher than its adjusted basis (computed without regard to this section and section 1016 (a) (6)).

Determinations under subparagraph (B) shall be exclusive of interest.

(2) The term "cost of securities sold" means the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum of—

(A) the inventory value of the opening inventory for such year, and

(B) the cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(Aug. 16, 1954, ch. 736, 68A Stat. 25; Sept. 2, 1958, Pub. L. 85–866, title I. § 2(a), 72 Stat. 1606.)

AMENDMENTS

1958—Subsec. (a). Pub. L. 85–866, § 2(a)(2), (3), eliminated "short-term" each place it appeared, and added sentence to provide that no reduction to cost of securities sold during taxable year shall be made in respect of subsec. (b)(1)(A)(ii) obligations held at close of year, and to permit reduction in cost of securities sold in taxable year sold if obligation is municipal bond.

Subsec. (b)(1). Pub. L. 85–866, § 2(a)(1), substituted "municipal bond" for "short-term municipal bond", designated former subpars. (A) and (B) as (A) (i) and (ii), respectively, and added subpar. (B).

EFFECTIVE DATE OF 1958 AMENDMENT

Section 2 (c) of Pub. L. 85–866 provided that: "The amendments made by subsections (a) and (b) [to subsecs. (a) and (b) (1) of this section and to section 1016 (a) (6) of this title] shall apply with respect to taxable years ending after December 31, 1957, but only with respect to obligations acquired after such date."

SHORT TITLE

Section 1 (a) of Pub. L. 85–866 provided that Pub. L. 85–866, which added sections 178, 455, 558, 1242, 1243, 1306, 1371—1377, 1482, 2208, 2517, 6037, 7513 and 7514 of this title, amended sections 35, 75, 101, 152, 162, 164—168, 170—172, 213, 243, 246, 337, 341, 358, 372, 381, 391, 403, 404, 421, 453, 481, 503, 534, 535, 545, 556, 582, 611, 613, 614, 851, 852, 871, 904, 905, 911, 1015, 1016, 1031, 1033, 1034, 1053, 1071, 1231—1235, 1237, 1239, 1312, 1314, 1341, 1347, 1441, 1504, 2011, 2014, 2015, 2039, 2055, 2106, 2501, 2517, 2522, 3121, 3122, 3504, 6012 6013, 6015, 6033, 6104, 6163, 6164, 6212, 6325, 6338, 6339, 6501 6504 6532, 6601, 6611, 6652, 6653, 6851, 6871, 7213, 7324, 7325, 7422, 7455 and 7502 of this title, and sections 22, 131, 812, 813, 925—927, 3771 and 3794 of Internal Revenue Code of 1939, repealed section 120 of this title, and enacted notes set out under sections 75, 120, 152, 162, 164, 168, 170—172, 178, 213, 243, 246, 341, 372, 391, 403, 421, 453, 455, 481, 545, 556, 613, 614, 852, 871, 904, 905, 1016, 1071, 1231, 1233, 1235, 1306, 1312, 1341, 1347, 1361, 1482, 2011, 2015, 2039, 2517, 3504, 6012, 6104, 6163, 6511, 6601, and 7502 of this title, and under sections 22, 42, 106, 812 and 3772 of Internal Revenue Code of 1939, should be popularly known as the "Technical Amendments Act of 1958".

CROSS REFERENCES

General rule for inventories, see section 471 of this title.
Last-in, first-out inventories, see section 472 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 76. Mortgages made or obligations issued by joint-stock land banks.

All income (except interest) derived from mortgages made, or obligations issued, after May 28, 1938, by a joint-stock land bank shall (notwithstanding section 26 of the Federal Farm Loan Act; 12 U. S. C. 931–3) be included in gross income. (Aug. 16, 1954, ch. 736, 68A Stat. 25.)

§ 77. Commodity credit loans.

(a) Election to include loans in income.

Amounts received as loans from the Commodity Credit Corporation shall, at the election of the taxpayer, be considered as income and shall be included in gross income for the taxable year in which received.

(b) Effect of election on adjustments for subsequent years.

If a taxpayer exercises the election provided for in subsection (a) for any taxable year, then the method of computing income so adopted shall be adhered to with respect to all subsequent taxable years unless with the approval of the Secretary or his delegate a change to a different method is authorized. (Aug. 16, 1954, ch. 736, 68A Stat. 25.)

CROSS REFERENCES

Adjustments to basis, see section 1016 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 78. Dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit.

If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a)(1) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1)(C) (relating to taxes paid by foreign corporation) for such taxable year shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation. (Added Pub. L. 87–834, § 9(b), Oct. 16, 1962, 76 Stat. 1001.)

EFFECTIVE DATE

Section applicable in respect of any distribution received by a domestic corporation after Dec. 31, 1964, and in respect of any distribution received by a domestic corporation before Jan. 1, 1965, in a taxable year of such corporation beginning after Dec. 31, 1962, but only to the extent that such distribution is made out of the accumulated profits of a foreign corporation for a taxable year (of such foreign corporation) beginning after Dec. 31, 1962, see section 9(e) of Pub. L. 87–834, set out as a note under section 902 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 902, 906 of this title.

§ 79. Group-term life insurance purchased for employees.

(a) General rule.

There shall be included in the gross income of an employee for the taxable year an amount equal to the cost of group-term life insurance on his life provided for part or all of such year under a policy (or policies) carried directly or indirectly by his employer (or employers); but only to the extent that such cost exceeds the sum of—

(1) the cost of $50,000 of such insurance, and

(2) the amount (if any) paid by the employee toward the purchase of such insurance.

(b) Exceptions.

Subsection (a) shall not apply to—

(1) the cost of group-term life insurance on the life of an individual which is provided under a policy carried directly or indirectly by an employer after such individual has terminated his employment with such employer and either has reached the retirement age with respect to such employer or is disabled (within the meaning of section 72 (m)(7)),

(2) the cost of any portion of the group-term life insurance on the life of an employee provided during part or all of the taxable year of the employee under which—

(A) the employer is directly or indirectly the beneficiary, or

(B) a person described in section 170(c) is the sole beneficiary,

for the entire period during such taxable year for which the employee receives such insurance, and

(3) the cost of any group-term life insurance which is provided under a contract to which section 72(m)(3) applies.

(c) Determination of cost of insurance.

For purposes of this section and section 6052, the cost of group-term insurance on the life of an employee provided during any period shall be determined on the basis of uniform premiums (computed on the basis of 5-year age brackets) prescribed by regulations by the Secretary or his delegate. In the case of an employee who has attained age 64, the cost prescribed shall not exceed the cost with respect to such individual if he were age 63. (Added Pub. L. 88–272, title II, § 204(a)(1), Feb. 26, 1964, 78 Stat. 36, and amended Pub. L. 89–97, title I, § 106(d)(3), July 30, 1965, 79 Stat. 337.)

AMENDMENTS

1965—Subsec. (b)(1). Pub. L. 89–97 substituted "section 72(m)(7)" for "paragraph (3) of section 213(g), determined without regard to paragraph (4) thereof".

EFFECTIVE DATE OF 1965 AMENDMENT

Amendment of this section by Pub. L. 89–97 applicable to taxable years beginning after Dec. 31, 1966, see section 106(e) of Pub. L. 89–97, set out as a note under section 213 of this title.

EFFECTIVE DATE

Section 204(d) of Pub. L. 88–272 provided that: "The amendments made by subsections (a) [to this section, and section 7701(a)(20) of this title] and (c) [to sections 6052 and 6678 of this title] and paragraph (3) of section 6652(a) of the Internal Revenue Code of 1954 (as amended by section 221(b)(2) of this Act) [to section 6652(a) of this title], shall apply with respect to group-term life insurance provided after December 31, 1963, in taxable years ending after such date. The amendments made by subsection (b) [to section 3401(a)(13), (14) of this title] shall apply with respect to remuneration paid after December 31, 1963, in the form of group-term life insurance provided after such date. In applying section 79(b) of the Internal Revenue Code of 1954 (as added by subsection (a)(1) of this section) to a taxable year beginning before May 1, 1964, if paragraph (2)(B) of such section applies with respect to an employee for the period beginning May 1, 1964, and ending with the close of his first taxable year ending after April 30, 1964, such paragraph (2)(B) shall be treated as applying with respect to such employee for the period beginning January 1, 1964, and ending April 30, 1964."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 6052, 7701 of this title.

§ 80. Restoration of value of certain securities.

(a) General rule.

In the case of a domestic corporation subject to the tax imposed by section 11 or 802, if the value of any security (as defined in section 165(g)(2))—

(1) which became worthless by reason of the expropriation, intervention, seizure, or similar taking by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing of property to which such security was related, and

(2) which was taken into account as a loss from the sale or exchange of a capital asset or with respect to which a deduction for a loss was allowed under section 165,

is restored in whole or in part during any taxable year by reason of any recovery of money or other property in respect of the property to which such security was related, the value so restored (to the extent that, when added to the value so restored during prior taxable years, it does not exceed the amount of the loss described in paragraph (2)) shall, except as provided in subsection (b), be included in gross income for the taxable year in which such restoration occurs.

(b) Reduction for failure to receive tax benefit.

The amount otherwise includible in gross income under subsection (a) in respect of any security shall be reduced by an amount equal to the amount (if any) of the loss described in subsection (a)(2) which did not result in a reduction of the taxpayer's tax under this subtitle for any taxable year, determined under regulations prescribed by the Secretary or his delegate.

(c) Character of income.

For purposes of this subtitle—

(1) Except as provided in paragraph (2), the amount included in gross income under this section shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(2) If the loss described in subsection (a)(2) was taken into account as a loss from the sale or exchange of a capital asset, the amount included in gross income under this section shall be treated as long-term capital gain.

(d) Treatment under foreign expropriation loss recovery provisions.

This section shall not apply to any recovery of a foreign expropriation loss to which section 1351 applies. (Added Pub. L. 89–384, § 1(b)(1), Apr. 8, 1966, 80 Stat. 101.)

EFFECTIVE DATE

Section 1(b)(3) of Pub. L. 89–384 provided that: "The amendments made by this subsection [adding this section] shall apply to taxable years beginning after December 31, 1965, but only with respect to losses described in section 80(a)(2) of the Internal Revenue Code of 1954 (as added by paragraph (1) of this subsection) [subsec. (a)(2) of this section] which were sustained after December 31, 1958."

§ 81. Increases in suspense account under section 166(g).

The amount of any increase in the suspense account required by paragraph (4)(B)(ii) of section 166(g) (relating to certain debt obligations guaranteed by dealers) shall be included in gross income for the taxable year for which such increase is required. (Added Pub. L. 89–722, § 1(b)(1), Nov. 2, 1966, 80 Stat. 1152.)

EFFECTIVE DATE

Section applicable, except as otherwise provided, to taxable years ending after Oct. 21, 1965, see section 2 of Pub. L. 89–722, set out as a note under section 166 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 166 of this title.

§ 82. Reimbursement for expenses of moving.

There shall be included in gross income (as compensation for services) any amount received or accrued, directly or indirectly, by an individual as a payment for or reimbursement of expenses of moving from one residence to another residence which is attributable to employment or self-employment. (Added Pub. L. 91–172, title II, § 231(b), Dec. 30, 1969, 83 Stat. 579.)

EFFECTIVE DATE

Section applicable to taxable years beginning after December 31, 1969, except that it does not apply to moving expenses paid or incurred before July 1, 1970, in connection with the commencement of work by the taxpayer as an employee at a new principal place of work of which the taxpayer had been notified by his employer on or before December 19, 1969, see section 231(d) of Pub. L. 91–172, set out as a note under section 217 of this title.

§ 83. Property transferred in connection with performance of services.

(a) General rule.

If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property,

shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) Election to include in gross income in year of transfer.

(1) In general.

Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income for the taxable year in which such property is transferred, the excess of—

(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over

(B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) Election.

An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary or his delegate prescribes and shall be made not later than 30 days after the date of such transfer (or, if later, 30 days after the date of the enactment of the Tax Reform Act of 1969). Such election may not be revoked except with the consent of the Secretary or his delegate.

(c) Special rules.

For purposes of this section—

(1) Substantial risk of forfeiture.

The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

(2) Transferability of property.

The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

(d) Certain restrictions which will never lapse.

(1) Valuation.

In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary or his delegate, and the burden of proof shall be on the Secretary or his delegate with respect to such value.

(2) Cancellation.

If, in the case of property subject to a restriction which by its terms will never lapse, the restriction is canceled, then, unless the taxpayer establishes—

(A) that such cancellation was not compensatory, and

(B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary or his delegate shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of—

(C) the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(D) the amount, if any, paid for the cancellation,

shall be treated as compensation for the taxable year in which such cancellation occurs.

(e) Applicability of section.

This section shall not apply to—

(1) a transaction to which section 421 applies,

(2) a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2)

(3) the transfer of an option without a readily ascertainable fair market value, or

(4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant.

(f) Holding period.

In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

(g) Certain exchanges.

If property to which subsection (a) applies is exchanged for property subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject, and if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applied to such exchange, or if such exchange was pursuant to the exercise of a conversion privilege—

(1) such exchange shall be disregarded for purposes of subsection (a), and

(2) the property received shall be treated as property to which subsection (a) applies.

(h) Deduction by employer.

In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

(i) Transition rules.

This section shall apply to property transferred after June 30, 1969, except that this section shall not apply to property transferred—

(1) pursuant to a binding written contract entered into before April 22, 1969,

(2) upon the exercise of an option granted before April 22, 1969,

(3) before May 1, 1970, pursuant to a written plan adopted and approved before July 1, 1969,

(4) before January 1, 1973, upon the exercise of an option granted pursuant to a binding written contract entered into before April 22, 1969, between a corporation and the transferor requiring the transferor to grant options to employees of such corporation (or a subsidiary of such corporation) to purchase a determinable number of shares of stock of such corporation, but only if the transferee was an employee of such corporation (or a subsidiary of such corporation) on or before April 22, 1969, or

(5) in exchange for (or pursuant to the exercise of a conversion privilege contained in) property transferred before July 1, 1969, or for property to which this section does not apply (by reason of paragraphs (1), (2), (3), or (4)), if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies, or if gain or loss is not otherwise required to be recognized upon the exercise of such conversion privilege, and if the property received in such exchange is subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject.

(Added Pub. L. 91–172, title III, § 321(a), Dec. 30, 1969, 83 Stat. 588.)

EFFECTIVE DATE

Section 321(d) of Pub. L. 91–172 provided that: "The amendments made by subsections (a) and (c) [to sections 402(b), 403(c) and (d), and 404(a)(5) of this title] shall apply to taxable years ending after June 30, 1969. The amendments made by subsection (b) [enacting this section] shall apply with respect to contributions made and premiums paid after August 1, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 402, 403, 1348 of this title.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

Sec.

101. Certain death payments.
102. Gifts and inheritances.
103. Interest on certain governmental obligations.
104. Compensation for injuries or sickness.
105. Amounts received under accident and health plans.
106. Contributions by employer to accident and health plans.
107. Rental value of parsonages.
108. Income from discharge of indebtedness.
109. Improvements by lessee on lessor's property.
110. Income taxes paid by lessee corporation.
111. Recovery of bad debts, prior taxes, and delinquency amounts.
112. Certain combat pay of members of the Armed Forces.
113. Mustering-out payments for members of the Armed Forces.
114. Sports programs conducted for the American National Red Cross.
115. Income of States, municipalities, etc.
116. Partial exclusion of dividends received by individuals.
117. Scholarships and fellowship grants.
118. Contributions to the capital of a corporation.
119. Meals or lodging furnished for convenience of employer.
121. Gain from sale or exchange of residence of individual who has attained age 65.
122. Certain reduced uniformed services retirement pay.
123. Amounts received under insurance contracts for certain living expenses.
124. Cross references to other Acts.

AMENDMENTS

1969—Pub. L. 91–172, title IX, § 901(b), Dec. 30, 1969, 83 Stat. 709, redesignated former item 123 as 124, and added item 123.

1966—Pub. L. 89–365, § 1(a)(2), Mar. 8, 1966, 80 Stat. 32, redesignated former item 122 as 123, and added item 122.

1964—Pub. L. 88–272, title II, § 206(b)(2), Feb. 26, 1964, 78 Stat. 40, redesignated item 121 as 122, and added item 121.

1958—Pub. L. 85–866, title I, § 3(b), Sept. 2, 1958, 72 Stat. 1607, eliminated item 120.

§ 101. Certain death benefits.

(a) Proceeds of life insurance contracts payable by reason of death.

(1) General rule.

Except as otherwise provided in paragraph (2) and in subsection (d), gross income does not include amounts received (whether in a single sum

or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.

(2) Transfer for valuable consideration.

In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by paragraph (1) shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee. The preceding sentence shall not apply in the case of such a transfer—

(A) if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor, or

(B) if such transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

(b) Employees' death benefits.

(1) General rule.

Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) Special rules for paragraph (1).

(A) $5,000 limitation.

The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5,000.

(B) Nonforfeitable rights.

Paragraph (1) shall not apply to amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. This subparagraph shall not apply to total distributions payable (as defined in section 402 (a) (3)) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death—

(i) by a stock bonus, pension, or profit-sharing trust described in section 401 (a) which is exempt from tax under section 501 (a),

(ii) under an annuity contract under a plan described in section 403(a), or

(iii) under an annuity contract purchased by an employer which is an organization referred to in seetion 170(b)(1)(A)(ii) or (vi) or which is a religious organization (other than a trust) and which is exempt from tax under section 501(a), but only with respect to the portion of such total distributions payable which bears the same ratio to the amount of such total distributions payable which is (without regard to this subsection) includible in gross income, as the amounts contributed by the employer for such annuity contract which are excludable from gross income under section 403(b) bear the total amounts contributed by the employer for such annuity contract.

(C) Joint and survivor annuities.

Paragraph (1) shall not apply to amounts received by a surviving annuitant under a joint and survivor's annuity contract after the first day of the first period for which an amount was received as an annuity by the employee (or would have been received if the employee had lived).

(D) Other annuities.

In the case of any amount to which section 72 (relating to annuities, etc.) applies, the amount which is excludable under paragraph (1) (as modified by the preceding subparagraphs of this paragraph) shall be determined by reference to the value of such amount as of the day on which the employee died. Any amount so excludable under paragraph (1) shall, for purposes of section 72, be treated as additional consideration paid by the employee. Paragraph (1) shall not apply in the case of an annuity under chapter 73 of title 10 of the United States Code if the individual who made the election under such chapter died after attaining retirement age.

(3) Self-employed individual not considered an employee.

For purposes of this subsection, the term "employee" does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).

(c) Interest.

If any amount excluded from gross income by subsection (a) or (b) is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

(d) Payment of life insurance proceeds at a date later than death.

(1) General rule.

The amounts held by an insurer with respect to any beneficiary shall be prorated (in accordance with such regulations as may be prescribed by the Secretary or his delegate) over the period or periods with respect to which such payments are to be made. There shall be excluded from the gross income of such beneficiary in the taxable year received—

(A) any amount determined by such proration, and

(B) in the case of the surviving spouse of the insured, that portion of the excess of the amounts received under one or more agreements specified in paragraph (2) (A) (whether or not payment of any part of such amounts is guaranteed by the insurer) over the amount determined in subparagraph (A) of this paragraph which is not greater than $1,000 with respect to any insured.

Gross income includes, to the extent not excluded by the preceding sentence, amounts received under agreements to which this subsection applies.

(2) Amount held by an insurer.

An amount held by an insurer with respect to any beneficiary shall mean an amount to which subsection (a) applies which is—

(A) held by any insurer under an agreement provided for in the life insurance contract, whether as an option or otherwise, to pay such amount on a date or dates later than the death of the insured, and

(B) is equal to the value of such agreement to such beneficiary

(i) as of the date of death of the insured (as if any option exercised under the life insurance contract were exercised at such time), and

(ii) as discounted on the basis of the interest rate and mortality tables used by the insurer in calculating payments under the agreement.

(3) Surviving spouse.

For purposes of this subsection, the term "surviving spouse" means the spouse of the insured as of the date of death, including a spouse legally separated but not under a decree of absolute divorce.

(4) Application of subsection.

This subsection shall not apply to any amount to which subsection (c) is applicable.

(e) Alimony, etc., payments.

(1) In general.

This section shall not apply to so much of any payment as is includible in the gross income of the wife under section 71 (relating to alimony) or section 682 (relating to income of an estate or trust in case of divorce, etc.).

(2) Cross reference.

For definition of "wife", see section 7701 (a) (17).

(f) Effective date of section.

This section shall apply only to amounts received by reason of the death of an insured or an employee occurring after the date of enactment of this title. Section 22 (b) (1) of the Internal Revenue Code of 1939 shall apply to amounts received by reason of the death of an insured or an employee occurring on or before such date. (Aug. 16, 1954, ch. 736, 68A Stat. 26; Sept. 2, 1958, Pub. L. 85–866, title I, § 23(d), 72 Stat. 1622; Oct. 10, 1962, Pub. L. 87–792, § 7(c), 76 Stat. 829; Mar. 8, 1966, Pub. L. 89–365, § 1(c), 80 Stat. 32; Dec. 30, 1969, Pub. L. 91–172, title I, § 101 (j)(1), 83 Stat. 526.)

REFERENCES IN TEXT

Date of enactment of this title, referred to in subsec. (f), is Aug. 16, 1954.

AMENDMENTS

1969—Subsec. (b)(2)(B)(iii). Pub. L. 91–172 substituted references to section 170(b)(1)(A) (ii) and (vi), and to religious organizations, for references to section 503(b)(1), 2, or 3.

1966—Subsec. (b)(2)(D). Pub. L. 89–365 provided that par. (1) shall not apply in the case of an annuity under chapter 73 of Title 10 if the individual who made the election under that chapter died after attaining retirement age.

1962—Subsec. (b)(2)(B). Pub. L. 87–792, § 7(c)(1), substituted "described in section 403(a)" for "which meets the requirements of paragraphs (3), (4), (5), and (6) of section 401(a)" in cl. (ii).

Subsec. (b)(3). Pub. L. 87–792, § 7(c)(2), added subsec. (b)(3).

1958—Subsec. (b)(2)(B). Pub. L. 85–866 substituted "This subparagraph shall not apply to total distributions payable (as defined in section 402(a)(3) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death—" for "(other than total distributions payable, as defined in section 402(a)(3), which are paid to distributee, by a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a), or under an annuity contract under a plan which meets the requirements of paragraphs (3), (4), (5), and (6) of section 401(a), within one taxable year of the distributee by reason of the employee's death)", and added clauses (i), (ii), and (iii).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L., 91–172 to take effect on Jan. 1, 1970, see section 101(k)(1) of Pub. 91–172, set out as a note under section 4940 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsec. (b)(2)(D) by Pub. L. 89–365 applicable with respect to individuals making an election under chapter 73 of Title 10 who died after Dec. 31, 1965, see section 1(d) of Pub. L. 89–365, set out as a note under section 122 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (b)(2)(B) by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1957, see section 23(g) of Pub. L. 85–866, set out as a note under section 403 of this title.

CROSS REFERENCES

Basis rules of general application, see section 1011 et seq. of this title.

Employee defined, see section 7701 (a) (20) of this title.

Limitation on retirement income as inapplicable to amount excluded from gross income under this section relating to life insurance proceeds, see section 37 of this title.

Rules and regulations, see section 7805 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 72, 406, 407, 872, 7701 of this title.

SECTION REFERRED TO IN D.C. CODE

This section is referred to in section 46–301 of the District of Columbia Code.

§ 102. Gifts and inheritances.

(a) General rule.

Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

(b) Income.

Subsection (a) shall not exclude from gross income—

(1) the income from any property referred to in subsection (a); or

(2) where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.

Where, under the terms of the gift, bequest, devise, or inheritance, the payment, crediting, or distribution thereof is to be made at intervals, then, to the extent that it is paid or credited or to be distributed out of income from property, it shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property. Any amount included in the gross income of a beneficiary under subchapter J shall be treated for purposes of

paragraph (2) as a gift, bequest, devise, or inheritance of income from property. (Aug. 16, 1954, ch. 736, 68A Stat. 28.)

CROSS REFERENCES

Estate tax, see section 2001 et seq. of this title.
Gift tax, see section 2501 et seq. of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 274 of this title.

§ 103. Interest on certain governmental obligations.

(a) General rule.

Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia;

(2) the obligations of the United States; or

(3) the obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

(b) Exception.

Subsection (a) (2) shall not apply to interest on obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit, to the extent they represent deposits made before March 1, 1941), unless under the respective Acts authorizing the issuance thereof such interest is wholly exempt from the taxes imposed by this subtitle.

(c) Industrial development bonds.

(1) Subsection (a)(1) not to apply.

Except as otherwise provided in this subsection, any industrial development bond shall be treated as an obligation not described in subsection (a) (1).

(2) Industrial development bond.

For purposes of this subsection, the term "industrial development bond" means any obligation—

(A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person (within the meaning of paragraph (3)), and

(B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part—

(i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or

(ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

(3) Exempt person.

For purposes of paragraph (2)(A), the term "exempt person" means—

(A) a governmental unit, or

(B) an organization described in section 501 (c) (3) and exempt from tax under section 501 (a) (but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business, determined by applying section 513(a) to such organization).

(4) Certain exempt activities.

Paragraph (1) shall not apply to any obligation which is issued as part of an issue substantially all of the proceeds of which are to be used to provide—

(A) residential real property for family units,

(B) sports facilities,

(C) convention or trade show facilities,

(D) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to any of the foregoing,

(E) sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy, gas, or water, or

(F) air or water pollution control facilities.

(5) Industrial parks.

Paragraph (1) shall not apply to any obligation issued as part of an issue substantially all of the proceeds of which are to be used for the acquisition or development of land as the site for an industrial park. For purposes of the preceding sentence, the term "development of land" includes the provision of water, sewage, drainage, or similar facilities, or of transportation, power, or communication facilities, which are incidental to use of the site as an industrial park, but, except with respect to such facilities, does not include the provision of structures or buildings.

(6) Exemption for certain small issues.

(A) In general.

Paragraph (1) shall not apply to any obligation issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and substantially all of the proceeds of which are to be used (i) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or (ii) to redeem part or all of a prior issue which was issued for purposes described in clause (i) or this clause.

(B) Certain prior issues taken into account.

If—

(i) the proceeds of two or more issues of obligations (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same country (but not in any incorporated municipality),

(ii) the principal user of such facilities is or will be the same person or two or more related persons, and

(iii) but for this subparagraph, subparagraph (A) would apply to each such issue,

then, for purposes of subparagraph (A), in determining the aggregate face amount of any later issue there shall be taken into account the face amount of obligations issued under all prior such issues and outstanding at the time of such

later issue (not including as outstanding any obligation which is to be redeemed from the proceeds of the later issue).

(C) Related persons.

For purposes of this paragraph and paragraph (7), a person is a related person to another person if—

(i) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

(ii) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein).

(D) $5,000,000 limit in certain cases.

At the election of the issuer, made at such time and in such manner as the Secretary or his delegate shall by regulations prescribe, with respect to any issue this paragraph shall be applied—

(i) by substituting "$5,000,000" for "$1,000,000" in subparagraph (A), and

(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in subparagraph (B), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (E) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of proceeds of outstanding issues to which subparagraph (A) applied), as if the aggregate amount of such capital expenditures constituted the face amount a prior outstanding issue described in subparagraph (B).

(E) Facilities taken into account.

For purposes of subparagraph (D)(ii), the facilities described in this subparagraph are facilities—

(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

(ii) the principal user of which is or will be the same person or two or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

(F) Certain capital expenditures not taken into account.

For purposes of subparagraph (D)(ii), any capital expenditure—

(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance, or

(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed $250,000),

shall not be taken into account.

(G) Limitation on loss of tax exemption.

In applying subparagraph (D)(ii) with respect to capital expenditures made after the date of any issue, no obligation issued as a part of such issue shall be treated as an obligation not described in subsection (a)(1) by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

(H) Certain refinancing issues.

In the case of any issue described in subparagraph (A)(ii), an election may be made under subparagraph (D) only if all of the prior issues being redeemed are issues to which subparagraph (A) applies. In applying subparagraph (D)(ii) with respect to such a refinancing issue, capital expenditures shall be taken into account only for purposes of determining whether the prior issues being redeemed qualified (and would have continued to qualify) under subparagraph (A).

(7) Exception.

Paragraphs (4), (5), and (6) shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of the facilities or a related person.

(d) Arbitrage bonds.

(1) Subsection (a)(1) not to apply.

Except as provided in this subsection, any arbitrage bond shall be treated as an obligation not described in subsection (a)(1).

(2) Arbitrage bond.

For purposes of this subsection, the term "arbitrage bond" means any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly—

(A) to acquire securities (within the meaning of section 165(g)(2)(A) or (B)) or obligations (other than obligations described in subsection (a)(1)) which may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue which is materially higher (taking into account any discount or premium) than the yield on obligations of such issue, or

(B) To replace funds which were used directly or indirectly to acquire securities or obligations described in subparagraph (A).

(3) Exceptions.

Paragraph (1) shall not apply to any obligation—

(A) which is issued as part of an issue substantially all of the proceeds of which are

reasonably expected to be used to provide permanent financing for real property used or to be used for residential purposes for the personnel of an educational institution (within the meaning of section 151(e)(4)) which grants baccalaureate or higher degrees, or to replace funds which were so used, and

(B) the yield on which over the term of the issue is not reasonably expected, at the time of issuance of such issue, to be substantially lower than the yield on obligations acquired or to be acquired in providing such financing.

This paragraph shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of property financed by the proceeds of the issue of which such obligation is a part, or by a member of the family (within the meaning of section 318(a)(1)) of any such person.

(4) Special rules.

For purposes of paragraph (1), an obligation shall not be treated as an arbitrage bond solely by reason of the fact that—

(A) the proceeds of the issue of which such obligation is a part may be invested for a temporary period in securities or other obligations until such proceeds are needed for the purpose for which such issue was issued, or

(B) an amount of the proceeds of the issue of which such obligation is a part may be invested in securities or other obligations which are part of a reasonably required reserve or replacement fund.

The amount referred to in subparagraph (B) shall not exceed 15 percent of the proceeds of the issue of which such obligation is a part unless the issuer establishes that a higher amount is necessary.

(5) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

(e) Cross references.

For provisions relating to the taxable status of—

(1) Bonds and certificates of indebtedness authorized by the First Liberty Bond Act, see sections 1 and 6 of that Act (40 Stat. 35, 36; 31 U. S. C. 746, 755);

(2) Bonds issued to restore or maintain the gold reserve, see section 2 of the Act of March 14, 1900 (31 Stat. 46; 31 U. S. C. 408);

(3) Bonds, notes, certificates of indebtedness, and Treasury bills authorized by the Second Liberty Bond Act, see sections 4, 5 (b) and (d), 7, 18 (b), and 22 (d) of that Act, as amended (40 Stat. 290; 46 Stat. 20, 775; 40 Stat. 291, 1310; 55 Stat. 8; 31 U. S. C. 752a, 754, 747, 753, 757c);

(4) Bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation owned by certain nonresidents, see section 3 of the Fourth Liberty Bond Act, as amended (40 Stat. 1311, § 4; 31 U. S. C. 750);

(5) Certificates of indebtedness issued after February 4, 1910, see section 2 of the Act of that date (36 Stat. 192; 31 U. S. C. 769);

(6) Consols of 1930, see section 11 of the Act of March 14, 1900 (31 Stat. 48; 31 U. S. C. 751);

(7) Obligations and evidences of ownership issued by the United States or any of its agencies or instrumentalities on or after March 28, 1942, see section 4 of the Public Debt Act of 1941, as amended (c. 147, 61 Stat. 180; 31 U. S. C. 742a);

(8) Commodity Credit Corporation obligations, see section 5 of the Act of March 8, 1938 (52 Stat. 103; 15 U. S. C. 713a-5);

(9) Debentures issued by Federal Housing Administrator, see sections 204 (d) and 207 (i) of the National Housing Act, as amended (52 Stat. 14, 20; 12 U. S. C. 1710, 1713);

(10) Debentures issued to mortgagees by United States Maritime Commission, see section 1105 (c) of the Merchant Marine Act, 1936, as amended (52 Stat. 972; 46 U. S. C. 1275);

(11) Federal Deposit Insurance Corporation obligations, see section 15 of the Federal Deposit Insurance Act (64 Stat. 890; 12 U. S. C. 1825);

(12) Federal Home Loan Bank obligations, see section 13 of the Federal Home Loan Bank Act, as amended (49 Stat. 295, § 8; 12 U. S. C. 1433);

(13) Federal savings and loan association loans, see section 5 (h) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 133; 12 U. S. C. 1464);

(14) Federal Savings and Loan Insurance Corporation obligations, see section 402 (e) of the National Housing Act (48 Stat. 1257; 12 U. S. C. 1725);

(15) Home Owners' Loan Corporation bonds, see section 4 (c) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 644, c. 168; 12 U. S. C. 1463);

(16) Obligations of Central Bank for Cooperatives, production credit corporations, production credit associations, and banks for cooperatives, see section 63 of the Farm Credit Act of 1933 (48 Stat. 267; 12 U. S. C. 1138c);

(17) Panama Canal bonds, see section 1 of the Act of December 21, 1904 (34 Stat. 5; 31 U. S. C. 743), section 8 of the Act of June 28, 1902 (32 Stat. 484; 31 U. S. C. 744), and section 39 of the Tariff Act of 1909 (36 Stat. 117; 31 U. S. C. 745);

(18) Philippine bonds, etc., issued before the independence of the Philippines, see section 9 of the Philippine Independence Act (48 Stat. 463; 48 U. S. C. 1239);

(19) Postal savings bonds, see section 10 of the Act of June 25, 1910 (36 Stat. 817; 39 U. S. C. 760);

(20) Puerto Rican bonds, see section 3 of the Act of March 2, 1917, as amended (50 Stat. 844; 48 U. S. C. 745);

(21) Treasury notes issued to retire national bank notes, see section 18 of the Federal Reserve Act (38 Stat. 268; 12 U. S. C. 447);

(22) United States Housing Authority obligations, see sections 5 (e) and 20 (b) of the United States Housing Act of 1937 (50 Stat. 890, 898; 42 U. S. C. 1405, 1420);

(23) Virgin Islands insular and municipal bonds, see section 1 of the Act of October 27, 1949 (63 Stat. 940; 48 U. S. C. 1403).

(Aug. 16, 1954, ch. 736, 68A Stat. 29; June 28, 1968, Pub. L. 90-364, title I, § 107(a), 82 Stat. 266; Oct. 24, 1968, Pub. L. 90-634, title IV, § 401(a), 82 Stat. 1349; Dec. 30, 1969, Pub. L. 91-172, title VI, § 601(a), 83 Stat. 656.)

REFERENCES IN TEXT

Section 2 of the act of March 14, 1900 (31 Stat. 46; 31 U.S.C. 408), referred to in subsec. (e)(2), was repealed by Pub. L. 90-262, § 10, Mar. 18, 1968, 82 Stat. 51.

Section 7 of the Second Liberty Bond Act (31 U.S.C. 747), referred to in subsec. (e)(3), was repealed by Pub. L. 86-346, title I, § 105(b)(2), Sept. 22, 1959, 73 Stat. 622, and is now covered by section 742 of Title 31, Money and Finance.

Section 4(c) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1463), referred to in subsec. (e)(15), was omitted from the code. See notes under former section 1463 of Title 12, Banks and Banking.

Section 9 of the Philippine Independence Act (48 U.S.C. 1239), referred to in subsec. (e)(18), was omitted from the code. See notes under former sections 1010—1276e of Title 48, Territories and Insular Possessions.

Section 10 of the act of June 25, 1910 (39 U.S.C. 760), referred to in subsec. (e)(19), was repealed by Pub. L. 86-682, § 12(c), Sept. 2, 1960, 74 Stat. 708.

AMENDMENTS

1969—Subsec. (d). Pub. L. 91-172 added subsec. (d). Former subsec. (d) redesignated (e).

Subsec. (e). Pub. L. 91-172 redesignated former subsec. (d) as (e).

1968—Subsec. (c). Pub. L. 90-364 added subsec. (c). Former subsec. (c) redesignated (d).

Subsec. (c)(6)(D)—(H). Pub. L. 90-634 added subsec. (c)(6)(D)—(H).

Subsec. (d). Pub. L. 90-364 redesignated former subsec. (c) as (d).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 601(b) of Pub. L. 91-172 provided that: "The amendments made by subsection (a) [amending this section] shall apply with respect to obligations issued after October 9, 1969."

EFFECTIVE DATE OF 1968 AMENDMENTS

Section 401(b) of Pub. L. 90-634 provided that: "The amendment made by subsection (a) [amending this section] shall apply with respect to obligations issued after the date of the enactment of this Act [Oct. 24, 1968]."

Section 107(b)(1) of Pub. L. 90–364 provided that: "Except as provided by paragraph (2) [set out as a note below], the amendment made by subsection (a) [adding subsec. (c) of this section] shall apply to taxable years ending after April 30, 1968, but only with respect to obligations issued after such date."

TRANSITIONAL PROVISIONS FOR INDUSTRIAL DEVELOPMENT BONDS ISSUED BEFORE JANUARY 1, 1969

Section 107(b)(2) of Pub. L. 90–364 provided that: "Section 103(c)(1) of the Internal Revenue Code of 1954, as amended by subsection (a) [subsec. (c)(1) of this section], shall not apply with respect to any obligation issued before January 1, 1969, if before May 1, 1968—

"(A) the issuance of the obligation (or the project in connection with which the proceeds of the obligations are to be used) was authorized or approved by the governing body of the governmental unit issuing the obligation or by the voters of such governmental unit;

"(B) in connection with the issuance of such obligation or with the use of the proceeds to be derived from the sale of such obligation or the property to be acquired or improved with such proceeds, a governmental unit has made a significant financial commitment;

"(C) any person (other than a governmental unit) who will use the proceeds to be derived from the sale of such obligation or the property to be acquired or improved with such proceeds has expended (or has entered into a binding contract to expend) for purposes which are related to the use of such proceeds or property, an amount equal to or in excess of 20 percent of such proceeds; or

"(D) in the case of an obligation issued in conjunction with a project where financial assistance will be provided by a governmental agency concerned with economic development, such agency has approved the project or an application for financial assistance is pending."

CROSS REFERENCES

Bonds and other evidences of indebtedness having tax-free interest as not subject to special rules for determining capital gains and losses, see section 1232 of this title.

Credits against tax of partially tax-exempt interest received by individuals, see section 35 of this title.

Estates, trusts and beneficiaries, tax-exempt interest in determining distributable net income, see section 643 of this title.

Insurance company taxable income as gross income less, among others, deduction for tax-free interest, see section 832 of this title.

Life insurance companies, taxable income as gross income minus, among others, deduction for tax-free interest, see section 803 of this title.

Mutual insurance companies, gross amount of income as subject to deduction, among others of interest under this section, see section 821 of this title.

Mutual insurance companies, taxable income as gross investment income minus, among others, deduction for tax-free interest, see section 822 of this title.

Partially tax-exempt interest deduction for corporations, see section 242 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 593, 643, 804, 809, 818, 819, 822, 832, 1232, 4940, 4942, 6049 of this title; title 15 sections 77c, 78c.

§ 104. Compensation for injuries or sickness.

(a) In general.

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22 U.S.C. 1081; 60 Stat. 1021).

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee.

(b) Cross references.

(1) For exclusion from employee's gross income of employer contributions to accident and health plans, see section 106.

(2) For exclusion of part of disability retirement pay from the application of subsection (a) (4) of this section, see section 402 (h) of the Career Compensation Act of 1949 (37 U. S. C. 272 (h)).

(Aug. 16, 1954, ch. 736, 68A Stat. 30; Sept. 8, 1960, Pub. L. 86–723, § 51, 74 Stat. 847; Oct. 10, 1962, Pub. L. 87–792, § 7(d), 76 Stat. 829.)

REFERENCES IN TEXT

Section 402 (h) of Career Compensation Act of 1949 (37 U. S. C. 272 (h)), referred to in par. (2) of subsec. (b), was repealed by act Aug. 10, 1956, ch. 1041, § 53, 70A Stat. 641. See section 1403 of Title 10, Armed Forces.

AMENDMENTS

1962—Subsec. (a). Pub. L. 87–792 inserted sentence requiring contributions made on behalf of an individual who is, or has been, an employee within the meaning of section 401(c)(1), while he was such an employee to a trust which is exempt from tax, or under a plan described in section 403(a), to be treated as contributions by the employer which were not includible in the gross income of the employee.

1960—Subsec. (a)(4). Pub. L. 86–723 provided for exclusion from gross income of amounts received as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of subsec. (a)(4) by Pub. L. 86–723 effective with respect to taxable years ending after Sept. 8, 1960, see section 56(e) of Pub. L. 86–723, set out as a note under section 809 of Title 22, Foreign Relations and Intercourse.

TRANSFER OF FUNCTIONS

All functions of Public Health Service, of the Surgeon General of the Public Health Service, and of all other officers and employees of the Public Health Service, and all

functions of all agencies of or in the Public Health Service transferred to Secretary of Health, Education, and Welfare by 1966 Reorg. Plan No. 3, 31 F.R. 8855, 80 Stat. 1610, effective June 25, 1966, set out in the Appendix to Title 5, Government Organization and Employees.

The Environmental Science Services Administration in the Department of Commerce, including the offices of Administrator and Deputy Administrator thereof, were abolished by Reorg. Plan No. 4 of 1970, eff. Oct. 30, 1970, 35 F.R. 15627, 84 Stat. ------, set out in the Appendix to Title 5, Government Organization and Employees, which created the National Oceanic and Atmospheric Administration in the Department of Commerce and transferred the personnel, property, records, and unexpended balances of funds of the Environmental Science Services Administration to such newly created National Oceanic and Atmospheric Administration. The components of the Environmental Science Services Administration thus transferred included the Weather Bureau, the Coast and Geodetic Survey, the Environmental Data Service, the National Environmental Satellite Center, and the ESSA Research Laboratories.

The Coast and Geodetic Survey was consolidated with the Weather Bureau of the Department of Commerce to form a new agency in the Department of Commerce to be known as the Environmental Science Services Administration by Reorg. Plan No. 2 of 1965, eff. July 13, 1965, 30 F.R. 8819, 79 Stat. 1318, set out in the Appendix to Title 5, Government Organization and Employees. All personnel (including commissioned officers) of the Survey and all property held or used by the Survey were deemed transferred to the Administration, and all functions of the Survey, not previously transferred by 1950 Reorg. Plan No. 5, were transferred to the Secretary of Commerce.

CROSS REFERENCES

Amounts received through accident or health insurance, treatment as, see section 105 of this title.

Disability retired pay, treatment under this title, see section 1403 of Title 10, Armed Forces.

Employee defined, see section 7701 (a) (20) of this title.

Limitation on retirement income inapplicable to exclusions under this section, see section 37 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 105, 7701 of this title; title 10 section 1403.

SECTION REFERRED TO IN D.C. CODE

This section is referred to in section 47–1557a of the District of Columbia Code.

§ 105. Amounts received under accident and health plans.

(a) Amounts attributable to employer contributions.

Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

(b) Amounts expended for medical care.

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213 (e)) of the taxpayer, his spouse, and his dependents (as defined in section 152).

(c) Payments unrelated to absence from work.

Gross income does not include amounts referred to in subsection (a) to the extent such amounts—

(1) constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement, of the taxpayer, his spouse, or a dependent (as defined in section 152), and

(2) are computed with reference to the nature of the injury without regard to the period the employee is absent from work.

(d) Wage continuation plans.

Gross income does not include amounts referred to in subsection (a) if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but this subsection shall not apply to the extent that such amounts exceed a weekly rate of $100. The preceding sentence shall not apply to amounts attributable to the first 30 calendar days in such period, if such amounts are at a rate which exceeds 75 percent of the regular weekly rate of wages of the employee (as determined under regulations prescribed by the Secretary or his delegate). If amounts attributable to the first 30 calendar days in such period are at a rate which does not exceed 75 percent of the regular weekly rate of wages of the employee, the first sentence of this subsection (1) shall not apply to the extent that such amounts exceed a weekly rate of $75, and (2) shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of personal injuries or sickness for at least one day during such period. If such amounts are not paid on the basis of a weekly pay period, the Secretary or his delegate shall by regulations prescribe the method of determining the weekly rate at which such amounts are paid.

(e) Accident and health plans.

For purposes of this section and section 104—

(1) amounts received under an accident or health plan for employees, and

(2) amounts received from a sickness and disability fund for employees maintained under the law of a State, a Territory, or the District of Columbia,

shall be treated as amounts received through accident or health insurance.

(f) Rules for application of section 213.

For purposes of section 213 (a) (relating to medical, dental, etc., expenses) amounts excluded from gross income under subsection (c) or (d) shall not be considered as compensation (by insurance or otherwise) for expenses paid for medical care.

(g) Self-employed individual not considered an employee.

For purposes of this section, the term "employee" does not include an individual who is an employee within the meaning of section 401 (c) (1) (relating to self-employed individuals). (Aug. 16, 1954, ch. 736, 68A Stat. 30; Oct. 10, 1962, Pub. L. 87–792, § 7(e), 76 Stat. 829; Feb. 26, 1964, Pub. L. 88–272, title II, § 205(a), 78 Stat. 38.)

AMENDMENTS

1964—Subsec. (d). Pub. L. 88–272 substituted provisions stating that "The preceding sentence shall not apply to amounts attributable to the first 30" days if

the amounts exceed 75 percent of regular weekly wages, and if they do not exceed said 75 percent, the first sentence of this subsection shall not apply to the extent the amounts exceed $75 weekly and shall not apply to amounts attributable to the first 7 calendar days unless the employee is hospitalized for injury or sickness for at least 1 day in such period, for provisions stating that said "preceding sentence" did not apply in cases of sickness, to amounts attributable to the first 7 days unless the employee was hospitalized for sickness for at least 1 day during such period.

1962—Subsec. (g). Pub. L. 87–792 added subsec. (g).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 205(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to subsec. (d) of this section] shall apply to amounts attributable to periods of absence commencing after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

CROSS REFERENCES

Employee defined, see section 7701 (a) (20) of this title.
Limitation on retirement income inapplicable to exclusions under this section, see section 37 of this title.
Rules and regulations, see section 7805 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 403, 7701 of this title.

§ 106. Contributions by employer to accident and health plans.

Gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to his employees for personal injuries or sickness. (Aug. 16, 1954, ch. 736, 68A Stat. 32.)

CROSS REFERENCES

Compensation for injuries or sickness, exclusion of, see section 104 of this title.
Employee defined, see section 7701 (a) (20) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 7701 of this title.

SECTION REFERRED TO IN D.C. CODE

This section is referred to in section 7–135 of the District of Columbia Code.

§ 107. Rental value of parsonages.

In the case of a minister of the gospel, gross income does not include—

(1) the rental value of a home furnished to him as part of his compensation; or

(2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

(Aug. 16, 1954, ch. 736, 68A Stat. 32.)

CROSS REFERENCES

Inclusion in gross income, see section 61 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1402 of this title; title 42 section 411.

§ 108. Income from discharge of indebtedness.

(a) Special rule of exclusion.

No amount shall be included in gross income by reason of the discharge, in whole or in part, within the taxable year, of any indebtedness for which the taxpayer is liable, or subject to which the taxpayer holds property, if—

(1) the indebtedness was incurred or assumed—

(A) by a corporation, or

(B) by an individual in connection with property used in his trade or business, and

(2) such taxpayer makes and files a consent to the regulations prescribed under section 1017 (relating to adjustment of basis) then in effect at such time and in such manner as the Secretary or his delegate by regulations prescribes.

In such case, the amount of any income of such taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income, and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction.

(b) Railroad corporations.

No amount shall be included in gross income by reason of the discharge, cancellation, or modification, in whole or in part, within the taxable year, of any indebtedness of a railroad corporation, as defined in section 77(m) of the Bankruptcy Act (11 U.S.C. 205(m)), if such discharge, cancellation, or modification is effected pursuant to an order of a court—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77 of the Bankruptcy Act,

commenced before January 1, 1960. In such cases, the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income, and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. Subsection (a) of this section shall not apply with respect to any discharge of indebtedness to which this subsection applies. (Aug. 16, 1954, ch. 736, 68A Stat. 32; June 29, 1956, ch. 463, § 5, 70 Stat. 403; June 8, 1960, Pub. L. 86–496, § 1(a), 74 Stat. 164.)

AMENDMENTS

1960—Subsec. (b). Pub. L. 86–496 provided that if the discharge, cancellation, or modification of any indebtedness is effected pursuant to a court order in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act, commenced before Jan. 1, 1960, then no amount is to be included in gross income with respect to it, and eliminated provisions which made subsection inapplicable to discharges occurring in a taxable year beginning after Dec. 31, 1957.

1956—Subsec. (b) amended by act June 29, 1956, which substituted "December 31, 1957" for "December 31, 1955".

EFFECTIVE DATE OF 1960 AMENDMENT

Section 1(b) of Pub. L. 86–496 provided that: "The amendment made by subsection (a) [to subsec. (b) of this section] shall apply to taxable years ending after December 31, 1959, but only with respect to discharges occurring after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1017 of this title.

§ 109. Improvements by lessee on lessor's property.

Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee. (Aug. 16, 1954, ch. 736, 68A Stat. 33.)

CROSS REFERENCES

Basic rule for property on which lessee has made improvements, see section 1019 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1019 of this title.

§ 110. Income taxes paid by lessee corporation.

If—

(1) a lease was entered into before January 1, 1954,

(2) both lessee and lessor are corporations, and

(3) under the lease, the lessee is obligated to pay, or to reimburse the lessor for, any part of the tax imposed by this subtitle on the lessor with respect to the rentals derived by the lessor from the lessee,

then gross income of the lessor does not include such payment or reimbursement, and no deduction for such payment or reimbursement shall be allowed to the lessee. For purposes of the preceding sentence, a lease shall be considered to have been entered into before January 1, 1954, if it is a renewal or continuance of a lease entered into before such date and if such renewal or continuance was made in accordance with an option contained in the lease on December 31, 1953. (Aug. 16, 1954, ch. 736, 68A Stat. 33.)

§ 111. Recovery of bad debts, prior taxes, and delinquency amounts.

(a) General rule.

Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.

(b) Definitions.

For purposes of subsection (a)—

(1) Bad debt.

The term "bad debt" means a debt on account of the worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

(2) Prior tax.

The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

(3) Delinquency amount.

The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time required by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

(4) Recovery exclusion.

The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Secretary or his delegate, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this subtitle (not including the accumulated earnings tax imposed by section 531 or the tax on personal holding companies imposed by section 541) or corresponding provisions of prior income tax laws (other than subchapter E of chapter 2 of the Internal Revenue Code of 1939, relating to World War II excess profits tax), reduced by the amount excludable in previous taxable years with respect to such debt, tax, or amount under this section.

(c) Special rules for accumulated earnings tax and for personal holding company tax.

In applying subsections (a) and (b) for the purpose of determining the accumulated earnings tax under section 531 or the tax under section 541 (relating to personal holding companies)—

(1) a recovery exclusion allowed for purposes of this subtitle (other than section 531 or section 541) shall be allowed whether or not the bad debt, prior tax, or delinquency amount resulted in a reduction of the tax under section 531 or the tax under section 541 for the prior taxable year; and

(2) where a bad debt, prior tax, or delinquency amount was not allowable as a deduction or credit for the prior taxable year for purposes of this subtitle other than of section 531 or section 541 but was allowable for the same taxable year under section 531 or section 541, then a recovery exclusion shall be allowable if such bad debt, prior tax, or delinquency amount did not result in a reduction of the tax under section 531 or the tax under section 541.

(Aug. 16, 1954, ch. 736, 68A Stat. 33.)

CROSS REFERENCES

Additions to the tax and additional amounts—
Failure to file tax return, see section 6651 of this title.
Failure to pay tax, see section 6653 of this title.
Penalties for willful failure to—
File return, or pay tax, see section 7203 of this title.
Pay over tax, see section 7202 of this title.
Recovery of bad debts, prior taxes, or delinquency amounts as item of distributor or transferor corporation with respect to carryovers in certain corporate acquisitions, see section 381 of this title.
Rules and regulations, see section 7805 of this title.
Tax adjustment measured by prior benefits with respect to war loss recoveries, see section 1333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 381, 1333, 1351 of this title.

§ 112. Certain combat pay of members of the Armed Forces.

(a) Enlisted personnel.

Gross income does not include compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member—

(1) served in a combat zone during an induction period, or

(2) was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone during an induction period; but this paragraph shall not apply for any month during any part of which there are no combatant activities in any combat zone as determined under subsection (c) (3) of this section.

(b) Commissioned officers.

Gross income does not include so much of the compensation as does not exceed $500 received for active service as a commissioned officer in the Armed Forces of the United States for any month during any part of which such officer—

(1) served in a combat zone during an induction period, or

(2) was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone during an induction period; but this paragraph shall not apply for any month during any part of which there are no combatant activities in any combat zone as determined under subsection (c) (3) of this section.

(c) Definitions.

For purposes of this section—

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

(2) The term "combat zone" means any area which the President of the United States by Executive Order designates, for purposes of this section or corresponding provisions of prior income tax laws, as an area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat.

(3) Service is performed in a combat zone only if performed on or after the date designated by the President by Executive Order as the date of the commencing of combatant activities in such zone, and on or before the date designated by the President by Executive Order as the date of the termination of combatant activities in such zone; except that June 25, 1950, shall be considered the date of the commencing of combatant activities in the combat zone designated in Executive Order 10195.

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

(5) The term "induction period" means any period during which, under laws heretofore or hereafter enacted relating to the induction of individuals for training and service in the Armed Forces of the United States, individuals (other than individuals liable for induction by reason of a prior deferment) are liable for induction for such training and service.

(Aug. 16, 1954, ch. 736, 68A Stat. 34; Nov. 2, 1966, Pub. L. 89–739, § 1, 80 Stat. 1165.)

AMENDMENTS

1966—Subsec. (b). Pub. L. 89–739 substituted "$500" for "$200."

EFFECTIVE DATE OF 1966 AMENDMENT

Section 2 of Pub. L. 89–739 provided that: "The amendment made by the first section of this Act [amending subsec. (b) of this section] shall apply with respect to compensation received in taxable years ending after December 31, 1965, for periods of active service after such date."

EX. ORD. NO. 10585. TERMINATION OF COMBATANT ACTIVITIES IN KOREA

Ex. Ord. No. 10585, Jan. 1, 1955, 20 F.R. 17, provided: By virtue of the authority vested in me by section 112 (c) (3) of the Internal Revenue Code of 1954 [subsection (c) (3) of this section], January 31, 1955, as of midnight thereof, is hereby designated as the date of termination of combatant activities in the zone comprised of the area described in Executive Order No. 10195 of December 20, 1950 (15 F. R. 9177) [set out as a note under section 22 of Title 26 (I. R. C. 1939)].

DWIGHT D. EISENHOWER

EX. ORD. NO. 11216. DESIGNATION OF VIETNAM AND ADJACENT WATERS AS COMBAT ZONE

Ex. Ord. No. 11216, Apr. 24, 1965, 30 F.R. 5817, provided: Pursuant to the authority vested in me by section 112 of the Internal Revenue Code of 1954, I hereby designate, for the purposes of that section, as an area in which Armed Forces of the United States are and have been engaged in combat:

Vietnam, including the waters adjacent thereto within the following-described limits: From a point on the East Coast of Vietnam at the juncture of Vietnam with China southeastward to 21° N Lat., 108°15′ E Long.; thence southward to 18° N Lat., 108°15′ E Long.; thence southeastward to 17°30 N Lat., 111° E Long.; thence southward to 11° N Lat., 111° E Long.; thence southwestward to 7° N Lat., 105° E Long.; thence westward to 7° N Lat., 103° E Long.; thence northward to 9°30′ N Lat., 103° E Long.; thence northeastward to 10°15′ N Lat., 104°27′ E Long.; thence northward to a point on the West Coast of Vietnam at the juncture of Vietnam with Cambodia.

The date of the commencing of combatant activities in such area is hereby designated as January 1, 1964.

LYNDON B. JOHNSON.

CROSS REFERENCES

Additional estate taxes inapplicable to members of armed forces dying during induction period, see section 2201 of this title.

Communications excise tax, exemption from, see section 4253 of this title.

Income taxes on members of armed forces on death, see section 692 of this title.

Sale or exchange of residence, see section 1034 of this title.

Time for performing certain acts postponed by reason of war, see section 7508 of this title.

Wages as not including remuneration paid to members of armed services entitled to benefits of this section, see section 3401 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 692, 1034, 2201, 3401, 4251 of this title.

§ 113. Mustering-out payments for members of the Armed Forces.

Gross income does not include amounts received during the taxable year as mustering-out payments with respect to service in the Armed Forces of the United States. (Aug. 16, 1954, ch. 736, 68A Stat. 35.)

§ 114. Sports programs conducted for the American National Red Cross.

(a) General rule.

In the case of a taxpayer which is a corporation primarily engaged in the furnishing of sports programs, gross income does not include amounts received as proceeds from a sports program conducted by the taxpayer if—

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

(2) the taxpayer turns over to the American National Red Cross the proceeds from such sports program, minus the expenses paid or incurred by the taxpayer—

(A) which would not have been so paid or incurred but for such sports program, and

(B) which would be allowable as a deduction under section 162 (relating to trade or business expenses) but for subsection (b) of this section; and

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

For purposes of this subsection, the term "proceeds from such sports program" includes all amounts paid for admission to the sports program, plus all proceeds received by the taxpayer from such program or activities carried on in connection therewith.

(b) Treatment of expenses.

Expenses described in subsection (a) (2) shall be allowed as a deduction under section 162 only to the extent that such expenses exceed the amount excluded from gross income by subsection (a) of this section. (Aug. 16, 1954, ch. 736, 68A Stat. 35.)

CROSS REFERENCES

American National Red Cross, see section 1 et seq. of Title 36, Patriotic Societies and Observances.

§ 115. Income of states, municipalities, etc.

(a) General rule.

Gross income does not include—

(1) income derived from any public utility or the exercise of any essential governmental function and accruing to a State or Territory, or any political subdivision thereof, or the District of Columbia; or

(2) income accruing to the government of any possession of the United States or any political subdivision thereof.

(b) Contracts made before September 8, 1916, relating to public utilities.

Where a State or Territory, or any political subdivision thereof, or the District of Columbia, before September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which was to acquire, construct, operate, or maintain a public utility—

(1) If—

(A) by the terms of such contract the tax imposed by this subtitle is to be paid out of the proceeds from the operation of such public utility before any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia, and

(B) a part of such proceeds for the taxable year would (but for the imposition of the tax imposed by this subtitle) accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia,

then a tax on the taxable income from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle, but there shall be refunded to such State, Territory, political subdivision, or the District of Columbia (under regulations prescribed by the Secretary or his delegate) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this subtitle) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the taxable income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this subtitle, accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax on the taxable income of such person from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle.

(c) Contracts made before May 29, 1928, relating to bridge acquisitions.

Where a State or political subdivision thereof, pursuant to a contract entered into before May 29, 1928, to which it is not a party, is to acquire a bridge—

(1) If—

(A) by the terms of such contract the tax imposed by this subtitle is to be paid out of the proceeds from the operation of such bridge before any division of such proceeds, and

(B) a part of such proceeds for the taxable year would (but for the imposition of the tax imposed by this subtitle) accrue directly to or for the use of or would be applied for the benefit of such State or political subdivision,

then a tax on the taxable income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle, but there shall be refunded to such State or political subdivision (under regulations to be prescribed by the Secretary or his delegate) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this subtitle) would have accrued directly to or for the use of or would be applied for the benefit of such State or political subdivision bears to the amount of the taxable income from the operation of such bridge for such taxable year. No such refund shall be made unless the entire amount of the refund is to be applied in part payment for the acquisition of such bridge.

(2) If by the terms of such contract no part of the proceeds from the operation of the bridge for the taxable year would, irrespective of the tax imposed by this subtitle, accrue directly to or for the use of or be applied for the benefit of such State or political subdivision, then the tax on the taxable income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle. (Aug. 16, 1954, ch. 736, 68A Stat. 35.)

§ 116. Partial exclusion of dividends received by individuals.

(a) Exclusion from gross income.

Effective with respect to any taxable year ending after July 31, 1954, gross income does not include amounts received by an individual as dividends from domestic corporations, to the extent that the dividends do not exceed $100. If the dividends received in a taxable year exceed $100, the exclusion provided by the preceding sentence shall apply to the dividends first received in such year.

(b) Certain dividends excluded.

Subsection (a) shall not apply to any dividend from—

(1) a corporation organized under the China Trade Act, 1922 (see sec. 941);

(2) a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is—

(A) a corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations); or

(B) a corporation to which section 931 (relating to income from sources within possessions of the United States) applies; or

(3) a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following).

(c) Special rules for certain distributions.

For purposes of subsection (a)—

(1) Any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.) shall not be treated as a dividend.

(2) A dividend received from a regulated investment company shall be subject to the limitations prescribed in section 854.

(3) The amount of dividends properly allocable to a beneficiary under section 652 or 662 shall be deemed to have been received by the beneficiary ratably on the same date that the dividends were received by the estate or trust.

(d) Certain nonresident aliens ineligible for exclusion.

In the case of a nonresident alien individual, subsection (a) shall apply only—

(1) in determining the tax imposed for the taxable year pursuant to section 871(b)(1) and only in respect of dividends which are effectively connected with the conduct of a trade or business within the United States, or

(2) in determining the tax imposed for the taxable year pursuant to section 877(b).

(Aug. 16, 1954, ch. 736, 68A Stat. 37; June 25, 1959, Pub. L. 86–69, § 3(a)(2), 73 Stat. 139; Sept. 14, 1960, Pub. L. 86–779, § 10(f), 74 Stat. 1009; Feb. 26, 1964, Pub. L. 88–272, title II, § 201 (c), (d)(6)(C), 78 Stat. 32; Nov. 13, 1966, Pub. L. 89–809, title I, § 103 (g), 80 Stat. 1552.)

REFERENCES IN TEXT

The China Trade Act, 1922, referred to in subsec. (b)(1), is classified to section 141 et seq. of Title 15, Commerce and Trade.

AMENDMENTS

1966—Subsec. (d). Pub. L. 89–809 limited the availability of the exclusion to dividends which are effectively connected with the conduct of a trade or business in the United States and extended the allowance of the exclusion to an expatriate subject to tax under section 877(b).

1964—Subsec. (a). Pub. L. 88–272, § 201(c), substituted "$100" for "$50" wherever appearing.

Subsec. (c)(3). Pub. L. 88–272, § 201(d)(6)(C), added par. (3).

1960—Subsec. (b). Pub. L. 86–779 added par. (3).

1959—Subsec. (b). Pub. L. 86–69 redesignated pars. (2) and (3) as (1) and (2) and eliminated former par. (1) which related to dividends from insurance companies subject to a tax imposed by part I or II of subchapter L.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (a) by Pub. L. 88–272, § 201(c), applicable to taxable years beginning after Dec. 31, 1963, and of subsec. (c)(3) by Pub. L. 88–272, § 201(d)(6)(C), applicable to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of subsec. (b) of this section by Pub. L. 86–69 applicable to dividends received after December 31, 1958, in taxable years ending after such date, see section 3(a)(3) of Pub. L. 86–69, set out as a note under section 34 of this title.

CROSS REFERENCES

Common trust funds, see section 584 of this title.

Corporate distributions of property, see section 301 of this title.

Dividends received by individuals, credits against tax, see section 34 of this title.

Dividends received credit not allowed on distributions of electing small business corporations, see section 1375 of this title.

Estates, trusts, and beneficiaries, see sections 642, 643 of this title.

Income and credits of partner, see section 702 of this title.

Limitations applicable to dividends received from regulated investment company, see section 854 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 584, 643, 702, 854, 857, 1375 of this title.

§ 117. Scholarships and fellowship grants.

(a) General rule.

In the case of an individual, gross income does not include—

(1) any amount received—

(A) as a scholarship at an educational institution (as defined in section 151 (e) (4)), or

(B) as a fellowship grant,

including the value of contributed services and accommodations; and

(2) any amount received to cover expenses for—

(A) travel,

(B) research,

(C) clerical help, or

(D) equipment,

which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

(b) Limitations.

(1) Individuals who are candidates for degrees.

In the case of an individual who is a candidate for a degree at an educational institution (as defined in section 151 (e) (4)), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph.

(2) Individuals who are not candidates for degrees.

In the case of an individual who is not a candidate for a degree at an educational institution (as defined in section 151 (e) (4)), subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

(A) Conditions for exclusion.

The grantor of the scholarship or fellowship grant is—

(i) an organization described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) a foreign government,

(iii) an international organization, or a binational or multinational education and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

(iv) the United States, or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia.

(B) Extent of exclusion.

The amount of the scholarship or fellowship grant excluded under subsection (a) (1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151 (e) (4)).

(Aug. 16, 1954, ch. 736, 68A Stat. 38; Sept. 21, 1961, Pub. L. 87–256, § 110(a), 75 Stat. 535.)

REFERENCES IN TEXT

The Mutual Educational and Cultural Exchange Act of 1961, referred to in subsec. (b)(2)(A), is classified to chapter 33 of Title 22, Foreign Relations and Intercourse.

AMENDMENTS

1961—Subsec. (b)(2)(A). Pub. L. 87–256 included cases where the grantor of the scholarship or fellowship grant is a foreign government, an international organization, or a binational or multinational educational and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961.

EFFECTIVE DATE OF 1961 AMENDMENT

Section 110(h)(1) of Pub. L. 37–256 provided that: "The amendments made by subsections (a), (b), and (c) of this section [to subsec. (b)(2)(A) of this section and sections 871 and 872 of this title] shall apply to taxable years beginning after December 31, 1961."

CROSS REFERENCES

Prizes and awards as includible in gross income, see section 74 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 74, 1441 of this title.

§ 118. Contributions to the capital of a corporation.

(a) General rule.

In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

(b) Cross reference.

For basis of property acquired by a corporation through a contribution to its capital, see section 362.

(Aug. 16, 1954, ch. 736, 68A Stat. 39.)

§ 119. Meals or lodging furnished for the convenience of the employer.

There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer, but only if—

(1) in the case of meals, the meals are furnished on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation. (Aug. 16, 1954, ch. 736, 68A Stat. 39.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1402 of this title; title 42 section 411.

§ 120. Repealed. Pub. L. 85–866, title I, § 3 (a), Sept. 2, 1958, 72 Stat. 1607.

Section, act Aug. 16, 1954, ch. 736, 68A Stat. 39, related to statutory subsistence allowance received by police.

EFFECTIVE DATE OF REPEAL

Section 3 (c) of Pub. L. 35–866 provided that: "The amendments made by subsections (a) [which repealed this section] and (b) [which amended analysis preceding section 101 of this title] shall apply with respect to taxable years ending after September 30, 1953, but only with respect to amounts received as a statutory subsistence allowance for any day after September 30, 1953."

§ 121. Gain from sale or exchange of residence of individual who has attained age 65.

(a) General rule.

At the election of the taxpayer, gross income does not include gain from the sale or exchange of property if—

(1) the taxpayer has attained the age of 65 before the date of such sale or exchange, and

(2) during the 8-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as his principal residence for periods aggregating 5 years or more.

(b) Limitations.

(1) Where adjusted sales price exceeds $20,000.

If the adjusted sales price of the property sold or exchanged exceeds $20,000, subsection (a) shall apply to that portion of the gain which bears the same ratio to the total amount of such gain as $20,000 bears to such adjusted sales price. For purposes of the preceding sentence, the term "adjusted sales price" has the meaning assigned to such term by section 1034(b)(1) (determined without regard to subsection (d)(7) of this section).

(2) Application to only one sale or exchange.

Subsection (a) shall not apply to any sale or exchange by the taxpayer if an election by the taxpayer or his spouse under subsection (a) with respect to any other sale or exchange is in effect.

(c) Election.

An election under subsection (a) may be made or revoked at any time before the expiration of the period for making a claim for credit or refund of the tax imposed by this chapter for the taxable year in which the sale or exchange occurred, and shall be made or evoked in such manner as the Secretary or his delegate shall by regulations prescribe. In the case of a taxpayer who is married, an election under subsection (a) or a revocation thereof may be made only if his spouse joins in such election or revocation.

(d) Special rules.

(1) Property held jointly by husband and wife.

For purposes of this section, if—

(A) property is held by a husband and wife as joint tenants, tenants by the entirety, or community property,

(B) such husband and wife make a joint return under section 6013 for the taxable year of the sale or exchange, and

(C) one spouse satisfies the age, holding, and use requirements of subsection (a) with respect to such property,

then both husband and wife shall be treated as satisfying the age, holding, and use requirements of subsection (a) with respect to such property.

(2) Property of deceased spouse.

For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, if—

(A) the deceased spouse (during the 8-year period ending on the date of the sale or exchange) satisfied the holding and use requirements of subsection (a)(2) with respect to such property, and

(B) no election by the deceased spouse under subsection (a) is in effect with respect to a prior sale or exchange,

then such individual shall be treated as satisfying the holding and use requirements of subsection (a)(2) with respect to such property.

(3) Tenant-stockholder in cooperative housing corporation.

For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

(A) the holding requirements of subsection (a)(2) shall be applied to the holding of such stock, and

(B) the use requirements of subsection (a)(2) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

(4) Involuntary conversions.

For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

(5) Property used in part as principal residence.

In the case of property only a portion of which, during the 8-year period ending on the date of the sale or exchange, has been owned and used by the taxpayer as his principal residence for periods aggregating 5 years or more, this section shall apply with respect to so much of the gain from the sale or exchange of such property as is determined, under regulations prescribed by the Secretary or his delegate, to be attributable to the portion of the property so owned and used by the taxpayer.

(6) Determination of marital status.

In the case of any sale or exchange, for purposes of this section—

(A) the determination of whether an individual is married shall be made as of the date of the sale or exchange; and

(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(7) Application of sections 1033 and 1034.

In applying sections 1033 (relating to involuntary conversions) and 1034 (relating to sale or exchange of residence), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to an election under this section.

(Added Pub. L. 88-272, title II, § 206(a), Feb. 26, 1964, 78 Stat. 38.)

EFFECTIVE DATE

Section 206(c) of Pub. L. 88-272 provided that: "The amendments made by this section [adding this section, redesignating former section 121 as 122, and amending sections 1033, 1034 and 6012 of this title] shall apply to dispositions after Dec. 31, 1963, in taxable years ending after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1038, 1250, 6012 of this title.

§ 122. Certain reduced uniformed services retirement pay.

(a) General rule.

In the case of a member or former member of the uniformed services of the United States who has made an election under chapter 73 of title 10 of the United States Code to receive a reduced amount of retired or retainer pay, gross income does not include the amount of any reduction after December 31, 1965, in his retired or retainer pay by reason of such election.

(b) Special rule.

(1) Amount excluded from gross income.

In the case of any individual referred to in subsection (a), all amounts received after December 31, 1965, as retired or retainer pay shall be excluded from gross income until there has been so excluded an amount equal to the consideration for the contract. The preceding sentence shall apply only to the extent that the amounts received would, but for such sentence, be includible in gross income.

(2) Consideration for the contract.

For purposes of paragraph (1) and section 72(o), the term "consideration for the contract" means, in respect of any individual, the sum of—

(A) the total amount of the reductions before January 1, 1966, in his retired or retainer pay by reason of an election under chapter 73 of title 10 of the United States Code, and

(B) any amounts deposited at any time by him pursuant to section 1438 of such title 10.

(Added Pub. L. 89–365, § 1(a)(1), Mar. 8, 1966, 80 Stat. 32.)

EFFECTIVE DATE

Section 1(d) of Pub. L. 89–365 provided that: "The amendments made by subsections (a) and (b) [enacting this section and amending section 72 of this title] shall apply with respect to taxable years ending after December 31, 1965. The amendment made by subsection (c) [amending section 101(b)(2)(D) of this title] shall apply with respect to individuals making an election under chapter 73 of title 10 of the United States Code who die after December 31, 1965."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 72 of this title.

§ 123. Amounts received under insurance contracts for certain living expenses.

(a) General rule.

In the case of an individual whose principal residence is damaged or destroyed by fire, storm, or other casualty, or who is denied access to his principal residence by governmental authorities because of the occurrence or threat of occurrence of such a casualty, gross income does not include amounts received by such individual under an insurance contract which are paid to compensate or reimburse such individual for living expenses incurred for himself and members of his household resulting from the loss of use or occupancy of such residence.

(b) Limitation.

Subsection (a) shall apply to amounts received by the taxpayer for living expenses incurred during any period only to the extent the amounts received do not exceed the amount by which—

(1) the actual living expenses incurred during such period for himself and members of his household resulting from the loss of use or occupancy of their residence, exceed

(2) the normal living expenses which would have been incurred for himself and members of his household during such period.

(Added Pub. L. 91–172, title IX, § 901(a), Dec. 30, 1969, 83 Stat. 709.)

EFFECTIVE DATE

Section 901(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section] shall apply with respect to amounts received on or after January 1, 1969."

§ 124. Cross references to other acts.

(a) For exemption of—

(1) Adjustments of indebtedness under wage earners' plans, see section 679 of the Bankruptcy Act (52 Stat. 938; 11 U. S. C. 1079);

(2) Allowances and expenditures to meet losses sustained by persons serving the United States abroad, due to appreciation of foreign currencies, see the Acts of March 6, 1934 (48 Stat. 466; 5 U. S. C. 118c) and April 25, 1938 (52 Stat. 221; 5 U. S. C. 118c–1);

(3) Amounts credited to the Maritime Administration under section 9 (b) (6) of the Merchant Ship Sales Act of 1946, see section 9 (c) (1) of that Act (60 Stat. 48; 50 U. S. C. App. 1742);

(4) Benefits under World War Adjusted Compensation Act, see section 308 of that Act, as amended (43 Stat. 125; 44 Stat. 827, § 3; 38 U. S. C. 618);

(5) Benefits under World War Veterans' Act, 1924, see section 3 of the Act of August 12, 1935 (49 Stat. 609; 38 U. S. C. 454a);

(6) Dividends and interest derived from certain preferred stock by Reconstruction Finance Corporation, see section 304 of the Act of March 9, 1933, as amended (49 Stat. 1185; 12 U. S. C. 51d);

(7) Earnings of ship contractors deposited in special reserve funds, see section 607 (h) of the Merchant Marine Act, 1936, as amended (52 Stat. 961, § 28; 46 U. S. C. 1177);

(8) Income derived from Federal Reserve banks, including capital stock and surplus, see section 7 of the Federal Reserve Act (38 Stat. 258; 12 U. S. C. 531);

(9) Income derived from Ogdensburg bridge across Saint Lawrence River, see section 4 of the Act of June 14, 1933, as amended (54 Stat. 259, § 2);

(10) Income derived from Owensboro bridge across Ohio River and nearby ferries, see section 4 of the Act of August 14, 1937 (50 Stat. 643);

(11) Income derived from Saint Clair River bridge and ferries, see section 4 of the Act of June 25, 1930, as amended (48 Stat. 140, § 1);

(12) Leave compensation payments under section 6 of Armed Forces Leave Act of 1946, see section 7 of that Act (60 Stat. 967; 37 U. S. C. 36);

(13) Mustering-out payments made to or on account of veterans under the Mustering-Out Payment Act of 1944, see section 5 (a) of that Act (58 Stat. 10; 38 U. S. C. 691e);

(14) Railroad retirement annuities and pensions, see section 12 of the Railroad Retirement Act of 1935, as amended (50 Stat. 316; 45 U. S. C. 228*l*);

(15) Railroad unemployment benefits, see section 2 (e) of the Railroad Unemployment Insurance Act, as amended (52 Stat. 1097; 53 Stat. 845, § 9; 45 U. S. C. 352);

(16) Special pensions of persons on Army and Navy medal of honor roll, see section 3 of the Act of April 27, 1916 (39 Stat. 54; 38 U. S. C. 393);

(17) Gain derived from the sale or other disposition of Treasury Bills, issued after June 17, 1930, under the Second Liberty Bond Act, as amended, see Act of June 17, 1930 (C. 512, 46 Stat. 775; 31 U. S. C. 754).

(18) Benefits under laws administered by the Veterans' Administration, see section 3101 of title 38, United States Code.

(b) For extension of military income tax-exemption benefits to commissioned officers of Public Health Service in certain circumstances, see section 212 of the Public Health Service Act (58 Stat. 689; 42 U. S. C. 213).

(Aug. 16, 1954, ch. 736, 68A Stat. 39, § 124, formerly § 121; Aug. 1, 1956, ch. 837, title V, § 501(t), 70 Stat. 885; June 17, 1957, Pub. L. 85–56, title XXII, § 2201 (25), 71 Stat. 160; Sept. 2, 1958, Pub. L. 85–857, § 13 (t) 72 Stat. 1266; renumbered § 122, Feb. 26, 1964, Pub. L. 88–272, title II, § 206(a), 78 Stat. 38; renumbered § 123, Mar. 8, 1966, Pub. L. 89–365, § 1(a)(1), 80 Stat. 32; renumbered § 124, Dec. 30, 1969, Pub. L. 91–172, title IX, § 901(a), 83 Stat. 709.)

REFERENCES IN TEXT

The acts of March 26, 1934 (48 Stat. 466; 5 U.S.C. 118c), and April 25, 1938 (52 Stat. 221; 5 U.S.C. 118c–1), referred to in subsec. (a)(2), were repealed by Pub. L. 89–554, Sept. 6, 1966, 80 Stat. 378, and are now covered by section 5943 of Title 5, Government Organization and Employees.

Section 308 of the World War Adjusted Compensation Act, as amended (43 Stat. 125; 44 Stat. 827, § 3; 38 U.S.C. 618), referred to in subsec. (a)(4), was repealed by Pub. L. 85–857, § 14 (47), Sept. 2, 1958, 72 Stat. 1271.

Section 3 of act Aug. 12, 1935 (49 Stat. 609; 38 U.S.C. 454a), referred to in subsec. (a)(5), was repealed by Pub. L. 85–56, title XXII, § 2202 (135), June 17, 1957, 71 Stat. 168, eff. Jan. 1, 1958, and is now covered by section 3101 of Title 38, Veterans' Benefits.

Section 304 of the act of Mar. 9, 1933, as amended (49 Stat. 1185; 12 U.S.C. 51d), referred to in subsec. (a)(6), was repealed by act June 30, 1947, ch. 166, title II, § 206 (b), 61 Stat. 208.

Section 7 of the Armed Forces Leave Act of 1946 (60 Stat. 967; 37 U.S.C. 36), referred to in subsec. (a)(12), was repealed by Pub. L. 87–649, § 14, Sept. 7, 1962, 76 Stat. 498.

Section 5 (a) of the Mustering-Out Payment Act of 1944 (58 Stat. 10; 38 U.S.C. 691e), referred to in subsec. (a)(13), was repealed by Pub. L. 85–857, § 14(86), Sept. 2, 1958, 72 Stat. 1272.

Section 3 of the act of April 27, 1916 (39 Stat. 54; 38 U.S.C. 893), referred to in subsec. (a)(16), is now covered by section 562 of Title 38, Veterans' Benefits.

Act of June 17, 1930 (c. 512, 46 Stat. 775; 31 U.S.C. 754), referred to in subsec. (a)(17), enacted subsec. (d) of section 754 of Title 31, Money and Finance. Such subsec. (d) was repealed by Pub. L. 86–346, Title I, § 105(b)(1), September 22, 1959, 73 Stat. 622, and is now covered by section 742 of Title 31, Money and Finance.

Section 210 of the Servicemen's and Veterans' Survivor Benefits Act, referred to in subsec. (a)(18), is now covered by section 3101 of Title 38, Veterans' Benefits.

AMENDMENTS

1958—Subsec. (a) (18). Pub. L. 85–857 substituted "section 3101 of Title 38, United States Code" for "section 1001 of the Veterans' Benefits Act of 1957".

1957—Subsec. (a)(18). Pub. L. 85–56 substituted provisions relating to benefits under laws administered by the Veterans' Administration, for provisions which related to dependency and indemnity compensation.

1956—Subsec. (a). Act Aug. 1, 1956, added par. (18), relating to dependency and indemnity compensation.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of section by Pub. L. 85–857 effective Jan. 1, 1959, see section 2 of Pub. L. 85–857, set out as a note preceding Part I of Title 38, Veterans' Benefits.

CROSS REFERENCES

Patronage refunds paid by Federal intermediate credit banks as exempt from income tax, see section 1072 (b) of Title 12, Banks and Banking.

PART IV.—STANDARD DEDUCTION FOR INDIVIDUALS

Sec.
141. Standard deduction.
142. Individuals not eligible for standard deduction.
143. Determination of marital status.
144. Election of standard deduction.
145. Cross reference.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 63 of this title.

§ 141. Standard deduction.

(a) Standard deduction.

Except as otherwise provided in this section, the standard deduction referred to in this title is the larger of the percentage standard deduction or the low income allowance.

(b) Percentage standard deduction.

The percentage standard deduction is an amount equal to the applicable percentage of adjusted gross income shown in the following table, but not to exceed the maximum amount shown in such table (or one-half of such maximum amount in the case of a separate return by a married individual):

Taxable years beginning in—	Applicable percentage	Maximum amount
1970	10	$1,000
1971	13	1,500
1972	14	2,000
1973 and thereafter	15	2,000

(c) Low income allowance.

(1) In general.

The low income allowance is an amount equal to the sum of—

(A) the basic allowance, and

(B) the additional allowance.

(2) Basic allowance.

For purposes of this subsection, the basic allowance is an amount equal to the sum of—

(A) $200, plus

(B) $100, multiplied by the number of exemptions.

The basic allowance shall not exceed $1,000.

(3) Additional allowance.

(A) In general.

For purposes of this subsection, the additional allowance is an amount equal to the excess (if any) of $900 over the sum of—

(i) $100, multiplied by the number of exemptions, plus

(ii) the income phase-out.

(B) Income phase-out.

For purposes of subparagraph (A)(ii), the income phase-out is an amount equal to one-half of the amount by which the adjusted gross income for the taxable year exceeds the sum of—

(i) $1,100, plus

(ii) $625, multiplied by the number of exemptions.

(4) Married individuals filing separate returns.

In the case of a married taxpayer filing a separato return—

(A) the low income allowance is an amount equal to the basic allowance, and

(B) the basic allowance is an amount (not in excess of $500) equal to the sum of—

(i) $100, plus

(ii) $100, multiplied by the number of exemptions.

(5) Number of exemptions.

For purpeses of this subsection, the number of exemptions is the number of exemptions allowed as a deduction for the taxable year under section 151.

(6) Special rule for 1971.

For a taxable year beginning after December 31, 1970, and before January 1, 1972—

(A) paragraph (3)(A) shall be applied by substituting "$850" for "$900,"

(B) paragraph (3)(B) shall be applied by substituting "one-fifteenth" for "one-half."

(C) paragraph (3)(B)(i) shall be applied by substituting "$1050" for "$1100", and

(D) paragraph (3)(B)(ii) shall be applied by substituting "$650" for "$625."

(d) Married individuals filing separate returns.

Notwithstanding subsection (a)—

(1) The low income allowance shall not apply in the case of a separate return by a married individual if the tax of the other spouse is determined with regard to the percentage standard deduction.

(2) A married individual filing a separate return may, if the low income allowance is less than the percentage standard deduction, and if the low income allowance of his spouse is greater than the percentage standard deduction of such spouse, elect (under regulations prescribed by the Secretary or his delegate) to have his tax determined with regard to the low income allowance in lieu of being determined with regard to the 10-percent standard deduction.

(Aug. 16, 1954, ch. 736, 68A Stat. 40; Feb. 26, 1964, Pub. L. 88–272, title I, § 112(a), 78 Stat. 23; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 802 (a), (c)(4), 83 Stat. 676, 678.)

LOW INCOME ALLOWANCE FOR YEARS AFTER 1971

Section 802(e) of Pub. L. 91–172 provided that, effective with respect to taxable years beginning after Dec. 31, 1971, subsec. (c) of this section (relating to low income allowance) shall read as follows:

"(c) Low income allowance.

"The low income allowance is $1,000 ($500, in the case of a married individual filing a separate return."

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 802(a), altered the definition of standard deduction by substituting "larger of the percentage standard deduction or the low income allowance" for "larger of the 10 per cent standard deduction or the minimum standard deduction" as the definition, and struck out the maximum limits.

Subsec. (b). Pub. L. 91–172, § 802(a), substituted a table to be used in determining the percentage standard deduction for the definition of the 10 per cent standard deduction.

Subsec. (c). Pub. L. 91–172, § 802(a), substituted low-income allowance provisions for minimum standard deduction provisions.

Subsec. (d). Pub. L. 91–172, § 802(c)(4), substituted "low income allowance" and "percentage" for "minimum standard deduction" and "10-percent", respectively, wherever appearing.

1964—Pub. L. 88–272 designated existing provisions as subsec. (a), substituted "Except as otherwise provided in this section, the standard deduction referred to in this title is the larger of the 10-percent standard deduction or the minimum standard deduction. The standard deduction shall not exceed $1,000" for "The standard deduction referred to in section 63(b) (defining taxable income in case of individual electing standard deduction) shall be an amount equal to 10 percent of the adjusted gross income or $1,000, whichever is the lesser" therein, and added subsecs. (b)–(d).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 802(d) of Pub. L. 91–172, set out as a note under section 4 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

CROSS REFERENCES

Individuals electing standard deduction, see section 63(b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 4, 144, 564, 703, 1051, 3402 of this title.

§ 142. Individuals not eligible for standard deduction.

(a) Husband and wife.

The standard deduction shall not be allowed to a husband or wife if the tax of the other spouse is determined under section 1 on the basis of the taxable income computed without regard to the standard deduction.

(b) Certain other taxpayers ineligible.

The standard deduction shall not be allowed in computing the taxable income of—

(1) a nonresident alien individual;

(2) a citizen of the United States entitled to the benefits of section 931 (relating to income from sources within possessions of the United States);

(3) an individual making a return under section 443(a)(1) for a period of less than 12 months on account of a change in his annual accounting period; or

(4) an estate or trust, common trust fund, or partnership.

(Aug. 16, 1954, ch. 736, 68A Stat. 40.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 144, 931, 6012 of this title.

§ 143. Determination of marital status.

(a) General rule.

For purposes of this part—

(1) The determination of whether an individual is married shall be made as of the close of his taxable year; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

(2) An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(b) Certain married individuals living apart.

For purposes of this part, if—

(1) an individual who is married (within the meaning of subsection (a)) and who files a separate return maintains as his home a household which constitutes for more than one-half of the taxable year the principal place of abode of a dependent (A) who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the individual, and (B) with respect to whom such individual is entitled to a deduction for the taxable year under section 151,

(2) such individual furnishes over half of the cost of maintaining such household during the taxable year, and

(3) during the entire taxable year such individual's spouse is not a member of such household, such individual shall not be considered as married.

(Aug. 16, 1954, ch. 736, 68A Stat. 41; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 802(b), 83 Stat. 677.)

AMENDMENTS

1969—Pub. L. 91–172 substituted "(a) General Rule.—For purposes of this part—" for "For purposes of this part—" in the material preceding par. (1) and added subsec. (b).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 802(d) of Pub. L. 91–172, set out as a note under section 4 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1, 2, 4, 1304 of this title.

§ 144. Election of standard deduction.

(a) Method and effect of election.

(1) If the adjusted gross income shown on the return is $5,000 or more, the standard deduction shall be allowed if the taxpayer so elects in his return, and the Secretary or his delegate shall by regulations prescribe the manner of signifying such election in the return. If the adjusted gross income shown on the return is $5,000 or more, but the correct adjusted gross income is less than $5,000, then an election by the taxpayer under the preceding sentence to take the standard deduction shall be considered as his election to pay the tax imposed by section 3 (relating to tax based on tax table); and his failure to make under the preceding sentence an election to take the standard deduction shall be considered his election not to pay the tax imposed by section 3.

(2) If the adjusted gross income shown on the return is less than $5,000, the standard deduction shall be allowed only if the taxpayer elects, in the manner provided in section 4, to pay the tax imposed by section 3. If the adjusted gross income shown on the return is less than $5,000, but the correct adjusted gross income is $5,000 or more, then an election by the taxpayer to pay the tax imposed by section 3 shall be considered as his election to take the standard deduction; and his failure to elect to pay the tax imposed by section 3 shall be considered his election not to take the standard deduction.

(3) If the taxpayer on making his return fails to signify, in the manner provided by paragraph (1) or (2), his election to take the standard deduction or to pay the tax imposed by section 3, as the case may be, such failure shall be considered his election not to take the standard deduction.

(h) Change of election.

Under regulations prescribed by the Secretary or his delegate, a change of election with respect to the standard deduction for any taxable year may be made after the filing of the return for such year. If the spouse of the taxpayer filed a separate return for any taxable year corresponding, for purposes of section 142 (a), to the taxable year of the taxpayer, the change shall not be allowed unless, in accordance with such regulations—

(1) the spouse makes a change of election with respect to the standard deduction for the taxable year covered in such separate return, consistent with the change of election sought by the taxpayer, and

(2) the taxpayer and his spouse consent in writing to the assessment, within such period as may be agreed on with the Secretary or his delegate, of any deficiency, to the extent attributable to such change of election, even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

This subsection shall not apply if the tax liability of the taxpayer's spouse, for the taxable year corresponding (for purposes of section 142 (a)) to the taxable year of the taxpayer, has been compromised under section 7122.

(c) Change of election defined.

For purposes of this title, the term "change of election with respect to the standard deduction" means—

(1) a change of an election to take (or not to take) the standard deduction;

(2) a change of an election to pay (or not to pay) the tax under section 3; or

(3) a change of an election under section 141(d)(2).

(d) Individuals electing income averaging.

In the case of a taxpayer who chooses to have the benefits of part I of subchapter Q (relating to income averaging) for the taxable year—

(1) subsection (a) shall not apply for such taxable year, and

(2) the standard deduction shall be allowed if the taxpayer so elects in his return for such taxable year.

The Secretary or his delegate shall by regulations prescribe the manner of signifying such election in the return. If the taxpayer on making his return fails to signify, in the manner so prescribed, his election to take the standard deduction, such failure shall be considered his election not to take the standard deduction. (Aug. 16, 1954, ch. 736, 68A Stat. 41; Feb. 26, 1964, Pub. L. 88–272, title I, § 112(c), title II, § 232(c), 78 Stat. 24, 110.)

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–272, § 112(c)(1), substituted "with respect to the standard deduction for any taxable year" for "for any taxable year to take, or not to take, the standard deduction, or to pay, or not to pay, the tax under section 3."

Subsec. (c). Pub. L. 88–272, § 112(c)(2), added subsec. (c).

Subsec. (d). Pub. L. 88–272, § 232(c), added subsec. (d).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsecs. (b), (c) by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

Amendment of section by Pub. L. 88–272 adding subsec. (d), applicable to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 36, 63 of this title.

§ 145. Cross reference.

For disallowance of certain credits against the tax in the case of individuals electing the standard deduction, see section 36.

(Aug. 16, 1954, ch. 736, 68A Stat. 42.)

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

Sec.
151. Allowance of deductions for personal exemptions.
152. Dependent defined.
153. Determination of marital status.
154. Cross references.

§ 151. Allowance of deductions for personal exemptions.

(a) Allowance of deductions.

In the case of an individual, the exemptions provided by this section shall be allowed as deductions in computing taxable income.

(b) Taxpayer and spouse.

An exemption of $650 for the taxpayer; and an additional exemption of $650 for the spouse of the taxpayer if a joint return is not made by the taxpayer and his spouse, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(c) Additional exemption for taxpayer or spouse aged 65 or more.

(1) For taxpayer.

An additional exemption of $650 for the taxpayer if he has attained the age of 65 before the close of his taxable year.

(2) For spouse.

An additional exemption of $650 for the spouse of the taxpayer if a joint return is not made by the taxpayer and his spouse, and if the spouse has attained the age of 65 before the close of such taxable year, and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(d) Additional exemption for blindness of taxpayer or spouse.

(1) For taxpayer.

An additional exemption of $650 for the taxpayer if he is blind at the close of his taxable year.

(2) For spouse.

An additional exemption of $650 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. For purposes of this paragraph, the determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer; except that if the spouse dies during such taxable year such determination shall be made as of the time of such death.

(3) Blindness defined.

For purposes of this subsection, an individual is blind only if his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or if his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

(e) Additional exemption for dependents.

(1) In general.

An exemption of $650 for each dependent (as defined in section 152)—

(A) whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $650, or

(B) who is a child of the taxpayer and who (i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or (ii) is a student.

(2) Exemption denied in case of certain married dependents.

No exemption shall be allowed under this subsection for any dependent who has made a joint return with his spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

(3) Child defined.

For purposes of paragraph (1) (B), the term "child" means an individual who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer.

(4) Student and educational institution defined.

For purposes of paragraph (1) (B) (ii), the term "student" means an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins—

(A) is a full-time student at an educational institution; or

(B) is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution or of a State or political subdivision of a State.

For purposes of this paragraph, the term "educational institution" means only an educational institution which normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on.

(Aug. 16, 1954, ch. 736, 68A Stat. 42; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 801(a)(1), (b)(1), title IX, § 941(b), 83 Stat. 675, 726.)

INCREASES IN PERSONAL EXEMPTION

Section 801(c)(1) of Pub. L. 91–172 provided for an increase of the personal exemption to $700, effective with respect to taxable years beginning after Dec. 31, 1971 and before Jan. 1, 1973.

Section 801(d)(1) of Pub. L. 91–172 provided for an increase of the personal exemption to $750, effective with respect to taxable years beginning after Dec. 31, 1972.

AMENDMENTS

1969—Pub. L. 91–172, §§ 801(a)(1), (b)(1), increased the exemption from $600 to $625, and for $625 to $650 wherever appearing.

Subsecs. (b), (c), Pub. L. 91–172, § 941(b), substituted "if a joint return is not made by the taxpayer and his spouse" for "if a separate return is made by the taxpayer".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 801(a)(1) of Pub. L. 91–172 provided in part that the increase in exemption from $600 to $625 is effective with respect to taxable years beginning after Dec. 31, 1969, and before Jan. 1, 1971.

Section 801(b)(1) provided in part that the increase in the exemption from $625 to $650 is effective with respect to taxable years beginning after Dec. 31, 1970, and before Jan. 1, 1972.

Section 941(c) of Pub. L. 91–172 provided that: "The amendments made by subsections (a) [amending section 6012 of this title] and (b) [amending this section] shall apply to taxable years beginning after December 31, 1969."

CROSS REFERENCES

Adjusted gross income minus standard deduction and deductions for personal exemptions as taxable income, see section 63 of this title.

Adjustment in deduction for personal exemption on making return for short period, see section 443 (c) of this title.

Benefit of personal exemptions in tax-free covenant bond cases, see section 1451 (d) of this title.

Deduction for—

Exemptions in case of optional tax, see sections 3 and 4 (a) of this title.

Personal exemptions not allowed in self-employment partnership income, see section 1402 (a) (8) of this title.

Nonresident alien entitled to benefits of this section, see section 874 (b) of this title.

Partnership not entitled to personal exemptions under this section, see section 703 (a) (2) (B) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 2, 4, 63, 103, 117, 141, 143, 152, 163, 170, 172, 214, 403, 443, 512, 642, 703, 873, 874, 891, 904, 911, 931, 933, 1211, 1303, 1402, 1451, 3402, 4914, 4941, 4945, 6012, 6654 of this title.

§ 152. Dependent defined.

(a) General definition.

For purposes of this subtitle, the term "dependent" means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) or (e) as received from the taxpayer):

(1) A son or daughter of the taxpayer, or a descendant of either,

(2) A stepson or stepdaughter of the taxpayer,

(3) A brother, sister, stepbrother, or stepsister of the taxpayer,

(4) The father or mother of the taxpayer, or an ancestor of either,

(5) A stepfather or stepmother of the taxpayer,

(6) A son or daughter of a brother or sister of the taxpayer,

(7) A brother or sister of the father or mother of the taxpayer,

(8) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer,

(9) An individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to section 153, of the taxpayer) who, for the taxable year of the taxpayer, has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household, or

(10) An individual who—

(A) is a descendant of a brother or sister of the father or mother of the taxpayer,

(B) for the taxable year of the taxpayer receives institutional care required by reason of a physical or mental disability, and

(C) before receiving such institutional care, was a member of the same household as the taxpayer.

(b) Rules relating to general definition.

For purposes of this section—

(1) The terms "brother" and "sister" include a brother or sister by the halfblood.

(2) In determining whether any of the relationships specified in subsection (a) or paragraph (1) of this subsection exists, a legally adopted child of an individual (and a child who is a member of an individual's household, if placed with such individual by an authorized placement agency for legal adoption by such individual), or a foster child of an individual (if such child satisfies the requirements of subsection (a)(9) with respect to such individual), shall be treated as a child of such individual by blood.

(3) The term "dependent" does not include any individual who is not a citizen of the United States unless such individual is a resident of the United States, of a country contiguous to the United States, of the Canal Zone, or of the Republic of Panama. The preceding sentence shall not exclude from the definition of "dependent" any child of the taxpayer—

(A) born to him, or legally adopted by him, in the Philippine Islands before January 1, 1956, if the child is a resident of the Republic of the Philippines, and if the taxpayer was a member of the Armed Forces of the United States at the time the child was born to him or legally adopted by him, or

(B) legally adopted by him, if, for the taxable year of the taxpayer, the child has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household, and if the taxpayer is a citizen of the United States.

(4) A payment to a wife which is includible in the gross income of the wife under section 71 or 682 shall not be treated as a payment by her husband for the support of any dependent.

(5) An individual is not a member of the taxpayer's household if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law.

(c) Multiple support agreements.

For purposes of subsection (a), over half of the support of an individual for a calendar year shall be treated as received from the taxpayer if—

(1) no one person contributed over half of such support;

(2) over half of such support was received from persons each of whom, but for the fact that he did not contribute over half of such support, would have been entitled to claim such individual as a dependent for a taxable year beginning in such calendar year;

(3) the taxpayer contributed over 10 percent of such support; and

(4) each person described in paragraph (2) (other than the taxpayer) who contributed over 10 percent of such support files a written declaration (in such manner and form as the Secretary or his delegate may by regulations prescribe) that he will not claim such individual as a dependent for any taxable year beginning in such calendar year.

(d) Special support test in case of students.

For purposes of subsection (a), in the case of any individual who is—

(1) a son, stepson, daughter, or stepdaughter of the taxpayer (within the meaning of this section), and

(2) a student (within the meaning of section 151 (e) (4)),

amounts received as scholarships for study at an educational institution (as defined in section 151(e)(4)) shall not be taken into account in determining whether such individual received more than half of his support from the taxpayer.

(e) Support test in case of child of divorced parents, etc.

(1) General rule.

If—

(A) a child (as defined in section 151(e)(3)) receives over half of his support during the calendar year from his parents who are divorced or legally separated under a decree of divorce or separate maintenance, or who are separated under a written separation agreement, and

(B) such child is in the custody of one or both of his parents for more than one-half of the calendar year,

such child shall be treated, for purposes of subsection (a), as receiving over half of his support during the calendar year from the parent having custody for a greater portion of the calendar year unless he is treated, under the provisions of paragraph (2), as having received over half of his support for such year from the other parent (referred to in this subsection as the parent not having custody).

(2) Special rule.

The child of parent described in paragraph (1) shall be treated as having received over half of his support during the calendar year from the parent not having custody if—

(A) (i) the decree of divorce or of separate maintenance, or a written agreement between the parents applicable to the taxable year beginning in such calendar year, provides that the parent not having custody shall be entitled to any deduction allowable under section 151 for such child, and

(ii) such parent not having custody provides at least $600 for the support of such child during the calendar year, or

(B) (i) the parent not having custody provides $1,200 or more for the support of such child (or if there is more than one such child, $1,200 or more for all of such children) for the calendar year, and

(ii) the parent having custody of such child does not clearly establish that he provided more for the support of such child during the calendar year than the parent not having custody.

For the purposes of this paragraph, amounts expended for the support of a child or children shall be treated as received from the parent not having custody to the extent that such parent provided amounts for such support.

(3) Itemized statements required.

If a taxpayer claims that paragraph (2)(B) applies with respect to a child for a calendar year and the other parent claims that paragraph (2)(B)(i) is not satisfied or claims to have provided more for the support of such child during such calendar year than the taxpayer, each parent shall be entitled to receive, under regulations to be prescribed by the Secretary or his delegate, an itemized statement of the expenditures upon which the other parent's claim of support is based.

(4) Exception for multiple-support agreement.

The provisions of this subsection shall not apply in any case where over half of the support of the child is treated as having been received from a taxpayer under the provisions of subsection (c).

(5) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

(Aug. 16, 1954, ch. 736, 68A Stat. 43; Aug. 9, 1955, ch. 693, § 2, 69 Stat. 626; Sept. 2, 1958, Pub. L. 85–866, title I, § 4(a–c), 72 Stat. 1607; Sept. 23, 1959, Pub. L. 86–376, § 1(a), 73 Stat. 699; Aug. 31, 1967, Pub. L. 90–78, § 1, 81 Stat. 191; Dec. 30, 1969, Pub. L. 91–172, title IX, § 912(a), 83 Stat. 722.)

AMENDMENTS

1969—Subsec. (b)(2). Pub. L. 91–172 inserted reference to foster children who satisfy the requirements of subsec. (a)(9) of this section.

1967—Subsec. (a). Pub. L. 90–78, § 1(b), inserted "or (e)" following "subsection (c)".

Subsec. (e). Pub. L. 90–78, §1(a), added subsec. (e).

1959—Subsec. (b)(2). Pub. L. 86–376 provided that a child who is a member of an individual's household if placed with such individual by an authorized placement agency for legal adoption by such individual shall be treated as a child by blood.

1958—Subsec. (a)(9). Pub. L. 85–866, § 4(a), inserted "(other than an individual who at any time during the taxable year was the spouse, determined without regard to section 153, of the taxpayer)".

Subsec. (b)(3). Pub. L. 85–866, § 4(b), among other changes, eliminated provision that the term "dependent" does not include any individual who is not a United States citizen unless such individual is a resident of United States or of a contiguous country, or of Canal Zone or Panama, and added provision barring exclusion from definition of "dependent" any child of taxpayer, legally adopted by him, if, for taxable year of taxpayer, child's principal place of abode is taxpayer's home and child is member of taxpayer's household, if taxpayer is United States citizen.

Subsec. (b)(5). Pub. L. 85–866, § 4(c), added subsec. (b)(5).

1959—Subsec. (b)(8). Act Aug. 9, 1955, substituted "January 1, 1956" for "July 5, 1946".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 912(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) of this section [amending this section] shall apply to taxable years beginning after December 31, 1969."

EFFECTIVE DATE OF 1967 AMENDMENT

Section 2 of Pub. L. 90–78 provided that: "The amendments made by the first section of this Act [to subsecs. (a) and (e) of this section] shall apply with respect to taxable years beginning after December 31, 1966."

EFFECTIVE DATE OF 1959 AMENDMENT

Section 1(b) of Pub. L. 86–376 provided that: "The amendment made by subsection (a) [to subsec. (b)(2) of this section] shall apply to taxable years beginning after December 31, 1958."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendments of subsecs. (a) (9) and (b) (5) of this section by Pub. L. 85–866, applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 4 (d) of Pub. L. 85–866 provided that: "The amendment made by subsection (b) [to subsec. (b) (3) of this section] shall apply with respect to taxable years beginning after December 31, 1957."

EFFECTIVE DATE OF 1955 AMENDMENT

Section 3 (b) of act Aug. 9, 1955, provided that the amendment of this section by section 2 of such act shall apply with respect to taxable years beginning after Dec. 31, 1953 and ending Aug. 16, 1954.

CROSS REFERENCES

Alimony payments by husband deductible, see section 215 of this title.

Husband and wife, definition of, see section 7701 (a) (17) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 2, 105, 143, 151, 170, 213, 214, 7701 of this title.

§ 153. Determination of marital status.

For purposes of this part—

(1) The determination of whether an individual is married shall be made as of the close of his taxable year; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

(2) An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married. (Aug. 16, 1954, ch. 736, 68A Stat. 45.)

§ 154. Cross references.

(1) For definitions of "husband" and "wife", as used in section 152 (b) (4), see section 7701 (a) (17).

(2) For deductions of estates and trusts, in lieu of the exemptions under section 151, see section 642 (b).

(3) For exemptions of nonresident aliens, see section 873 (b)(3).

(4) For exemptions of citizens deriving income mainly from sources within possessions of the United States, see section 931 (e).

(Aug. 16, 1954, ch. 736, 68A Stat. 45; Nov. 13, 1966, Pub. L. 89–809, title I, § 103(c)(2), 80 Stat. 1551.)

AMENDMENTS

1966—Par. (3). Pub. L. 89–809 substituted "873(b)(3)" for "873(d)".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

Sec.
161. Allowance of deductions.
162. Trade or business expenses.
163. Interest.
164. Taxes.
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183. Activities not engaged in for profit.
184. Amortization of certain railroad rolling stock.
185. Amortization of railroad grading and tunnel bores.
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AMENDMENTS

1969—Pub. L. 91–172, title II, § 213(c)(1), title VII, §§ 704(b)(1), 705(b), 707(b), title IX, § 904(b), Dec. 30, 1969, 83 Stat. 572, 669, 674, 675, 712, substituted reference to pollution control facilities for reference to grain storage facilities in item 169, and added items 183 to 187.

1964—Pub. L. 88–272, title II, § 203(a)(8)(D), Feb. 26, 1964, 78 Stat. 34, deleted item 181.

1962—Pub. L. 87–834, §§ 2(g)(3), 21(c), Oct. 16, 1962, 76 Stat. 973, 1064, added items 181, 182.

1960—Pub. L. 86–779, § 6(b), Sept. 14, 1960, 74 Stat. 1001, added item 180.

1958—Pub. L. 85–866 title I, § 15 (b), title II, § 204 (b), Sept. 2, 1958, 72 Stat. 1613, 1680, added items 178 and 179.

1956—Act June 29, 1956, ch. 464, § 4 (b), 70 Stat. 406, added item 177.

1954—Act Sept. 1, 1954, ch. 1206, title II, § 210 (b), 68 Stat. 1097, added item 176.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in sections 62, 241 of this title.

§ 161. Allowance of deductions.

In computing taxable income under section 63 (a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible). (Aug. 16, 1954, ch. 736, 68A Stat. 45.)

CROSS REFERENCES

Adjusted gross income as gross income minus certain deductions, see section 62 of this title.

Deductions of nonresident alien individuals, see section 873 of this title.

§ 162. Trade or business expenses.

(a) In general.

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of

property to which the taxpayer has not taken or is not taking title or in which he has no equity. For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

(b) Charitable contributions and gifts excepted.

No deduction shall be allowed under subsection (a) for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section.

(c) Bribes and illegal kickbacks.

(1) Illegal payments to government officials or employees.

No deduction shall be allowed under subsection (a) for any payment made, directly or indirectly, to an official or employee of any government, or of any agency or instrumentality of any government, if the payment constitutes an illegal bribe or kickback or, if the payment is to an official or employee of a foreign government, the payment would be unlawful under the laws of the United States if such laws were applicable to such payment and to such official or employee. The burden of proof in respect of the issue, for the purposes of this paragraph, as to whether a payment constitutes an illegal bribe or kickback (or would be unlawful under the laws of the United States) shall be upon the Secretary or his delegate to the same extent as he bears the burden of proof under section 7454 (concerning the burden of proof when the issue relates to fraud).

(2) Other bribes or kickbacks.

If in a criminal proceeding a taxpayer is convicted of making a payment (other than a payment described in paragraph (1)) which is an illegal bribe or kickback, or his plea of guilty or nolo contendere to an indictment or information charging the making of such a payment is entered or accepted in such a proceeding, no deduction shall be allowed under subsection (a) on account of such payment or any related payment made prior to the date of the final judgment in such proceeding.

(3) Statute of limitations.

If a taxpayer claimed a deduction for a payment described in paragraph (2) which is disallowed because of a final judgment entered after the close of the taxable year for which the deduction was claimed, and if the proceeding was based on an indictment returned or an information filed prior to the expiration of the period for the assessment of any deficiency for such taxable year, the period for the assessment of any deficiency attributable to the deduction of such payment shall not expire prior to the expiration of one year from the date of such final judgment, and such deficiency may be assessed prior to the expiration of such one-year period notwithstanding the provision of any other law or rule of law which would otherwise prevent such assessment.

(d) Capital contributions to Federal National Mortgage Association.

For purposes of this subtitle, whenever the amount of capital contributions evidenced by a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718) exceeds the fair market value of the stock as of the issue date of such stock, the initial holder of the stock shall treat the excess as ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.

(e) Appearances, etc., with respect to legislation.

(1) In general.

The deduction allowed by subsection (a) shall include all the ordinary and necessary expenses (including, but not limited to, traveling expenses described in subsection (a)(2) and the cost of preparing testimony) paid or incurred during the taxable year in carrying on any trade or business—

(A) in direct connection with appearances before, submission of statements to, or sending communications to, the committees, or individual members, of Congress or of any legislative body of a State, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer, or

(B) in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization,

and that portion of the dues so paid or incurred with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the activities described in subparagraphs (A) and (B) carried on by such organization.

(2) Limitation.

The provisions of paragraph (1) shall not be construed as allowing the deduction of any amount paid or incurred (whether by way of contribution, gift, or otherwise)—

(A) for participation in, or intervention in, any political campaign on behalf of any candidate for public office, or

(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.

(f) Fines and penalties.

No deduction shall be allowed under subsection (a) for any fine or similar penalty paid to a government for the violation of any law.

(g) Treble damage payments under the antitrust laws.

If in a criminal proceeding a taxpayer is convicted of a violation of the antitrust laws, or his plea of

guilty or nolo contendere to an indictment or information charging such a violation is entered or accepted in such a proceeding, no deduction shall be allowed under subsection (a) for two-thirds of any amount paid or incurred—

(1) on any judgment for damages entered against the taxpayer under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914 (commonly known as the Clayton Act), on account of such violation or any related violation of the antitrust laws which occurred prior to the date of the final judgment of such conviction, or

(2) in settlement of any action brought under such section 4 on account of such violation or related violation.

The preceding sentence shall not apply with respect to any conviction or plea before January 1, 1970, or to any conviction or plea on or after such date in a new trial following an appeal of a conviction before such date.

(h) Cross reference.

(1) For special rule relating to expenses in connection with subdividing real property for sale, see section 1237.

(2) For special rule relating to the treatment of payments by a transferee of a franchise, trademark, or trade name, see section 1253.

(Aug. 16, 1954, ch. 736, 68A Stat. 45; Sept. 2, 1958, Pub. L. 85–866, title I, § 5 (a), 72 Stat. 1608; Sept. 14, 1960, Pub. L. 86–779, §§ 7(b), 8(a), 74 Stat. 1002, 1003; Oct. 16, 1962, Pub. L. 87–834, §§ 3(a), 4(b), 76 Stat. 973, 976; Dec. 30, 1969, Pub. L. 91–172, title V, § 516(c)(2)(A), title IX, § 902(a), (b) 83 Stat. 648, 710).

AMENDMENTS

1969—Subsec. (c). Pub. L. 91–172, § 902(b), designated existing provisions as par. (1), and in par. (1) so designated, extended the applicability of nondeductible expenses for payments to any official or employee of any government, or of any agency or instrumentality of any government, and added pars. (2) and (3).

Subsec. (f). Pub. L. 91–172, § 902(a), added subsec. (f). Former subsec. (f) was redesignated as subsec. (h).

Subsec. (g). Pub. L. 91–172, § 902(a), added subsec. (g).

Subsec. (h). Pub. L. 91–172, §§ 516(c)(2)(A), 902(a), redesignated former subsec. (f) as (h) and, in subsec. (h) as so redesignated, substituted "(1) For" for "For" and added reference to section 1253 for special rule relating to the treatment of payments by a transferee of a franchise, trademark, or trade name.

Pub. L. 91–172, § 902(a), redesignated former subsec. (f) as (h).

1962—Subsec. (a)(2). Pub. L. 87–834, § 4(b), substituted "(including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances)" for "including the entire amount expended for meals and lodging)."

Subsec. (e). Pub. L. 87–834, § 3(a), added subsec. (e), and redesignated former subsec. (e) as (f).

Subsec. (f). Pub. L. 87–834, § 3(a), redesignated former subsec. (e) as (f).

1960—Subsec. (b). Pub. L. 86–779, § 7(b), inserted "the dollar limitations," following "the percentage limitations,".

Subsec. (d). Pub. L. 86–779, § 8(a), added subsec. (d). Former subsec. (d) redesignated (e).

Subsec. (e). Pub. L. 86–779, § 8(a), redesignated former subsec. (d) as (e).

1958—Subsec. (c). Pub. L. 85–866, § 5(a), added subsec. (c) and redesignated former subsec. (c) as (d).

Subsec. (d). Pub. L. 85–866, § 5(a), redesignated former subsec. (c) as (d).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 902(c) of Pub. L. 91–172 provided that: "Section 162(f) of the Internal Revenue Code of 1954 [subsec. (f) of this section] (as added by subsection (a)) shall apply to all taxable years to which such Code [this title] applies. Section 162(g) of such Code [subsec. (g) of this section] (as added by subsection (a)) shall apply with respect to amounts paid or incurred after December 31, 1969. Section 162(c)(1) of such Code [subsec. (c)(1) of this section] (as amended by subsection (b)) shall apply to all taxable years to which such Code applies. Sections 162(c)(2) and (3) of such Code [subsec. (c)(2) and (3) of this section] (as amended by subsection (b)) shall apply with respect to payments made after the date of the enactment of this Act [Dec. 30, 1969]."

Amendment of section by section 516(c)(2)(A) of Pub. L. 91–172 applicable to transfers after Dec. 31, 1969, see section 516(d)(3) of Pub. L. 91–172, set out as a note under section 1001 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Section 4(c) of Pub. L. 87–834 provided that: "The amendments made by this section [amending subsec. (a) of this section and adding section 274 of this title] shall apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date."

Section 3(b) of Pub. L. 87–834 provided that: "The amendments made by this section [adding subsec. (e) and redesignating former subsec. (e) as (f)] shall apply to taxable years beginning after December 31, 1962."

EFFECTIVE DATE OF 1960 AMENDMENT

Section 7(c) of Pub. L. 86–779 provided that: "The amendments made by subsections (a) and (b) [to section 170 of this title and subsec. (b) of this section] shall apply with respect to taxable years beginning after December 31, 1959."

Section 8(d) of Pub. L. 86–779 provided that: "The amendments made by subsections (a), (b), and (c) [adding subsec. (d) of this section and section 1054 of this title and amending table of sections for Part IV by adding item 1054 and numbering former item 1054 as 1055] shall apply with respect to taxable years beginning after December 31, 1959."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 5(b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsecs. (c) and (d) of this section] shall apply only with respect to expenses paid or incurred after the date of the enactment of this Act [Sept. 2, 1958]. The determination as to whether any expense paid or incurred on or before the date of the enactment of this Act [Sept. 2, 1958] shall be allowed as a deduction shall be made as if this section had not been enacted and without inference drawn from the fact that this section is not made applicable with respect to expenses paid or incurred on or before the date of the enactment of this Act [Sept. 2, 1958]."

DEDUCTIBILITY OF ACCRUED VACATION PAY

Section 97 of Pub. L. 35–866, as amended by Pub. L. 86–496, § 2, June 8, 1960, 74 Stat. 164; Pub. L. 88–153, Oct. 17, 1963, 77 Stat. 272; Pub. L. 86–554, § 1, Aug. 31, 1964, 78 Stat. 761; Pub. L. 89–692, Oct. 15, 1966, 80 Stat. 1025; Pub. L. 91–172, title IX, § 903, Dec. 30, 1969, 83 Stat. 711, provided that: "Deduction under section 162 of the Internal Revenue Code of 1954 [this section] for accrued vacation pay, computed in accordance with the method of accounting, consistently followed by the taxpayer in arriving at such deduction, shall not be denied for any taxable year ending before January 1, 1971, solely by reason of the fact that (1) the liability for the vacation pay to a specific person has not been clearly established, or (2) the amount of the liability to each individual is not capable of computation with reasonable accuracy, if at the time of the accrual the employee in respect of whom the vacation pay is accrued has performed the qualifying service necessary under a plan or policy (communicated to the employee before the beginning of the vacation year) which provides for vacations with pay to qualified employees."

INVESTIGATION OF, AND REPORTS ON, TREATMENT OF ENTERTAINMENT AND CERTAIN OTHER EXPENSES

Pub. L. 86–564, title III, § 301, June 30, 1960, 74 Stat. 291, provided that:

"(a) Investigation and report by Joint Committee on Internal Revenue Taxation.

"The Joint Committee on Internal Revenue Taxation is hereby authorized and directed to make a full and complete investigation and study of the operation and effects of present law, regulations, and practices relating to the deduction, as ordinary and necessary business expenses, of expenses for entertainment, gifts, dues or initiation fees in social, athletic, or sporting clubs or organizations, and similar or related items. The Joint Committee shall report to the House of Representatives and to the Senate the results of its investigation and study as soon as practicable during the 87th Congress, together with its recommendations for any changes in the law and administrative practices which in its judgment are necessary or appropriate.

"(b) Report by Secretary of the Treasury.

"The Secretary of the Treasury is hereby authorized and directed to report as soon as practicable during the 87th Congress to the House of Representatives and to the Senate the results of the enforcement program of the Internal Revenue Service (announced in Technical Information Release 221, dated April 4, 1960) relating to the deductions, as ordinary and necessary business expenses, of expenses for entertainment, travel, yachts, hunting lodges, club dues, and similar or related items, together with such recommendations with respect thereto as he considers necessary or appropriate to avoid misuse of the business expense deduction.

"(c) Consultation of staffs.

"The staff of the Joint Committee on Internal Revenue Taxation, and the staff of the Secretary of the Treasury, shall consult and cooperate with each other in performing any duties assigned to carry out the purposes of this section."

FILING OF CLAIMS FOR REFUNDS OF OVERPAYMENTS

Extension of time for filing of claims for refunds or credit of overpayments of income tax resulting from application of this section, see section 96 of Pub. L. 85–866, set out as a note under section 6511 of this title.

CROSS REFERENCES

Adjusted gross income as gross income minus, among others, trade and business deductions, see section 62 of this title.

Capital expenditures not deductible, see section 263 of this title.

Charitable contributions and gifts deductible, see section 170 of this title.

Corporate organizational expenses as deferred expenses, see section 248 of this title.

Employee stock options, disallowance of deduction under this section, see section 421 (a) (2) of this title.

Employer contributions to employees' trust or annuity plan negotiated during government operation as deductible under this section, see section 404 (c) of this title.

Nontrade or nonbusiness expenses deductible, see section 212 of this title.

Personal, living and family expenses not deductible, see section 262 of this title.

Taxable year deductions to be taken, see section 461 of this title.

Trade or business defined, see section 7701 (a) (26) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 81, 114, 163, 183, 263, 404, 421, 542, 543, 545, 556, 691, 707, 832, 1054, 1253, 1402 of this title; title 2 section 31c; title 15 section 78kkk; title 42 section 403.

§ 163. Interest.

(a) General rule.

There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

(b) Installment purchases where interest charge is not separately stated.

(1) General rule.

If personal property or educational services are purchased under a contract—

(A) which provides that payment of part or all of the purchase price is to be made in installments, and

(B) in which carrying charges are separately stated but the interest charge cannot be ascertained,

then the payments made during the taxable year under the contract shall be treated for purposes of this section as if they included interest equal to 6 percent of the average unpaid balance under the contract during the taxable year. For purposes of the preceding sentence, the average unpaid balance is the sum of the unpaid balance outstanding on the first day of each month beginning during the taxable year, divided by 12. For purposes of this paragraph, the term "educational services" means any service (including lodging) which is purchased from an educational institution (as defined in section 151(e)(4)) and which is provided for a student of such institution.

(2) Limitation.

In the case of any contract to which paragraph (1) applies, the amount treated as interest for any taxable year shall not exceed the aggregate carrying charges which are properly attributable to such taxable year.

(c) Redeemable ground rents.

For purposes of this subtitle, any annual or periodic rental under a redeemable ground rent (excluding amounts in redemption thereof) shall be treated as interest on an indebtedness secured by a mortgage.

(d) Limitation on interest on investment indebtedness.

(1) In general.

In the case of a taxpayer other than a corporation, the amount of investment interest (as defined in paragraph (3)(D)) otherwise allowable as a deduction under this chapter shall be limited, in the following order, to—

(A) $25,000 ($12,500, in the case of a separate return by a married individual), plus

(B) the amount of the net investment income (as defined in paragraph (3)(A)), plus

(C) an amount equal to the amount by which the net long-term capital gain exceeds the net short-term capital loss for the taxable year, plus

(D) one-half of the amount by which investment interest exceeds the sum of the amounts described in subparagraphs (A), (B), and (C).

In the case of a trust, the $25,000 amount specified in subparagraph (A) and in paragraph (2) (A) shall be zero. In determining the amount described in subparagraph (C), only gains and losses attributable to the disposition of property held for investment shall be taken into account.

(2) Carryover of disallowed investment interest.

(A) In general.

The amount of disallowed investment interest for any taxable year shall be treated as investment interest paid or accrued in the succeeding taxable year. The amount of the interest

so treated which is allowable as a deduction by reason of the first sentence of this paragraph for any taxable year shall not exceed one-half of the amount by which—

(i) the net investment income for such taxable year plus $25,000, exceeds

(ii) the investment interest paid or accrued during such taxable year (determined without regard to this paragraph) or $25,000, whichever is greater.

(B) Reduction for capital gain deduction.

If—

(i) an amount of disallowed investment interest treated under subparagraph (A) as investment interest paid or accrued in the taxable year is not allowable as a deduction for such taxable year by reason of the second sentence of subparagraph (A), and

(ii) the taxpayer is entitled to a deduction under section 1202 for such taxable year (whether or not the taxpayer claims such deduction), the amount of such disallowed investment interest shall be reduced by an amount equal to the amount of the deduction allowable under section 1202.

(3) Definitions.

For purposes of this subsection—

(A) Net investment income.

The term "net investment income" means the excess of investment income over investment expenses.

(B) Investment income.

The term "investment income" means—

(i) the gross income from interest, dividends, rents, and royalties,

(ii) the net short-term capital gain attributable to the disposition of property held for investment, and

(iii) any amount treated under sections 1245 and 1250 as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231,

but only to the extent such income, gain, and amounts are not derived from the conduct of a trade or business.

(C) Investment expenses.

The term "investment expenses" means the deductions allowable under sections 164(a) (1) or (2), 166, 167, 171, 212, or 611 directly connected with the production of investment income. For purposes of this subparagraph, the deduction allowable under section 167 with respect to any property may be treated as the amount which would have been allowable had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life for which the taxpayer has held the property, and the deduction allowable under section 611 with respect to any property may be treated as the amount which would have been allowable had the taxpayer determined the deduction under section 611 without regard to section 613 for each taxable year for which the taxpayer has held the property.

(D) Investment interest.

The term "investment interest" means interest paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment.

(E) Disallowed investment interest.

The term "disallowed investment interest" means with respect to any taxable year, the amount not allowable as a deduction solely by reason of the limitations in paragraphs (1) and (2)(A).

(4) Special rules.

(A) Property subject to net lease.

For purposes of this subsection, property subject to a lease shall be treated as property held for investment, and not as property used in a trade or business, for a taxable year, if—

(i) for such taxable year the sum of the deductions with respect to such property which are allowable solely by reason of section 162 is less than 15 percent of the rental income produced by such property, or

(ii) the lessor is either guaranteed a specified return or is guaranteed in whole or in part against loss of income.

(B) Partnerships.

In the case of a partnership, each partner shall, under regulations prescribed by the Secretary or his delegate, take into account separately his distributive share of the partnership's investment interest and the other items of income and expense taken into account under this subsection.

(C) Shareholders of electing small business corporations.

In the case of an electing small business corporation (as defined in section 1371(b)), the investment interest paid or accrued by such corporation and the other items of income and expense which would be taken into account if this subsection applied to such corporation shall, under regulations prescribed by the Secretary or his delegate, be treated as investment interest paid or accrued by the shareholders of such corporation and as items of such shareholders, and shall be apportioned pro rata among such shareholders in a manner consistent with section 1374(c)(1).

(D) Construction interest.

For purposes of this subsection, interest paid or accrued on indebtedness incurred or continued in the construction of property to be used in a trade or business shall not be treated as investment interest.

(5) Capital gains.

For purposes of sections 1201(b) (relating to alternative capital gains tax), 1202 (relating to deduction for capital gains), and 57(a)(9) (relating to treatment of capital gains as a tax preference), an amount equal to the amount of investment interest which is allowable as a deduction under this chapter by reason of subparagraph (C) of paragraph (1) shall be treated as gain from

the sale or other disposition of property which is neither a capital asset nor property described in section 1231.

(6) Exceptions.

This subsection shall not apply with respect to investment interest, investment income, and investment expenses attributable to a specific item of property, if the indebtedness with respect to such property—

(A) is for a specified term, and

(B) was incurred before December 17, 1969, or is incurred after December 16, 1969, pursuant to a written contract or commitment which, on such date and at all times thereafter prior to the incurring of such indebtedness, is binding on the taxpayer.

(e) Cross references.

(1) For disallowance of certain amounts paid in connection with insurance, endowment, or annuity contracts, see section 264.

(2) For disallowance of deduction for interest relating to tax-exempt income, see section 265 (2).

(3) For disallowance of deduction for carrying charges chargeable to capital account, see section 266.

(4) For disallowance of interest with respect to transactions between related taxpayers, see section 267.

(5) For treatment of redeemable ground rents and real property held subject to liabilities under redeemable ground rents, see section 1055.

(Aug. 16, 1954, ch. 736, 68A Stat. 46; Apr. 10, 1963, Pub. L. 88–9, § 1 (a), (c), 77 Stat. 6, 7; Feb. 26, 1964, Pub. L. 88–272, title II, § 224(c), 78 Stat. 79; Dec. 30, 1969, Pub. L. 91–172, title II, § 221(a), 83 Stat. 574.)

AMENDMENTS

1969—Pub. L. 91–172 added subsec. (d). Former subsec. (d) was redesignated as (e).

1964—Subsec. (b)(1). Pub. L. 88–272 included the purchase of educational services, and defined "educational services."

1963—Subsec. (c). Pub. L. 88–9, § 1(a), added subsec. (c). Former subsec. (c) redesignated (d).

Subsec. (d). Pub. L. 88–9, § 1(a), (c), redesignated former subsec. (c) as (d), and added par. (5).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 221(b) of Pub. L. 91–172 provided that: "The amendments made by this section [adding subsec. (d) of this section] shall apply to taxable years beginning after December 31, 1971."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 224(d) of Pub. L. 88–272 provided that: "The amendments made by subsections (a) [adding section 483 of this title] and (b) [to the analysis preceding section 481 of this title] shall apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 80, 1963, other than any sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963. The amendments made by subsection (c) [to subsec. (b)(1) of this section] shall apply to payments made during taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1963 AMENDMENT

Subsec. (c) of this section effective as of Jan. 1, 1962, and applicable with respect to taxable years ending on or after such date, see section 2 of Pub. L. 88–9, set out as a note under section 1055 of this title.

CROSS REFERENCES

Expenses and interest relating to tax-exempt income, see section 265 of this title.

Interest as income, see section 61 of this title.

Interest deductions—

Amortizable bond premium, see section 171 of this title.

Business leases, see section 514 of this title.

Cooperative housing corporation, tenant-stockholder, see section 216 of this title.

Local benefit assessments, see section 164 of this title.

Obligations of corporations organized under Act of Congress, see section 242 of this title.

Recipients of income in respect of decedents, see section 691 of this title.

Specially treated deductions, see section 270 of this title.

Tax-exempt income, see section 265 of this title.

Tax-free, see section 803 of this title.

Unpaid, see section 267 of this title.

Taxable year deduction to be taken, see section 461 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 216, 267, 483, 691, 809, 832 of this title.

§ 164. Taxes.

(a) General rule.

Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) State and local general sales taxes.

(5) State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income).

(b) Definitions and special rules.

For purposes of this section—

(1) Personal property taxes.

The term "personal property tax" means an ad valorem tax which is imposed on an annual basis in respect of personal property.

(2) General sales taxes.

(A) In general.

The term "general sales tax" means a tax imposed at one rate in respect of the sale at retail of a broad range of classes of items.

(B) Special rules for food, etc.

In the case of items of food, clothing, medical supplies, and motor vehicles—

(i) the fact that the tax does not apply in respect of some or all of such items shall not be taken into account in determining whether the tax applies in respect of a broad range of classes of items, and

(ii) the fact that the rate of tax applicable in respect of some or all of such items is lower than the general rate of tax shall not be taken into account in determining whether the tax is imposed at one rate.

(C) Items taxed at different rates.

Except in the case of a lower rate of tax applicable in respect of an item described in

subparagraph (B), no deduction shall be allowed under this section for any general sales tax imposed in respect of an item at a rate other than the general rate of tax.

(D) Compensating use taxes.

A compensating use tax in respect of an item shall be treated as a general sales tax. For purposes of the preceding sentence, the term "compensating use tax" means, in respect of any item, a tax which—

(i) is imposed on the use, storage, or consumption of such item, and

(ii) is complementary te a general sales tax, but only if a deduction is allowable under subsection (a)(4) in respect of items sold at retail in the taxing jurisdiction which are similar to such item.

(3) State or local taxes.

A State or local tax includes only a tax imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia.

(4) Foreign taxes.

A foreign tax includes only a tax imposed by the authority of a foreign country.

(5) Separately stated general sales taxes and gasoline taxes.

If the amount of any general sales tax or of any tax on the sale of gasoline, diesel fuel, or other motor fuel is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be treated as a tax imposed on, and paid by, such consumer.

(c) Deduction denied in case of certain taxes.

No deduction shall be allowed for the following taxes:

(1) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

(2) Taxes on real property, to the extent that subsection (d) requires such taxes to be treated as imposed on another taxpayer.

(d) Apportionment of taxes on real property between seller and purchaser.

(1) General rule.

For purposes of subsection (a), of real property is sold during any real property tax year, then—

(A) so much of the real property tax as is properly allocable to that part of such year which ends on the day before the date of the sale shall be treated as a tax imposed on the seller, and

(B) so much of such tax as is properly allocable to that part of such year which begins on the date of the sale shall be treated as a tax imposed on the purchaser.

(2) Special rules.

(A) in the case of any sale of real property, if—

(i) a taxpayer may not, by reason of his method of accounting, deduct any amount for taxes unless paid, and

(ii) the other party to the sale is (under the law imposing the real property tax) liable for the real property tax for the real property tax year,

then for purposes of subsection (a) the taxpayer shall be treated as having paid, on the date of the sale, so much of such tax as, under paragraph (1) of this subsection, is treated as imposed on the taxpayer. For purposes of the preceding sentence, if neither party is liable for the tax, then the party holding the property at the time the tax becomes a lien on the property shall be considered liable for the real property tax for the real property tax year.

(B) Paragraph (1) shall apply to taxable years ending after December 31, 1953, but only in the case of sales after December 31, 1953.

(C) Paragraph (1) shall not apply to any real property tax, to the extent that such tax was allowable as a deduction under the Internal Revenue Code of 1939 to the seller for a taxable year which ended before January 1, 1954.

(D) In the case of any sale of real property, if the taxpayer's taxable income for the taxable year during which the sale occurs is computed under an accrual method of accounting, and if no election under section 461 (c) (relating to the accrual of real property taxes) applies, then, for purposes of subsection (a), that portion of such tax which—

(i) is treated, under paragraph (1) of this subsection, as imposed on the taxpayer, and

(ii) may not, by reason of the taxpayer's method of accounting, be deducted by the taxpayer for any taxable year,

shall be treated as having accrued on the date of the sale.

(e) Taxes of shareholder paid by corporation.

Where a corporation pays a tax imposed on a shareholder on his interest as a shareholder, and where the shareholder does not reimburse the corporation, then—

(1) the deduction allowed by subsection (a) shall be allowed to the corporation; and

(2) no deduction shall be allowed the shareholder for such tax.

(f) Payments for municipal services in atomic energy communities.

For purposes of this section, amounts paid or accrued, to compensate the Atomic Energy Commission for municipal-type services, by any owner of real property within any community (within the meaning of section 21b of the Atomic Energy Community Act of 1955) shall be treated as State real property taxes paid or accrued. For purposes of this subsection, the term "owner" includes a person who holds the real property under a leasehold of 40 or more years and a person who has entered into a contract to purchase under section 61 of the Atomic Energy Community Act of 1955. Subsection (d) of this section shall not apply to a sale by the United States of property with respect to which this subsection applies.

(g) Cross references.

(1) For provisions disallowing any deduction for the payment of the tax imposed by subchapter B of chapter 3 (relating to tax-free covenant bonds), see section 1451.

(2) For provisions disallowing any deduction for certain taxes, see section 275.

(Aug. 16, 1954, ch. 736, 68A Stat. 47; Sept. 2, 1958, Pub. L. 85–866, title I, § 6(a), 72 Stat. 1608; Feb. 26, 1964, Pub. L. 88–272, title II, § 207 (a), (b) (1), (2), 78 Stat. 40–42.)

REFERENCES IN TEXT

Section 21b and section 61 of the Atomic Energy Community Act of 1955, referred to in subsec. (f) of this section, are classified to sections 2304 (b) and 2361, respectively, of Title 42, The Public Health and Welfare.

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272, § 207(a), limited the subsection to State, local and foreign real property, income, war profits, excess profits, and unspecified taxes, on a business or activity described in section 212, and to State and local personal property, general sales, gasoline, diesel fuel and other motor fuel taxes.

Subsec. (b). Pub. L. 88–272, § 207(a), added subsec. (b), and omitted a prior subsec. (b) which denied the deduction for certain Federal income taxes, for Federal war profits and excess profits taxes, import duties, excise and stamp taxes, and estate, inheritance, legacy, succession and gift taxes, local assessments against benefits increasing property values, and certain taxes imposed by any foreign country or possession of the United States if the taxpayer chose to benefit by section 901 relating to foreign tax credit, and for taxes on real property to the extent that they are treated as imposed on another taxpayer.

Subsec. (c). Pub. L. 88–272, § 207(a), substituted provisions denying the deduction for taxes assessed against local benefits which increase property value, except for so much as is properly allocable to maintenance or interest charges, and for real property taxes to the extent they are treated as imposed on another taxpayer, for provisions relating to certain retail sales taxes and gasoline taxes, the extent to which they were deductible, and to the definition of "State or local sales tax."

Subsec. (f). Pub. L. 88–272, § 207(b)(1), inserted "State" preceding "real property taxes."

Subsec. (g). Pub. L. 88–272, § 207(b)(2), designated existing provisions as par. (1), substituted "1451" for "1451(f)" therein, and added par. (2).

1958—Subsec. (f). Pub. L. 85–866, § 6(a), added subsec. (f) and redesignated former subsec. (f) as (g).

Subsec. (g). Pub. L. 85–866, § 6(a), redesignated former subsec. (f) as (g).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 207(c) of Pub. L. 88–272 provided that:

"(1) General rule.—Except as provided in paragraph (2), the amendments made by this section [adding section 275, and amending this section, and sections 535, 545(b)(1), 556(b)(1), 901 and 903 of this title] shall apply to taxable years beginning after December 31, 1963.

"(2) Special taxing districts.—Section 164(c)(1) of the Internal Revenue Code of 1954 (as amended by subsection (a)) shall not prevent the deduction under section 164 of such Code (as so amended) of taxes levied by a special taxing district which is described in section 164(b)(5) of such Code (as in effect for a taxable year ending on December 31, 1963) and which was in existence on December 31, 1963, for the purpose of retiring indebtedness existing on such date."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 6 (b) of Pub. L. 85–866 provided that: "The amendments made by subsection (a) [to subsecs. (f) and (g) of this section] shall apply with respect to taxable years beginning after December 31, 1957."

CROSS REFERENCES

Carrying charges not deductible, see section 266 of this title.

Federal employment taxes not deductible, see section 3502 (a) of this title.

Nondeductibility of employment taxes in computing taxable income, see section 3502 of this title.

Taxable year deduction to be taken, see section 461 of this title.

Withholding tax not deductible by employer or employee, see section 3502 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 163, 216, 275, 542, 556, 691, 703, 804, 822, 832, 853, 903, 960, 1001, 1012 of this title.

§ 165. Losses.

(a) General rule.

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) Amount of deduction.

For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) Limitation on losses of individuals.

In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) lossess of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds $100. For purposes of the $100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return.

(d) Wagering losses.

Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

(e) Theft losses.

For purposes of subsection (a), any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss.

(f) Capital losses.

Losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212.

(g) Worthless securities.

(1) General rule.

If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.

(2) Security defined.

For purposes of this subsection, the term "security" means—

(A) a share of stock in a corporation;

(B) a right to subscribe for, or to receive, a share of stock in a corporation; or

(C) a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

(3) Securities in affiliated corporation.

For purposes of paragraph (1), any security in a corporation affiliated with a taxpayer which is a domestic corporation shall not be treated as a capital asset. For purposes of the preceding sentence, a corporation shall be treated as affiliated with the taxpayer only if—

(A) stock possessing at least 80 percent of the voting power of all classes of its stock and at least 80 percent of each class of its nonvoting stock is owned directly by the taxpayer, and

(B) more than 90 percent of the aggregate of its gross receipts for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the corporation in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities.

In computing gross receipts for purposes of the preceding sentence, gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom. As used in subparagraph (A), the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(h) Disaster losses.

Notwithstanding the provisions of subsection (a), any loss

(1) attributable to a disaster which occurs during the period following the close of the taxable year and on or before the time prescribed by law for filing the income tax return for the taxable year (determined without regard to any extension of time), and

(2) occurring in an area subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Disaster Relief Act of 1970.

at the election of the taxpayer, may be deducted for the taxable year immediately preceding the taxable year in which the disaster occurred. Such deduction shall not be in excess of so much of the loss as would have been deductible in the taxable year in which the casualty occurred. If an election is made under this subsection, the casualty resulting in the loss will be deemed to have occurred in the taxable year for which the deduction is claimed.

(i) Certain property confiscated by the Government of Cuba.

(1) Treatment as subsection (c)(3) loss.

For purposes of this chapter, in the case of an individual who was a citizen of the United States, or a resident alien, on December 31, 1958, any loss of property which—

(A) was sustained by reason of the expropriation, intervention, seizure, or similar taking of the property, before January 1, 1964, by the government of Cuba, any political subdivision thereof, or any agency or instrumentality of the foregoing, and

(B) was not a loss described in paragraph (1) of subsection (c).

shall be treated as a loss to which paragraph (3) of subsection (c) applies. In the case of tangible property, the preceding sentence shall not apply unless the property was held by the taxpayer, and was located in Cuba, on one or more days in the period beginning on December 31, 1958, and ending on May 16, 1959.

(2) Special rules.

(A) For purposes of subsection (a), any loss described in paragraph (1) shall be treated as having been sustained on October 14, 1960, unless it is established that the loss was sustained on some other day.

(B) For purposes of subsection (a), the fair market value of property held by the taxpayer on one or more days during the period beginning on December 31, 1958, and ending on May 16, 1959, to which paragraph (1) applies, on the day on which the loss of such property was sustained, shall be its fair market value on the first day in such period on which the property was held by the taxpayer.

(C) For purposes of section 172, a loss described in paragraph (1) shall not be treated as an expropriation loss within the meaning of section 172(k).

(D) For purposes of section 6601, the amount of any tax imposed by this title shall not be reduced by virtue of this subsection for any period prior to February 26, 1964.

(j) Cross references.

(1) For special rule for banks with respect to worthless securities, see section 582.

(2) For disallowance of deduction for worthlessness of securities to which subsection (g) (2) (C) applies, if issued by a political party or similar organization, see section 271.

(3) For special rule for losses on stock in a small business investment company, see section 1242.

(4) For special rule for losses of a small business investment company, see section 1243.

(5) For special rule for losses on small business stock, see section 1244.

(Aug. 16, 1954, ch. 736, 68A Stat. 49; Sept. 2, 1958, Pub. L. 85-866, title I, §§ 7, 57(c)(1), title II, § 202(a), 72 Stat. 1608, 1646, 1676; Mar. 31, 1962, Pub. L. 87-426, § 2(a), 76 Stat. 51; Feb. 26, 1964, Pub. L. 88-272, title II, §§ 208(a), 238, 78 Stat. 43, 128; June 30, 1964, Pub. L. 88-348, § 3(a), 78 Stat. 237; Dec. 31, 1970, Pub. L. 91-606, title III, § 301(h), 84 Stat. 1759; Jan. 12, 1971, Pub. L. 91-677, § 1(a), 84 Stat. 2061; Jan. 12, 1971, Pub. L. 91-687, § 1, 84 Stat. 2071.)

REFERENCE IN TEXT

The Disaster Relief Act of 1970, referred to in subsec. (h)(2), is classified to chapter 58 (section 4401 et seq.) of Title 42, The Public Health and Welfare.

AMENDMENTS

1971—Subsec. (g)(3). Pub. L. 91-687 substituted "stock possessing at least 80 percent of the voting power of all classes of its stock and at least 80 percent of each class of its nonvoting stock" for "at least 95 percent of each class

of its stock" in subpar. (A), and inserted at the end of the subsection the sentence providing that the term "stock", as used in subpar. (A), does not include nonvoting stock which is limited and preferred as to dividends.

Subsec. (l)(1). Pub. L. 91–677, § 1(a)(1), (2), struck out "or (2)" following "paragraph (1)" in cl. (B), and substituted "one or more days in the period beginning on December 31, 1958, and ending on May 16, 1959" for "December 31, 1958".

Subsec. (l)(2)(B). Pub. L. 91–677, § 1(a)(3), substituted "one or more days during the period beginning on December 31, 1958, and ending on May 16, 1959" for "December 31, 1958" and "the first day in such period on which the property was held by the taxpayer" for "December 31, 1958".

Subsec. (l)(3). Pub. L. 91–677, § 1(a)(4), struck out subsec. (l)(3) which authorized a refund or credit to be given for any overpayment attributable to the application of par. (1), provided that a claim was filed for such refund or credit before Jan. 1, 1965.

1970—Subsec. (h)(2). Pub. L. 91–606 substituted "the Disaster Relief Act of 1970" for "sections 1855–1855g of title 42".

1964—Subsec. (c)(3). Pub. L. 88–272, § 208(a), inserted the requirement that losses must exceed $100 to be deductible.

Subsec. (l). Pub. L. 88–348 designated existing provisions as par. (1), substituted provisions permitting individuals who were citizens of the United States or resident aliens on Dec. 31, 1958, who sustained any loss of property prior to Jan. 1, 1964, and which was not a loss described in par. (1) or (2) of subsec. (c), to treat such loss as a loss under subsec. (c)(3), except that in cases of tangible property, the property had to be held by the taxpayer, and located in Cuba, on Dec. 31, 1958, for provisions which permitted any loss of tangible property to be treated as a loss from a casualty within subsec. (c)(3), therein, and added pars. (2) and (3).

Pub. L. 88–272, § 238, added subsec. (i). Former subsec. (i), redesignated (j).

Subsec. (j). Pub. L. 88–272, § 238, redesignated former subsec. (i) as (j).

1962—Subsec. (h). Pub. L. 87–426, § 2(a)(2), added subsec. (h), and redesignated former subsec. (h) as (i).

Subsec. (i). Pub. L. 87–426, § 2(a)(1), redesignated former subsec. (h) as (i).

1958—Subsec. (g)(3)(B). Pub. L. 85–866, § 7, substituted "rental of" for "rental from".

Subsec. (h)(3), (4). Pub. L. 85–866, § 57(c)(1), added subsec. (h)(3), (4).

Subsec. (h)(5). Pub. L. 85–866, § 202(a), added subsec. (h)(5).

EFFECTIVE DATE OF 1971 AMENDMENTS

Section 2 of Pub. L. 91–687 provided that: "The amendments made by this Act [to subsec. (g)(3) of this section] shall apply with respect to taxable years beginning on or after January 1, 1970."

Section 1(b)(1) of Pub. L. 91–677 provided that: "The amendments made by subsection (a) of this section [amending subsec. (l) of this section] shall apply in respect of losses sustained in taxable years ending after December 31, 1958."

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91–606 effective Dec. 31, 1970, see section 304 of Pub. L. 91–606, set out as a note under section 4401 of Title 42, The Public Health and Welfare.

EFFECTIVE DATE OF 1964 AMENDMENTS

Section 208(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to subsec. (c)(3) of this section] shall apply to losses sustained after December 31, 1963, in taxable years ending after such date."

Section 3(b) of Pub. L. 88–348 provided that: "The amendment made by subsection (a) [to subsec. (l) of this section] shall apply in respect of losses sustained in taxable years ending after December 31, 1958."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 2(b) of Pub. L. 87–426 provided that: "The amendments made by this section [adding subsec. (h) of this section and redesignating former subsec. (h) as (i)] shall be effective with respect to any disaster occurring after December 31, 1961."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 1(c) of Pub. L. 85–866 provided that:

"Except as otherwise expressly provided—

"(1) amendements made by this title to subtitle A of the Internal Revenue Code of 1954 (relating to income taxes) [adding section 558 of this title and amending sections 152 (a) (9), (b) (5), 165 (g) (3) (B), 166 (d) (2) (A), 168 (e) (2) (A), (B), (C), 170 (b) (3), 172 (f) (3), (4), (g) (3), (4), 213 (d) (2) (A), 337 (d), 404 (a), 421 (a), 535 (b) (2), (6) (B), 545 (b) (2), 556 (b) (2), 582 (c), 611 (b) (4), 613 (d), 851 (e) (1), (2), 1015 (d), 1031 (d), 1033 (a) (2), (g), (h), (i) (2), (3), 1053, 1232 (c), 1233 (a), (g), 1234, 1237 (a) (1), 1341 (a), 1341 (b) (2) (last sentence), 1341 (b) (3), 1347 (last sentence), 2501 (b), 3121 (*l*) (3) and 3122 of this title] shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954; and

"(2) amendments made by this title to subtitle F of such Code (relating to procedure and administration) [adding sections 7513 and 7514 of this title and amending sections 6013 (b) (2) (C), 6015 (f), 6212 (b) (1), 6325 (a) (1), (c)—(e), 6338 (c), 6339 (b) (2), 6501 (d), (g) (2), (h), (i), 6504 (15), 6511 (a), (b) (2), (d) (2) (A), 6601 (b), (h), 6652 (a), 6653 (c) (1), 6351 (d), 6871 (a), (b), 7213 (c), (d), 7324 (3), 7325 (3) and 7422 (f) (2) of this title] shall take effect as of August 17, 1954, and such subtitle, as so amended, shall apply as provided in section 7851 of the Internal Revenue Code of 1954".

Amendment of section by Pub. L. 85–866, § 57 (c) (1), which added subsec. (h) (3) (4), as applicable with respect to taxable years beginning after Sept. 2, 1958, see section 57 (d) of Pub. L. 85–866, set out as a note under section 243 of this title.

SHORT TITLE

Section 201 of Pub. L. 85–866 provided that title II of Pub. L. 85–866, which is classified to subsec. (h) (5) of this section and to sections 172 (b) (1), (2), (j), (l), 172 note, 179, 179 note, 535 (c) (2), (3), 535 note, 1244, 1551, 6161 (a) (2), 6161 note, 6166, 6503 (d), and 6601 (b) of this title, should be popularly known as the "Small Business Tax Revision Act of 1958".

REFUND OR CREDIT OF OVERPAYMENT; TIME FOR FILING CLAIM; INTEREST

Section 1(b)(2) of Pub. L. 91–677 provided that:: "Notwithstanding any law or rule of law, refund or credit of any overpayment attributable to the amendments made by subsection (a) [amending subsec. (l) of this section] may be made or allowed if claim therefor is filed after the date of the enactment of this Act [Jan. 12, 1971] and before July 1, 1971. No interest shall be allowed with respect to any such refund or credit for any period before January 1, 1972."

CROSS REFERENCES

Adjusted gross income as gross income minus, among others, losses from sale or exchange of property, see section 62 of this title.

General rules for determining capital losses, see section 1221 et seq. of this title.

Loss deductions for nonresident alien individuals, see section 873 (b) of this title.

Losses in transactions between related taxpayers not deductible, see section 267 of this title.

Special rules for determining capital losses, see section 1231 et seq. of this title.

Treatment of capital losses, see section 1211 et seq. of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 80, 103, 166, 271, 272, 582, 585, 593, 873, 877, 931, 934, 1212, 1351, 6511 of this title.

§ 166. Bad debts.

(a) General rule.

(1) Wholly worthless debts.

There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

(2) Partially worthless debts.

When satisfied that a debt is recoverable only in part, the Secretary or his delegate may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(b) Amount of deduction.

For purposes of subsection (a), the basis for determining the amount of the deduction for any bad debt shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) Reserve for bad debts.

In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary or his delegate) a deduction for a reasonable addition to a reserve for bad debts.

(d) Nonbusiness debts.

(1) General rule.

In the case of a taxpayer other than a corporation—

(A) subsections (a) and (c) shall not apply to any nonbusiness debt; and

(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months.

(2) Nonbusiness debt defined.

For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than—

(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

(e) Worthless securities.

This section shall not apply to a debt which is evidenced by a security as defined in section 165 (g) (2) (C).

(f) Guarantor of certain noncorporate obligations.

A payment by the taxpayer (other than a corporation) in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of a noncorporate obligation the proceeds of which were used in the trade or business of the borrower shall be treated as a debt becoming worthless within such taxable year for purposes of this section (except that subsection (d) shall not apply), but only if the obligation of the borrower to the person to whom such payment was made was worthless (without regard to such guaranty, endorsement, or indemnity) at the time of such payment.

(g) Reserve for certain guaranteed debt obligations.

(1) Allowance of deduction.

In the case of a taxpayer who is a dealer in property, in lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary or his delegate) for any taxable year ending after October 21, 1965, a deduction—

(A) for a reasonable addition to a reserve for bad debts which may arise out of his liability as a guarantor, endorser, or indemnitor of debt obligations arising out of the sale by him of real property or tangible personal property (including related services) in the ordinary course of his trade or business; and

(B) for the amount of any reduction in the suspense account required by paragraph (4) (B) (i).

(2) Deduction disallowed in other cases.

Except as provided in paragraph (1), no deduction shall be allowed to a taxpayer for any addition to a reserve for bad debts which may arise out of his liability as guarantor, endorser, or indemnitor of debt obligations.

(3) Opening balance.

The opening balance of a reserve described in paragraph (1)(A) for the first taxable year ending after October 21, 1965, for which a taxpayer maintains such reserve shall, under regulations prescribed by the Secretary or his delegate, be determined as if the taxpayer had maintained such reserve for the preceding taxable years.

(4) Suspense account.

(A) Requirement.

Except as provided by subparagraph (C), each taxpayer who maintains a reserve described in paragraph (1)(A) shall, for purposes of this subsection and section 81, establish and maintain a suspense account. The initial balance of such account shall be equal to the opening balance described in paragraph (3).

(B) Adjustments.

At the close of each taxable year the suspense account shall be—

(i) reduced by the excess of the suspense account at the beginning of the year over the reserve described in paragraph (1)(A) (after making the addition for such year provided in such paragraph), or

(ii) increased (but not to an amount greater than the initial balance of the suspense account) by the excess of the reserve described in paragraph (1)(A) (after making the addition for such year provided in such paragraph) over the suspense account at the beginning of such year.

(C) Limitations.

Subparagraphs (A) and (B) shall not apply in the case of the taxpayer who maintained for his last taxable year ending before October 22, 1965, a reserve for bad debts under subsection (c) which included debt obligations described in paragraph (1)(A).

(D) Section 381 acquisitions.

The application of this paragraph in any acquisition to which section 381(a) applies shall be determined under regulations prescribed by the Secretary or his delegate.

(b) Cross references.

(1) For disallowance of deduction for worthlessness of debts owed by political parties and similar organizations, see section 271.

(2) For special rule for banks with respect to worthless securities, see section 582.

(3) For special rule for bad debt reserves of certain mutual savings banks, domestic buildiug and loan associations, and cooperative banks, see section 593.

(4) For special rule for bad debt reserves of banks, small business investment-companies, etc., see sections 585 and 586.

(Aug. 16, 1954, ch. 736, 68A Stat. 50; Sept. 2, 1958, Pub. L. 85–866, title I, § 8, 72 Stat. 1608; Nov. 2, 1966, Pub. L. 89–722, § 1(a), 80 Stat. 1151; Dec. 30, 1969, Pub. L. 91–172, title IV, § 431(c)(1), 83 Stat. 619.)

AMENDMENTS

1969—Subsec. (h). Pub. L. 91–172 added par. (4).

1966—Subsec. (g). Pub. L. 89–722 added subsec. (g) and redesignated former subsec. (g) as (h).

Subsec. (h). Pub. L. 89–722 redesignated former subsec. (g) as (h).

1958—Subsec. (d)(2)(A). Pub. L. 85–866 substituted "a trade or business of the taxpayer" for "a taxpayer's trade or business".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after July 11, 1969, see section 431(d) of Pub. L. 91–172, set out as a note under section 585 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 2 of Pub. L. 89–722 provided that:

"(a) Except as provided in subsections (b) and (c), the amendments made by the first section of this Act [Enacting subsec. (g) of this section and section 81 of this title] shall apply to taxable years ending after October 21, 1965.

"(b) If—

"(1) the taxpayer before October 22, 1965, claimed a deduction, for a taxable year ending before such date, under section 166(c) of the Internal Revenue Code of 1954 [subsec. (c) of this section] for an addition to a reserve for bad debts on account of debt obligations described in section 166(g)(1)(A) of such Code (as amended by the first section of this Act) [subsec. (g)(1)(A) of this section], and

"(2) the assessment of a deficiency of the tax imposed by chapter 1 of such Code for such taxable year and each subsequent taxable year ending before October 22, 1965, is not prevented on December 31, 1966, by the operation of any law or rule of law,

then such deduction on account of such debt obligations shall be allowed for each such taxable year under such section 166(c) to the extent that the deduction would have been allowable under the provisions of such section 166(g)(1)(A) if such provisions applied to such taxable years.

"(c) Section 166(g)(2) of the Internal Revenue Code of 1954 (as amended by the first section of this Act) [subsec. (g)(2) of this section] shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (d) (2) (A) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

ESTABLISHMENT OF RESERVE FOR TAXABLE YEAR ENDING AFTER OCT. 21, 1965, AND BEGINNING BEFORE AUG. 2, 1966

Section 1(c) of Pub. L. 89–722 provided that: "If the taxpayer establishes a reserve described in section 166 (g)(1) of the Internal Revenue Code of 1954 (as amended by subsection (a) of this section) [subsec. (g)(1) of this section] for a taxable year ending after October 21, 1965, and beginning before August 2, 1966, the establishment of such reserve shall not be considered as a change in method of accounting for purposes of section 446(e) of such Code."

CROSS REFERENCES

Bad debts—

Addition to reserve, see section 593 of this title.

Carryover, see section 381 of this title.

Limitation of claim for credit or refund, see section 6511 of this title.

Debts owed political parties not deductible, see section 271 of this title.

Time for taking deduction, see section 461 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 81, 163, 271, 582, 585, 586, 593, 595, 809, 1351, 6511 of this title.

§ 167. Depreciation.

(a) General rule.

There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) Use of certain methods and rates.

For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) Limitations on use of certain methods and rates.

Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

(d) Agreement as to useful life on which depreciation rate is based.

Where, under regulations prescribed by the Secretary or his delegate, the taxpayer and the Secretary or his delegate have, after the date of enactment of this title, entered into an agreement in writing specifically dealing with the useful life and rate of depreciation of any property, the rate so agreed upon shall be binding on both the taxpayer and the Secretary in the absence of facts or circumstances not

taken into consideration in the adoption of such agreement. The responsibility of establishing the existence of such facts and circumstances shall rest with the party initiating the modification. Any change in the agreed rate and useful life specified in the agreement shall not be effective for taxable years before the taxable year in which notice in writing by certified mail or registered mail is served by the party to the agreement initiating such change.

(e) Change in method.

(1) Change from declining balance method.

In the absence of an agreement under subsection (d) containing a provision to the contrary, a taxpayer may at any time elect in accordance with regulations prescribed by the Secretary or his delegate to change from the method of depreciation described in subsection (b)(2) to the method described in subsection (b)(1).

(2) Change with respect to section 1245 property.

A taxpayer may, on or before the last day prescribed by law (including extensions thereof) for filing his return for his first taxable year beginning after December 31, 1962, and in such manner as the Secretary or his delegate shall by regulations prescribe, elect to change his method of depreciation in respect of section 1245 property (as defined in section 1245(a)(3)) from any declining balance or sum of the years-digits method to the straight line method. An election may be made under this paragraph notwithstanding any provision to the contrary in an agreement under subsection (d).

(3) Change with respect to section 1250 property.

A taxpayer may, on or before the last day prescribed by law (including extensions thereof) for filing his return for his first taxable year beginning after July 24, 1969, and in such manner as the Secretary or his delegate shall by regulation prescribe, elect to change his method of depreciation in respect of section 1250 property (as defined in section 1250(c)) from any declining balance or sum of the years-digits method of the straight line method. An election may be made under this paragraph notwithstanding any provision to the contrary in an agreement under subsection (d).

(f) Salvage value.

(1) General rule.

Under regulations prescribed by the Secretary or his delegate, a taxpayer may, for purposes of computing the allowance under subsection (a) with respect to personal property, reduce the amount taken into account as salvage value by an amount which does not exceed 10 percent of the basis of such property (as determined under subsection (g) as of the time as of which such salvage value is required to be determined).

(2) Personal property defined.

For purposes of this subsection, the term "personal property" means depreciable personal property (other than livestock) with a useful life of 3 years or more acquired after the date of the enactment of the Revenue Act of 1962.

(g) Basis for depreciation.

The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

(h) Life tenants and beneficiaries of trusts and estates.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. In the case of an estate, the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each.

(i) Limitation in case of property constructed or acquired during the suspension period.

(1) In general.

Under regulations prescribed by the Secretary or his delegate, paragraphs (2), (3), and (4) of subsection (b) shall not apply in the case of real property which is not section 38 property (as defined in section 48(a)) if the physical construction, reconstruction, or erection of such property by any person begins during the suspension period, or begins, pursuant to an order placed during such period, before May 24, 1967. Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (3), (4), (7), (8), (9), and (10) of section 48(h) shall be applied for purposes of the preceding sentence. In applying this paragraph to any property, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection before May 24, 1967.

(2) Exception.

Paragraph (1) shall not apply to any item of real property selected by the taxpayer if the cost of such property (when added to the cost of all other items of real property selected by the taxpayer under this paragraph) does not exceed $50,000. Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraph (2) of section 48(c) shall be applied for purposes of this paragraph.

(3) Suspension period.

For purposes of this subsection, the term "suspension period" means the period beginning on October 10, 1966, and ending on March 9, 1967.

(j) Special rules for section 1250 property.

(1) General rule.

Except as provided in paragraphs (2) and (3), in the case of section 1250 property, subsection (b) shall not apply and the term "reasonable allowance" as used in subsection (a) shall include an allowance computed in accordance with regula-

tions prescribed by the Secretary or his delegate, under any of the following methods:

(A) the straight line method,

(B) the declining balance method, using a rate not exceeding 150 percent of the rate which would have been used had the annual allowance been computed under the method described in subparagraph (A), or

(C) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in subparagraph (B).

Nothing in this paragraph shall be construed to limit or reduce an allowance otherwise allowable under subsection (a) except where allowable solely by reason of paragraph (2), (3), or (4) of subsection (b).

(2) Residential rental property.

(A) In general.

Paragraph (1) of this subsection shall not apply, and subsection (b) shall apply in any taxable year, to a building or structure—

(i) which is residential rental property located within the United States or any of its possessions, or located within a foreign country if a method of depreciation for such property comparable to the method provided in subsection (b) (2) or (3) is provided by the laws of such country, and

(ii) the original use of which commences with the taxpayer.

In the case of residential rental property located within a foreign country, the original use of which commences with the taxpayer, if the allowance for depreciation provided under the laws of such country for such property is greater than that provided under paragraph (1) of this subsection, but less than that provided under subsection (b), the allowance for depreciation under subsection (b) shall be limited to the amount provided under the laws of such country.

(B) Definition.

For purposes of subparagraph (A), a building or structure shall be considered to be residential rental property for any taxable year only if 80 percent or more of the gross rental income from such building or structure for such year is rental income from dwelling units (within the meaning of subsection (k)(3)(C)). For purposes of the preceding sentence, if any portion of such building or structure is occupied by the taxpayer, the gross rental income from such building or structure shall include the rental value of the portion so occupied.

(C) Change in method of depreciation.

Any change in the computation of the allowance for depreciation for any taxable year, permitted or required by reason of the application of subparagraph (A), shall not be considered a change in a method of accounting.

(3) Property constructed, etc., before July 25, 1969.

Paragraph (1) of this subsection shall not apply, and subsection (b) shall apply, in the case of property—

(A) the construction, reconstruction, or erection of which was begun before July 25, 1969, or

(B) for which a written contract entered into before July 25, 1969, with respect to any part of the construction, reconstruction, or erection or for the permanent financing thereof, was on July 25, 1969, and at all times thereafter, binding on the taxpayer.

(4) Used section 1250 property.

Except as provided in paragraph (5), in the case of section 1250 property acquired after July 24, 1969, the original use of which does not commence with the taxpayer, the allowance for depreciation under this section shall be limited to an amount computed under—

(A) the straight line method, or

(B) any other method determined by the Secretary or his delegate to result in a reasonable allowance under subsection (a), not including—

(i) any declining balance method,

(ii) the sum of the years-digits method, or

(iii) any other method allowable solely by reason of the application of subsection (b)(4) or paragraph (1)(C) of this subsection.

(5) Used residential rental property.

In the case of section 1250 property which is residential rental property (as defined in paragraph (2)(B) acquired after July 24, 1969, having a useful life of 20 years or more, the original use of which does not commence with the taxpayer, the allowance for depreciation under this section shall be limited to an amount computed under—

(A) the straight line method,

(B) the declining balance method, using a rate not exceeding 125 percent of the rate which would have been used had the annual allowance been computed under the method described in subparagraph (A), or

(C) any other method determined by the Secretary or his delegate to result in a reasonable allowance under subsection (a), not including—

(i) the sum of the years-digits method,

(ii) any declining balance method using a rate in excess of the rate permitted under subparagraph (B), or

(iii) any other method allowable solely by reason of the application of subsection (b)(4) or paragraph (1)(C) of this subsection.

(6) Special rules.

(A) Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided in paragraphs (5), (9), (10), and (13) of section 48(h) shall be applied for purposes of paragraphs (3), (4), and (5) of this subsection.

(B) For purposes of paragraphs (2), (4), and (5), if section 1250 property which is not property described in subsection (a) when its original use commences, becomes property described

in subsection (a) after July 24, 1969, such property shall not be treated as property the original use of which commences with the taxpayer.

(C) Paragraphs (4) and (5) shall not apply in the case of section 1250 property acquired after July 24, 1969, pursuant to a written contract for the acquisition of such property or for the permanent financing thereof, which was, on July 24, 1969, and at all times thereafter, binding on the taxpayer.

(k) Depreciation of expenditures to rehabilitate low-income rental housing.

(1) 60-month rule.

The taxpayer may elect, in accordance with regulations prescribed by the Secretary or his delegate, to compute the depreciation deduction provided by subsection (a) attributable to rehabilitation expenditures incurred with respect to low-income rental housing after July 24, 1969, and before January 1, 1975, under the straight line method using a useful life of 60 months and no salvage value. Such method shall be in lieu of any other method of computing the depreciation deduction under subsection (a), and in lieu of any deduction for amortization, for such expenditures.

(2) Limitations.

(A) The aggregate amount of rehabilitation expenditures paid or incurred by the taxpayer with respect to any dwelling unit in any low-income rental housing which may be taken into account under paragraph (1) shall not exceed $15,000.

(B) Rehabilitation expenditures paid or incurred by the taxpayer in any taxable year with respect to any dwelling unit in any low-income rental housing shall be taken into account under paragraph (1) only if over a period of two consecutive years, including the taxable year, the aggregate amount of such expenditures exceeds $3,000.

(3) Definitions.

(A) Rehabilitation expenditures.

The term "rehabilitation expenditures" means amounts chargeable to capital account and incurred for property or additions or improvements to property (or related faciiities) with a useful life of 5 years or more, in connection with the rehabilitation of an existing building for low-income rental housing; but such term does not include the cost of acquisition of such building or any interest therein.

(B) Low-income rental housing.

The term "low-income rental housmg" means any building the dwelling units in which are held for occupancy on a rental basis by families and individuals of low or moderate income, as determined by the Secretary or his delegate in a manner consistent with the policies of the Housing and Urban Development Act of 1968 pursuant to regulations prescribed under this subsection.

(C) Dwelling unit.

The term "dwelling unit" means a house or an apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, inn, or other establishment more than one-half of the units in which are used on a transient basis.

(l) Reasonable allowance in case of property of certain utilities.

(1) Pre-1970 public utility property.

(A) In general.

In the case of any pre-1970 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(i) a subsection (l) method, or

(ii) the applicable 1968 method for such property.

Except as provided in subparagraph (B), clause (ii) shall apply only if the taxpayer uses a normalization method of accounting.

(B) Flow-through metbod of accounting in certain cases.

In the case of any pre-1970 public utility property, the taxpayer may use the applicable 1968 method for such property if—

(i) the taxpayer used a flow-through method of accounting for such property for its July 1969 accounting period, or

(ii) the first accounting period with respect to such property is after the July 1969 accounting period, and the taxpayer used a flow-through method of accounting for its July 1969 accounting period for the property on the basis of which the applicable 1968 method for the property in question is established.

(2) Post-1969 public utility property.

In the case of any post-1969 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(A) a subsection (l) method,

(B) a method otherwise allowable under this section if the taxpayer uses a normalization method of accounting, or

(C) the applicable 1968 method, if, with respect to its pre-1970 public utility property of the same (or similar) kind most recently placed in service, the taxpayer used a flow-through method of accounting for its July 1969 accounting period.

(3) Definitions.

For purposes of this subsection—

(A) Public utility property.

The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—

(i) electrical energy, water, or sewage disposal services,

(ii) gas or steam through a local distribution system,

(iii) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(iv) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar bedy of any State or political subdivision thereof.

(B) Pre-1970 public utility property.

The term "pre-1970 public utility property" means property which was public utility property in the hands of any person at any time before January 1, 1970.

(C) Post-1969 public utility property.

The term "post-1969 public utility property" means any public utility property which is not pre-1970 public utility property,

(D) Applicable 1968 method.

The term "applicable 1968 method" means, with respect to any public utility property—

(i) the method of depreciation used on a return with respect to such property for the latest taxable year for which a return was filed before August 1, 1969,

(ii) if clause (i) does not apply, the method used by the taxpayer on a return for the latest taxable year for which a return was filed before August 1, 1969, with respect to its public utility property of the same kind (or if there is no property of the same kind, property of the most similar kind) most recently placed in service, or

(iii) if neither clause (i) nor (ii) applies, a subsection (*l*) method.

In the case of any section 1250 property to which subsection (j) applies, the term "applicable 1968 method" means the method permitted under subsection (j) which is most nearly comparable to the applicable 1968 method determined under the preceding sentence.

(E) Applicable 1968 method in certain cases.

If the taxpayer evidenced the intent to use a method of depreciation (other than its applicable 1968 method or a subsection (*l*) method) with respect to any public utility property in a timely application for change of accounting method filed before August 1, 1969, or in the computation of its tax expense for purposes of reflecting operating results in its regulated books of account for its July 1969 accounting period, such other method shall be deemed to be its applicable 1968 method with respect to such property and public utility property of the same (or similar) kind subsequently placed in service.

(F) Subsection (*l*) method.

The term "subsection (*l*) method" means any method determined by the Secretary or his delegate to result in a reasonable allowance under subsection (a), other than (i) a declining balance method, (ii) the sum of the years-digits method, or (iii) any other method allowable solely by reason of the application of subsection (b)(4) or (j)(1)(C).

(G) Normalization method of accounting.

In order to use a normalization method of accounting with respect to any public utility property—

(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation.

(H) Flow-through method of accounting.

The taxpayer used a "flow-through method of accounting" with respect to any public utility property if it used the same method of depreciation (other than a subsection (*l*) method) to compute its allowance for depreciation under this section and to compute its tax expense for purposes of reflecting operating results in its regulated books of account.

(I) July 1969 accounting period.

The term "July 1969 acoounting period" means the taxpayers latest accounting period ending before August 1, 1969, for which it computed its tax expense for purposes of reflecting operating results in its regulated books of account.

For purposes of this paragraph, different declining balance rates shall be treated as different methods of depreciation.

(4) Special rules as to flow-through method.

(A) Election as to new property representing growth in capacity.

If the taxpayer makes an election under this subparagraph within 180 days after the date of the enactment of this subparagraph in the manner prescribed by the Secretary or his delegate, in the case of taxable years beginning after December 31, 1970, paragraph (2)(C) shall not apply with respect to any post-1969 public utility property, to the extent that such property constitutes property which increases the productive or operational capacity of the taxpayer with respect to the goods or services described in paragraph (3)(A) and does not represent the replacement of existing capacity.

(B) Certain pending applications for changes in method.

In applying paragraph (1)(B), the taxpayer shall be deemed to have used a flow-through method of accounting for its July 1969 accounting period with respect to any pre-1970 public utility property for which it filed a timely application for change of accounting method before August 1, 1969, if with respect to public utility property of the same (or similar) kind most re-

cently placed in service, it used a flow-through method of accounting for its July 1969 accounting period.

(5) Reorganizations, assets acquisitions, etc.

If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary or his delegate shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

(m) Depreciation of improvements in the case of mines, etc.

For additional rule applicable to depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, see section 611.

(Aug. 16, 1954, ch. 736, 68A Stat. 51; Sept. 2, 1958, Pub. L. 85–866, title I, § 89(b), 72 Stat. 1665; Oct. 16, 1962, Pub. L. 87–834, § 13(b), (c)(1), 76 Stat. 1034; Nov. 8, 1966, Pub. L. 89–800, § 2, 80 Stat. 1513; June 13, 1967, Pub. L. 90–26, §§ 1, 2(b), 81 Stat. 57, 58; Dec. 30, 1969, Pub. L. 91–172, title IV, § 441(a), title V, § 521 (a), (d), 83 Stat. 625, 649, 653.)

REFERENCES IN TEXT

The date of the enactment of the Revenue Act of 1962, referred to in subsec. (f), means the date of the enactment of Pub. L. 87–834, which was approved on Oct. 16, 1962.

The Housing and Urban Development Act of 1963, referred to in subsec. (k)(3)(B), is Pub. L. 90–448, Aug. 1, 1968, 32 Stat. 476, which is classified principally to section 1701t et seq. of Title 12, Banks and Banking.

The Communications Satellite Act of 1962 (47 U.S.C. 701), referred to in subsec. (*l*)(3)(A)(iii), is Pub. L. 87–624, Aug 31, 1962, 76 Stat. 419, which is classified to section 701 et seq. of Title 47, Telegraphs, Telephones, and Radiotelegraphs.

AMENDMENTS

1969—Subsec. (e). Pub. L. 91–172, § 521(d), added par. (3).

Subsecs. (j), (k). Pub. L. 91–172, § 521(a), added subsecs. (j) and (k). Former subsec. (j) redesignated (m).

Subsec. (*l*). Pub. L. 91–172, § 441(a), added subsec. (*l*).

Subsec. (m). Pub. L. 91–172, § 521(a), redesignated former subsec. (j) as (m).

1967—Subsec. (i)(1). Pub. L. 90–26, § 2(b), provided that accelerated depreciation was not to apply if the physical construction, reconstruction or erection by any person was begun during the suspension period or begun, pursuant to an order placed during such period, before May 24, 1967, subject to the proviso that only that portion of the basis which was properly attributable to construction, reconstruction or erection before May 24, 1967, shall be affected by the applicability of the suspension period.

Subsec. (i)(3). Pub. L. 90–26, § 1, substituted "March 9, 1967" for "December 31, 1967".

1966—Subsec. (i). Pub. L. 89–800 added subsec. (i). Former subsec. (i) redesignated as subsec. (j).

Subsec. (j). Pub. L. 89–800 redesignated former subsec. (i) as subsec. (j).

1962—Subsec. (e). Pub. L. 87–834, § 13(b), designated existing provisions as par. (1) and added par. (2).

Subsec. (f). Pub. L. 8–834, § 13(c)(1), added subsec. (f) and redesignated former subsec. (f) as (g).

Subsecs. (g)—(i). Pub. L. 87–834, § 13(c)(1), redesignated former subsecs. (f), (g) and (h) as (g), (h) and (i), respectively.

1958—Subsec. (d). Pub. L. 85–866 inserted "certified mail or" preceding "registered mail".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 441(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding subsec. (*l*) to this section] shall apply with respect to all taxable years for which a return has not been filed before August 1, 1969."

Section 521(g) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and sections 381 and 1250 of this title] shall apply with respect to taxable years ending after July 24, 1969."

EFFECTIVE DATE OF 1967 AMENDMENT

Amendment of subsec. (i) by sections 1 and 2(b) of Pub. L. 90–26 applicable with respect to taxable years ending after March 9, 1967, see section 4 of Pub. L. 90–26, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of this section by Pub. L. 89–800 applicable to taxable years ending after Oct. 9, 1966, see section 4 of Pub. L. 89–800, set out as a note under section 46 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (e) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec. 31, 1962, and subsec. (f) of this section applicable to taxable years beginning after Dec. 31, 1961, and ending after Oct. 16, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (d) by Pub. L. 85–866 applicable only if mailing occurred after Sept. 2, 1958, see section 89 (d) of Pub. L. 85–866, set out as a note under section 7502 of this title.

CROSS REFERENCES

Adjusted gross income as gross income minus, among others, depreciation deduction, see section 62 of this title.

Allowance of deduction for depletion, see section 611 of this title.

Capital expenditures not deductible, see section 263 of this title.

Depreciation—

- Adjustments to basis for determining gain or loss, see section 1016 of this title.
- Allocation among partners, see section 704 of this title.
- Allowed before 1952, election in respect of, see section 1020 of this title.
- Development expenses, see section 616 of this title.
- Estates or trusts, see section 642 of this title.
- Exploration expenses, see section 615 of this title.
- Payments to encourage exploration, development and mining for defense purposes, see section 621 of this title.
- Property used in trade or business as property subject to depreciation allowance, see section 1231 of this title.
- Undivided interest in property contributed to partnership, see section 704 of this title.

Taxable year deductions to be taken, see section 461 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 62, 163, 168, 169, 172, 174, 175, 179, 182, 184, 187, 216, 312, 381, 615, 616, 617, 642, 817, 822, 832, 1016, 1071, 1082, 1221, 1231, 1239, 1245, 1250, 4940 of this title.

§ 168. Amortization of emergency facilities.

(a) General rule.

Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (in-

cluding the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (f), be in lieu of the depreciation deduction with respect to such facility for such month provided by section 167. The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

(b) Election of amortization.

The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the facility was completed or acquired, or with the taxable year succeeding the taxable year in which such facility was completed or acquired, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

(c) Termination of amortization deduction.

A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply and the taxpayer shall not be entitled to any further amortization deduction with respect to such emergency facility.

(d) Definitions.

(1) Emergency facility.

For purposes of this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1949, and with respect to which a certificate under subsection (e) has been made. In no event shall an amortization deduction be allowed in respect of any emergency facility for any taxable year unless a certificate in respect thereof under this paragraph shall have been made before the filing of the taxpayer's return for such taxable year.

(2) Emergency period.

For purposes of this section, the term "emergency period" means the period beginning January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (e) have been made is no longer required in the interest of national defense.

(e) Determination of adjusted basis of emergency facility.

In determining, for purposes of subsection (a) or (g), the adjusted basis of an emergency facility—

(1) Certification on or before August 22, 1957.

In the case of a certificate made on or before August 22, 1957, there shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by Executive Order, has certified as necessary in the interest of national defense during the emergency period, and only such portion of such amount as such authority has certified as attributable to defense purposes. Such certification shall be under such regulations as may be prescribed from time to time by such certifying authority with the approval of the President. An application for a certificate must be filed at such time and in such manner as may be prescribed by such certifying authority under such regulations, but in no event shall such certificate have any effect unless an application therefor is filed before March 24, 1951, or before the expiration of 6 months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, whichever is later.

(2) Certifications after August 22, 1957.

In the case of a certificate made after August 22, 1957, there shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority designated by the President by Executive order, has certified is to be used—

(A) to produce new or specialized defense items or components of new or specialized defense items (as defined in paragraph (4) during the emergency period,

(B) to provide research, developmental, or experimental services during the emergency period for the Department of Defense (or one of the component departments of such Department), or for the Atomic Energy Commission, as a part of the national defense program, or

(C) to provide primary processing for uranium ore or uranium concentrate under a program of the Atomic Energy Commission for the development of new sources of uranium ore or uranium concentrate,

and only such portion of such amount as such authority has certified is attributable to the national defense program. Such certification shall be under such regulations as may be prescribed from time to time by such certifying authority with the approval of the President. An application for a certificate must be filed at such time and in such manner as may be prescribed by such certifying authority under such regulations but in no event shall such certificate have any effect unless an application therefor is filed before the

expiration of 6 months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition. For purposes of the preceding sentence, an application which was timely filed under this subsection on or before August 22, 1957, and which was pending on such date, shall be considered to be an application timely filed under this paragraph.

(3) Separate facilities; special rule.

After the completion or acquisition of any emergency facility with respect to which a certificate under paragraph (1) or (2) has been made, any expenditure (attributable to such facility and to the period after such completion or acquisition) which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate is made under paragraph (1) or (2), shall not be applied in adjustment of the basis of such facility, but a separate basis shall be computed therefor pursuant to paragraph (1) or (2), as the case may be, as if it were a new and separate emergency facility.

(4) Definitions.

For purposes of paragraph (2)—

(A) New or specialized defense item.

The term "new or specialized defense item" means only an item (excluding services)—

(i) which is produced, or will be produced, for sale to the Department of Defense (or one of the component departments of such Department), or to the Atomic Energy Commission, for use in the national defense program, and

(ii) for the production of which existing productive facilities are unsuitable because of its newness or of its specialized defense features.

(B) Component of new or specialized defense item.

The term component of a new or specialized defense item means only an item—

(i) which is, or will become, a physical part of a new or specialized defense item, and

(ii) for the production of which existing productive facilities are unsuitable because of its newness or of its specialized defense features.

(5) Limitation with respect to uranium ore or uranium concentrate processing facilities.

No certificate shall be made under paragraph (2) (C) with respect to any facility unless existing facilities for processing the uranium ore or uranium concentrate which will be processed by such facility are unsuitable because of their location.

(f) Depreciation deduction.

If the adjusted basis of the emergency facility (computed without regard to this section) is in excess of the adjusted basis computed under subsection (e), the depreciation deduction provided by section 167 shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis for the purpose of such deduction were an amount equal to the amount of such excess.

(g) Payment by United States of unamortized cost of facility.

If an amount is properly includible in the gross income of the taxpayer on account of a payment with respect to an emergency facility and such payment is certified as provided in paragraph (1), then, at the election of the taxpayer in its return for the taxable year in which such amount is so includible—

(1) The amortization deduction for the month in which such amount is so includible shall (in lieu of the amount of the deduction for such month computed under subsection (a)) be equal to the amount so includible but not in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amortization deduction for such month). Payments referred to in this subsection shall be payments the amounts of which are certified, under such regulations as the President may prescribe, by the certifying authority designated by the President as compensation to the taxpayer for the unamortized cost of the emergency facility made because—

(A) a contract with the United States involving the use of the facility has been terminated by its terms or by cancellation, or

(B) the taxpayer had reasonable ground (either from provisions of a contract with the United States involving the use of the facility, or from written or oral representations made under authority of the United States) for anticipating future contracts involving the use of the facility, which future contracts have not been made.

(2) In case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility, the depreciation deduction allowable under section 167 on account of the month in which such amount is so includible shall be increased by such amount, but such deduction on account of such month shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amount allowable, on account of such month, under section 167 or this paragraph).

(h) Life tenant and remainderman.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowable to the life tenant.

(i) Termination.

No certificate under subsection (e) shall be made with respect to any emergency facility after December 31, 1959.

(j) Cross reference.

For special rule with respect to gain derived from the sale or exchange of property the adjusted basis of which is determined with regard to this section, see section 1238.

(Aug. 16, 1954, ch. 736, 68A Stat. 52; Aug. 26, 1957, Pub. L. 85–165, § 4, 71 Stat. 414; Sept. 2, 1958, Pub. L. 85–866, title I, § 9 (a), (b), 72 Stat. 1608, 1609.)

AMENDMENTS

1958—Subsec. (e) (2) (C). Pub. L. 85–866, § 9(a), added subsec. (e) (2) (C).

Subsec. (e) (5). Pub. L. 85–866, § 9(b), added subsec. (e) (5).

1957—Subsec. (e)(1). Pub. L. 85–165, § 4(a), limited authorization to certifications made on or before Aug. 22, 1957.

Subsec. (e)(2). Pub. L. 85–165, § 4(b), added subsec. (e)(2) and redesignated former subsec. (e)(2) as (e)(3).

Subsec. (e)(3). Pub. L. 85–165, § 4(b), redesignated former subsec. (e)(2) as (e)(3) and inserted "or (2)" following "paragraph (1)" wherever appearing and "as the case may be."

Subsec. (e)(4). Pub. L. 85–165, § 4(b), added subsec. (e)(4).

Subsec. (i). Pub. L. 85–165, § 4(c), added subsec. (i) and redesignated former subsec. (i) as (j).

Subsec. (j). Pub. L. 85–165, § 4(c), redesignated former subsec. (i) as (j).

EFFECTIVE DATE OF 1958 AMENDMENT

Subsec. (e)(2)(C) of this section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

AVAILABILITY OF EMERGENCY AMORTIZATION DEDUCTION

Section 9 (c) of Pub. L. 85–866 provided that: "In the case of any certificate which is made under section 168 (e) of the Internal Revenue Code of 1954 for any facility to which the amendment made by subsection (a) [which added subsec. (e) (2) (C) of this section] applies, if application for such certificate was filed before the date of the enactment of this Act [Sept. 2, 1958] and within the time prescribed by the next to the last sentence of section 168 (e) (2) of such Code, the second sentence of section 168 (d) (1) of such Code shall not apply with respect to any taxable year of the taxpayer which ends prior to the date on which such certificate is made. In the case of any certificate which is made under such section for any facility to which the amendment made by subsection (a) [which added subsec. (e) (2) (C) of this section] applies, if application for such certificate is filed at any time within 3 months after the date of the enactment of this Act [Sept. 2, 1958], the next to the last sentence of section 168 (e) (2) shall not apply and the second sentence of section 168 (d) (1) shall not apply with respect to any taxable year of the taxpayer which ends prior to the date on which such certificate is made."

CROSS REFERENCES

Adjustments to basis for determining gain or loss, see section 1016 of this title.

Effect of amortization deduction on basis of property acquired from decedent, see section 1014 of this title.

Estates and trusts allowed deduction under this section, see section 642 (f) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 642, 1082, 1238, 1245, 1250 of this title.

§ 169. Amortization of pollntion control facilities.

(a) Allowance of deduction.

Every person, at his election, shall be entitled to a deduction with respect to the amortization of the amortizable basis of any certified pollution control facility (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the amortizable basis of the pollution control facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such amortizable basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction provided by this section with respect to any month shall be in lieu of the depreciation deduction with respect to such pollution control facility for such month provided by section 167. The 60-month period shall begin, as to any pollution control facility, at the election of the taxpayer, with the month following the month in which such facility was completed or acquired, or with the succeeding taxable year.

(b) Election of amortization.

The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the facility is completed or acquired, or with the taxable year succeeding the taxable year in which such facility is completed or acquired, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

(c) Termination of amortization deduction.

A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction under this section with respect to such pollution control facility.

(d) Definitions.

For purposes of this section—

(1) Certified pollution control facility.

The term "certified pollution control facility" means a new identifiable treatment facility which is used, in connection with a plant or other property in operation before January 1, 1969, to abate or control water or atmospheric pollution or contamination by removing, altering, disposing, or storing of pollutants, contaminants, wastes, or heat and which—

(A) the State certifying authority having jurisdiction with respect to such facility has certified to the Federal certifying authorty as having been constructed, reconstructed, erected, or acquired in conformity with the State program or requirements for abatement or control of water or atmospheric pollution or contamination; and

(B) the Federal certifying authority has certified to the Secretary or his delegate (i) as being in compliance with the applicable regulations of Federal agencies and (ii) as being in furtherance of the general policy of the United States for cooperation with the States in the prevention and abatement of water pollution under the Federal Water Pollution Control Act, as amended (33 U.S.C. 466 et seq.), or in the prevention and abatement of atmospheric pollution and contamination under the Clean Air Act, as amended (42 U.S.C. 1857 et seq.).

(2) State certifying authority.

The term "State certifying authority" means, in the case of water pollution, the State water pollution control agency as defined in section 13

(a) of the Federal Water Pollution Control Act and, in the case of air pollution, the air pollution control agency as defined in section 302(b) of the Clean Air Act. The term "State certifying authority" includes any interstate agency authorized to act in place of a certifying authority of the State.

(3) Federal certifying authority.

The term "Federal certifying authority" means, in the case of water pollution, the Secretary of the Interior and, in the case of air pollution, the Secretary of Health, Education, and Welfare.

(4) New identifiable treatment facility.

For purposes of paragraph (1), the term "new identifiable treatment facility" includes only tangible property (not including a building and its structural components, other than a building which is exclusively a treatment facility) which is of a character subject to the allowance for depreciation provided in section 167, which is identifiable as a treatment facility, and which—

(A) is property—

(i) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1968, or

(ii) acquired after December 31, 1968, if the original use of the property commences with the taxpayer and commences after such date, and

(B) is placed in service by the taxpayer before January 1, 1975.

In applying this section in the case of property described in clause (i) of subparagraph (A), there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1968.

(e) Profitmaking abatement works, etc.

The Federal certifying authority shall not certify any property under subsection (d)(1)(B) to the extent it appears that by reason of profits derived through the recovery of wastes or otherwise in the operation of such property, its costs will be recovered over its actual useful life.

(f) Amortizable basis.

(1) Defined.

For purposes of this section, the term "amortizable basis" means that portion of the adjusted basis (for determining gain) of a certified pollution control facility which may be amortized under this section.

(2) Special rules.

(A) If a certified pollution control facility has a useful life (determined as of the first day of the first month for which a deduction is allowable under this section) in excess of 15 years, the amortizable basis of such facility shall be equal to an amount which bears the same ratio to the portion of the adjusted basis of such facility, which would be eligible for amortization but for the application of this subparagraph, as 15 bears to the number of years of useful life of such facility.

(B) The amortizable basis of a certified pollution control facility with respect to which an election under this section is in effect shall not be increased, for purposes of this section, for additions or improvements after the amortization period has begun.

(g) Depreciation deduction.

The depreciation deduction provided by section 167 shall, despite the provisions of subsection (a), be allowed with respect to the portion of the adjusted basis which is not the amortizable basis.

(h) Investment credit not to be allowed.

In the case of any property with respect to which an election has been made under subsection (a), so much of the adjusted basis of the property as (after the application of subsection (f)) constitutes the amortizable basis for purposes of this section shall not be treated as section 38 property within the meaning of section 48(a).

(i) Life tenant and remainderman.

In the case of property held by one person for life with remainder to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the property and shall be allowable to the life tenant.

(j) Cross reference.

For special rule with respect to certain gain derived from the disposition of property the adjusted basis of which is determined with regard to this section, see section 1245.

(Added Pub. L. 91–172, title VII, § 704(a), Dec. 30, 1969, 83 Stat. 667.)

EFFECTIVE DATE

Section 704(c) of Pub. L. 91–172 provided that: "The amendments made by this section [adding this section and amending sections 642, 1082, 1245, and 1250 of this title] shall apply with respect to taxable years ending after December 31, 1968."

PRIOR PROVISIONS

A prior section 169, act Aug. 16, 1954, ch. 736, 68A Stat. 55, dealing with the amortization of grain-storage facilities, was stricken in the reorganization of Part VI of subchapter B of chapter 1 of this title by Pub. L. 91–172.

TRANSFER OF FUNCTIONS

The functions vested in the Secretary of the Interior and the Secretary of Health, Education, and Welfare by subsec. (d)(1)(B) and (3) of this section were transferred to the Administrator of the Environmental Protection Agency by 1970 Reorg. Plan No. 3, § 2(a)(9), eff. Dec. 2, 1970, 35 F.R. 15623, 84 Stat. ——, set out in the Appendix to Title 5, Government Organization and Employees.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57 169, 1082, 1245, 1250 of this title.

§ 170. Charitable, etc., contributions and gifts.

(a) Allowance of deduction.

(1) General rule.

There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate.

(2) Corporations on accrual basis.

In the case of a corporation reporting its taxable income on the accrual basis, if—

(A) the board of directors authorizes a charitable contribution during any taxable year, and

(B) payment of such contribution is made after the close of such taxable year and on or before the 15th day of the third month following the close of such taxable year,

then the taxpayer may elect to treat such contribution as paid during such taxable year. The election may be made only at the time of the filing of the return for such taxable year, and shall be signified in such manner as the Secretary or his delegate shall by regulations prescribe.

(3) Future interests in tangible personal property.

For purposes of this section, payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in section 267(b). For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property.

(b) Percentage limitations.

(1) Individuals.

In the case of an individual, the deduction provided in subsection (a) shall be limited as provided in the succeeding subparagraphs.

(A) General rule.

Any charitable contribution to—

(i) a church or a convention or association of churches,

(ii) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on,

(iii) an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research, if the organization is a hospital, or if the organization is a medical research organization directly engaged in the continuous active conduct of medical research in conjunction with a hospital, and during the calendar year in which the contribution is made such organization is committed to spend such contributions for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

(iv) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public, and which is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university which is an organization referred to in clause (ii) of this subparagraph and which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political subdivision thereof or by an agency or instrumentality of one or more States or political subdivisions,

(v) a governmental unit referred to in subsection (c)(1),

(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public,

(vii) a private foundation described in subparagraph (E), or

(viii) an organization described in section 509(a)(2) or (3),

shall be allowed to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year.

(B) Other contributions.

Any charitable contribution other than a charitable contribution to which subparagraph (A) applies shall be allowed to the extent that the aggregate of such contributions does not exceed the lesser of—

(i) 20 percent of the taxpayer's contribution base for the taxable year, or

(ii) the excess of 50 percent of the taxpayer's contribution base for the taxable year over the amount of charitable contributions allowable under subparagraph (A) (determined without regard to subparagraph (D)).

(C) Unlimited deduction for certain individuals.

Subject to the provisions of subsections (f)(6) and (g), the limitations in subparagraphs (A), (B), and (D), and the provisions of subsection (e)(1)(B), shall not apply, in the case of an individual for a taxable year beginning before January 1, 1975, if in such taxable year and in 8 of the 10 preceding taxable years, the amount of the charitable contributions, plus the amount of income tax (determined without regard to chapter 2, relating to tax on self-employment income) paid during such year in respect of such year or preceding taxable years, exceeds the transitional deduction percentage (determined under subsection (f)(6)) of the taxpayer's taxable income for such year, computed without regard to—

(i) this section,

(ii) section 151 (allowance of deductions for personal exemption), and

(iii) any net operating loss carryback to the taxable year under section 172.

In lieu of the amount of income tax paid during any such year, there may be substituted for that year the amount of income tax paid in respect of such year, provided that any amount so included in the year in respect of which payment was made shall not be included in any other year. In the case of a separate return for the taxable year by a married individual who previously filed a joint return with a former deceased spouse for any of the 10 preceding taxable years, the amount of charitable contributions and taxes paid for any such preceding taxable year, for which a joint return was filed with the former deceased spouse, shall be determined in the same manner as if the taxpayer had not remarried after the death of such former spouse.

(D) Special limitation with respect to contributions of certain capital gain property.

(i) In the case of charitable contributions of capital gain property to which subsection (e)(1)(B) does not apply, the total amount of contributions of such property which may be taken into account under subsection (a) for any taxable year shall not exceed 30 percent of the taxpayer's contribution base for such year. For purposes of this subsection, contributions of capital gain property to which this paragraph applies shall be taken into account after all other charitable contributions.

(ii) If charitable contributions described in subparagraph (A) of capital gain property to which clause (i) applies exceeds 30 percent of the taxpayer's contribution base for any taxable year, such excess shall be treated, in a manner consistent with the rules of subsection (d)(1), as a charitable contribution of capital gain property to which clause (i) applies in each of the 5 succeeding taxable years in order of time.

(iii) At the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate prescribes by regulations), subsection (e)(1) shall apply to all contributions of capital gain property (to which subsection (e)(1)(B) does not otherwise apply) made by the taxpayer during the taxable year. If such an election is made, clauses (i) and (ii) shall not apply to contributions of capital gain property made during the taxable year, and, in applying subsection (d)(1) for such taxable year with respect to contributions of capital gain property made in any prior contribution year for which an election was not made under this clause, such contributions shall be reduced as if subsection (e)(1) had applied to such contributions in the year in which made.

(iv) For purposes of this subparagraph, the term "capital gain property" means with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain. For purposes of the preceding sentence, any property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset.

(E) Certain private foundations.

The private foundations referred to in subparagraph (A)(vii) and subsection (e)(1)(B) are—

(i) a private operating foundation (as defined in section 4942(j)(3)),

(ii) any other private foundation (as defined in section 509(a)) which, not later than the 15th day of the third month after the close of the foundation's taxable year in which contributions are received, makes qualifying distributions (as defined in section 4942(g), without regard to paragraph (3) thereof), which are treated, after the application of section 4942(g)(3), as distributions out of corpus (in accordance with section 4942(h)) in an amount equal to 100 percent of such contributions, and with respect to which the taxpayer obtains adequate records or other sufficient evidence from the foundation showing that the foundation made such qualifying distributions, and

(iii) a private foundation all of the contributions to which are pooled in a common fund and which would be described in section 509(a)(3) but for the right of any substantial contributor (hereafter in this clause called "donor") or his spouse to designate annually the recipients, from among organizations described in paragraph (1) of section 509(a), of the income attributable to the donor's contribution to the fund and to direct (by deed or by will) the payment, to an organization described in such paragraph (1), of the corpus in the common fund attributable to the donor's contribution; but this clause shall apply only if all of the income of the common fund is required to be (and is) distributed to one or more organizations described in such paragraph (1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the fund and only if all of the corpus attributable to any donor's contribution to the fund is requested to be (and is) distributed to one or more of such organizations not later than one year after his death or after the death of his surviving spouse if she has the right to designate the recipients of such corpus.

(F) Contribution base defined.

For purposes of this section, the term "contribution base" means adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172).

(2) Corporations.

In the case of a corporation, the total deductions under subsection (a) for any taxable year shall not exceed 5 percent of the taxpayer's taxable income computed without regard to—

(A) this section,

(B) part VIII (except section 248),

(C) any net operating loss carryback to the taxable year under section 172,

(D) section 922 (special deduction for Western Hemisphere trade corporations, and

(E) any capital loss carryback to the taxable year under section 1212(a)(1).

(c) Charitable contribution defined.

For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

(3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions, and

(B) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(5) A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

For purposes of this section, the term "charitable contribution" also means an amount treated under subsection (h) as paid for the use of an organization described in paragraph (2), (3), or (4).

(d) Carryovers of excess contributions.

(1) Individuals.

(A) In general.

In the case of an individual, if the amount of charitable contributions described in subsection (b)(1)(A) payment of which is made within a taxable year (hereinafter in this paragraph referred to as the "contribution year") exceeds 50 percent (30 percent, in the case of a contribution year beginning before January 1, 1970) of the taxpayer's contribution base for such year. such excess shall be treated as a charitable contribution described in subsection (b)(1)(A) paid in each of the 5 succeeding taxable years in order of time, but, with respect to any such succeeding taxable year, only to the extent of the lesser of the two following amounts:

(i) the amount by which 50 percent of the taxpayer's contribution base for such succeeding taxable year exceeds the sum of the charitable contributions described in subsection (b)(1)(A) payment of which is made by the taxpayer within such succeeding taxable year (determined without regard to this subparagraph) and the charitable contributions described in subsection (b)(1)(A) payment of which was made in taxable years before the contribution year which are treated under this subparagraph as having been paid in such succeeding taxable year; or

(ii) in the case of the first succeeding taxable year, the amount of such excess, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess not treated under this subparagraph as a charitable contribution described in subsection (b)(1)(A) paid in any taxable year intervening between the contribution year and such succeeding taxable year.

(B) Special rule for net operating loss carryovers.

In applying subparagraph (A), the excess determined under subparagraph (A) for the contribution year shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases the net operating loss deduction for a taxable year succeeding the contribution year.

(2) Corporations.

(A) In general.

Any contribution made by a corporation in a taxable year (hereinafter in this paragraph referred to as the "contribution year") in excess of the amount deductible for such year under subsection (b)(2) shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two

following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under subsection (b)(2) over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this subparagraph for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess contribution not deductible under this subparagraph for any taxable year intervening between the contribution year and such succeeding taxable year.

(B) Special rule for net operating loss carryovers.

For purposes of subparagraph (A), the excess of—

(i) the contributions made by a corporation in a taxable year to which this section applies, over

(ii) the amount deductible in such year under the limitation in subsection (b)(2),

shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases a net operating loss carryover under section 172 to a succeeding taxable year.

(e) Certain contributions of ordinary income and capital gain property.

(1) General rule.

The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of—

(A) the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution), and

(B) in the case of a charitable contribution—

(i) of tangible personal property, if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under section 501 (or, in the case of a governmental unit, to any purpose or function described in subsection (c)), or

(ii) to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in subsection (b)(1)(E),

50 percent (62½ percent, in the case of a corporation) of the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

For purposes of applying this paragraph (other than in the case of gain to which section 617(d)(1), 1245(a), 1250(a), 1251(c), or 1252(a) applies), property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset.

(2) Allocation of basis.

For purposes of paragraph (1), in the case of a charitable contribution of less than the taxpayer's entire interest in the property contributed, the taxpayer's adjusted basis in such property shall be allocated between the interest contributed and any interest not contributed in accordance with regulations prescribed by the Secretary or his delegate.

(f) Disallowance of deduction in certain cases and special rules.

(1) In general.

No deduction shall be allowed under this section for a contribution to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

(2) Contributions of property placed in trust.

(A) Remainder interest.

In the case of property transferred in trust, no deduction shall be allowed under this section for the value of a contribution of a remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664), or a pooled income fund (described in section 642(c)(5)).

(B) Income interests, etc.

No deduction shall be allowed under this section for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying section 671. If the donor ceases to be treated as the owner of such an interest for purposes of applying section 671, at the time the donor ceases to be so treated, the donor shall for purposes of this chapter be considered as having received an amount of income equal to the amount of any deduction he received under this section for the contribution reduced by the discounted value of all amounts of income earned by the trust and taxable to him before the time at which he ceases to be treated as the owner of the interest. Such amounts of income shall be discounted to the date of the contribution. The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph.

(C) Denial of deduction in case of payments in certain trusts.

In any case in which a deduction is allowed under this section for the value of an interest in property described in subparagraph (B), transferred in trust, no deduction shall be allowed under this section to the grantor or any other person for the amount of any contribution made by the trust with respect to such interest.

(D) Exception.

This paragraph shall not apply in a case in which the value of all interests in property transferred in trust are deductible under subsection (a).

(3) Denial of deduction in case of certain contributions of partial interests in property.

(A) In general.

In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

(B) Exceptions.

Subparagraph (A) shall not apply to a contribution of—

(i) a remainder interest in a personal residence or farm, or

(ii) an undivided portion of the taxpayer's entire interest in property.

(4) Valuation of remainder interests in real property.

For purposes of this section, in determining the value of a remainder interest in real property, depreciation (computed on the straight line method) and depletion of such property shall be taken into account, and such value shall be discounted at a rate of 6 percent per annum, except that the Secretary or his delegate may prescribe a different rate.

(5) Reduction for certain interest.

If, in connection with any charitable contribution, a liability is assumed by the recipient or by any other person, or if a charitable contribution is of property which is subject to a liability, then, to the extent necessary to avoid the duplication of amounts, the amount taken into account for purposes of this section as the amount of the charitable contribution—

(A) shall be reduced for interest (i) which has been paid (or is to be paid) by the taxpayer, (ii) which is attributable to the liability, and (iii) which is attributable to any period after the making of the contribution, and

(B) in the case of a bond, shall be further reduced for interest (i) which has been paid (or is to be paid) by the taxpayer on indebtedness incurred or continued to purchase or carry such bond, and (ii) which is attributable to any period before the making of the contribution.

The reduction pursuant to subparagraph (B) shall not exceed the interest (including interest equivalent) on the bond which is attributable to any period before the making of the contribution and which is not (under the taxpayer's method of accounting) includible in the gross income of the taxpayer for any taxable year. For purposes of this paragraph, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness.

(6) Partial reduction of unlimited deduction.

(A) In general.

If the limitations in subsections (b)(1)(A) and (B) do not apply because of the application of subsection (b)(1)(C), the amount otherwise allowable as a deduction under subsection (a) shall be reduced by the amount by which the taxpayer's taxable income computed without regard to this subparagraph is less than the transitional income percentage (determined under subparagraph (C)) of the taxpayer's adjusted gross income. However, in no case shall a taxpayer's deduction under this section be reduced below the amount allowable as a deduction under this section without the applicability of subsection (b)(1)(C).

(B) Transitional deduction percentage.

For purposes of applying subsection (b)(1)(C), the term "transitional deduction percentage" means—

(i) in the case of a taxable year beginning before 1970, 90 percent, and

(ii) in the case of a taxable year beginning in—

1970	80 percent
1971	74 percent
1972	68 percent
1973	62 percent
1974	56 percent

(C) Transitional income percentage.

For purposes of applying subparagraph (A), the term "transitional income percentage" means, in the case of a taxable year beginning in—

1970	20 percent
1971	26 percent
1972	32 percent
1973	38 percent
1974	44 percent

(g) Application of unlimited charitable contribution deduction.

(1) Allowance of deduction for taxable years beginning after December 31, 1963.

If the taxable year begins after December 31, 1963—

(A) subsection (b)(1)(C) shall apply only if the taxpayer so elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes); and

(B) for purposes of subsection (b)(1)(C), the amount of the charitable contributions for the taxable year (and for all prior taxable years beginning after December 31, 1963) shall be determined without the application of subsection (d)(1) and solely by reference to charitable contributions described in paragraph (2).

If the taxpayer elects to have subsection (b)(1)(C) apply for the taxable year, then for such taxable year subsection (a) shall apply only with respect to charitable contributions described in

paragraph (2), and no amount of charitable contributions made in the taxable year or any prior taxable year may be treated under subsection (d)(1) as having been made in the taxable year or in any succeeding taxable year.

(2) Qualified contributions.

The charitable contributions referred to in paragraph (1) are—

(A) any charitable contribution described in subsection (b)(1)(A);

(B) Repealed. Pub. L. 91–172, title II, § 201(a)(2)(A), Dec. 30, 1969, 83 Stat. 558.

(C) any charitable contribution, not described in subsection (b)(1)(A), to an organization described in subsection (c)(2) which meets the requirements of paragraph (3) with respect to such charitable contribution; and

(D) any charitable contribution payment of which is made on or before the date of the enactment of the Revenue Act of 1964.

(3) Organizations expending at least 50 percent of donor's contributions.

An organization shall be an organization referred to in paragraph (2)(C), with respect to any charitable contribution, only if—

(A) not later than the close of the third year after the organization's taxable year in which the contribution is received (or before such later time as the Secretary or his delegate may allow upon good cause shown by such organization), such organization expends an amount equal to at least 50 percent of such contribution for—

(i) the active conduct of the activities constituting the purpose or function for which it is organized and operated,

(ii) assets which are directly devoted to such active conduct,

(iii) contributions to organizations which are described in subsection (b)(1)(A) or in paragraph (2)(B) of this subsection, or

(iv) any combination of the foregoing; and

(B) for the period beginning with the taxable year in which such contribution is received and ending with the taxable year in which subparagraph (A) is satisfied with respect to such contribution, such organization expends all of its net income (determined without regard to capital gains and losses) for the purposes described in clauses (i), (ii), (iii), and (iv) of subparagraph (A).

If the taxpayer so elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) with respect to contributions made by him to any organization, then, in applying subparagraph (B) with respect to contributions made by him to such organization during his taxable year for which such election is made and during all his subsequent taxable years, amounts expended by the organization after the close of any of its taxable years and on or before the 15th day of the third month following the close of such taxable year shall be treated as expended during such taxable year.

(4) Disqualifying transactions.

An organization shall be an organization referred to in subparagraph (B) or (C) of paragraph (2) only if at no time during the period consisting of the organization's taxable year in which the contribution is received, its 3 preceding taxable years, and its 3 succeeding taxable years, such organization—

(A) lends any part of its income or corpus to,

(B) pays compensation (other than reasonable compensation for personal services actually rendered) to,

(C) makes any of its services available on a preferential basis to,

(D) purchases more than a minimal amount of securities or other property from, or

(E) sells more than a minimal amount of securities or other property to,

the donor of such contribution, any member of his family (as defined in section 267(c)(4)), any employee of the donor, any officer or employee of a corporation in which he owns (directly or indirectly) 50 percent or more in value of the outstanding stock, or any partner or employee of a partnership in which he owns (directly or indirectly) 50 percent or more of the capital interest or profits interest. This paragraph shall not apply to transactions occurring on or before the date of the enactment of the Revenue Act of 1964.

(h) Amounts paid to maintain certain students as members of taxpayer's household.

(1) In general.

Subject to the limitations provided by paragraph (2), amounts paid by the taxpayer to maintain an individual (other than a dependent, as defined in section 152, or a relative of the taxpayer) as a member of his household during the period that such individual is—

(A) a member of the taxpayer's household under a written agreement between the taxpayer and an organization described in paragraph (2), (3), or (4) of subsection (c) to implement a program of the organization to provide educational opportunities for pupils or students in private homes, and

(B) a full-time pupil or student in the twelfth or any lower grade at an educational institution (as defined in section 151(e)(4)) located in the United States,

shall be treated as amounts paid for the use of the organization.

(2) Limitations.

(A) Amount.

Paragraph (1) shall apply to amounts paid within the taxable year only to the extent that such amounts do not exceed $50 multiplied by the number of full calendar months during the taxable year which fall within the period described in paragraph (1). For purposes of the preceding sentence, if 15 or more days of a calendar month fall within such period such month shall be considered as a full calendar month.

(B) Compensation or reimbursement.

Paragraph (1) shall not apply to any amount paid by the taxpayer within the taxable year

if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the individual in his household during the period described in paragraph (1).

(3) Relative defined.

For purposes of paragraph (1), the term "relative of the taxpayer" means an individual who, with respect to the taxpayer, bears any of the relationships described in paragraphs (1) through (8) of section 152(a).

(4) No other amount allowed as deduction.

No deduction shall be allowed under subsection (a) for any amount paid by a taxpayer to maintain an individual as a member of his household under a program described in paragraph (1)(A) except as provided in this subsection.

(i) Disallowance of deductions in certain cases.

For disallowance of deductions for contributions to or for the use of communist controlled organizations, see section 11(a) of the Internal Security Act of 1950 (60 Stat. 996; 50 U.S.C. 790).

(j) Other cross references.

(1) For charitable contributions of estates and trusts, see section 642 (c).

(2) For nondeductibility of contributions by common trust funds, see section 584.

(3) For charitable contributions of partners, see section 702.

(4) For charitable contributions of nonresident aliens, see section 873.

(5) For treatment of gifts for benefit of or use in connection with the Naval Academy as gifts to or for the use of the United States, see section 3 of the Act of March 31, 1944 (58 Stat. 135; 34 U. S. C. 1115b).

(6) For treatment of gifts for benefit of the library of the Post Office Department as gifts to or for the use of the United States, see section 2 of the Act of August 8, 1946 (60 Stat. 924; 5 U. S. C. 393).

(7) For treatment of gifts accepted by the Secretary of State under the Foreign Service Act of 1946 as gifts to or for the use of the United States, see section 1021 (e) of that Act (60 Stat. 1032; 22 U. S. C. 809 (e)).

(8) For treatment of gifts of money accepted by the Attorney General for credit to the "Commissary Funds Federal Prisons" as gifts to or for the use of the United States, see section 2 of the Act of May 15, 1952 (66 Stat. 73, as amended by the Act of July 9, 1952, 66 Stat. 479, 31 U. S. C. 725s–4).

(Aug. 16, 1954, ch. 736, 68A Stat. 58; Aug. 7, 1956, ch. 1031, § 1, 70 Stat. 1117; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 10(a), 11, 12, 72 Stat. 1609, 1610; Sept. 14, 1960, Pub. L. 86–779, § 7(a), 74 Stat. 1002; Oct. 16, 1962, Pub. L. 87–834, § 13(d), 76 Stat. 1034; Oct. 23, 1962, Pub. L. 87–858, § 2(a), (b), 76 Stat. 1134; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 209(a), (b), (c)(1), (d)(1), (e), 231(b)(1), 78 Stat. 43, 45–47, 105; Sept. 12, 1966, Pub. L. 89–570; § 1(b)(1), 80 Stat. 762; Dec. 30, 1969, Pub. L. 91–172, title I, § 101(j)(2), title II, § 201(a)(1), (2)(A), (h)(1), 83 Stat. 526, 549, 558, 565.)

REFERENCES IN TEXT

The Revenue Act of 1964, referred to in subsec. (g), means Pub. L. 88–272. For classification of Pub. L. 88–272, see Short Title note under section 1 of this title.

Section 3 of Act March 31, 1944 (58 Stat. 135, 34 U.S.C. 1115b), referred to in subsec. j(5), was repealed by Act Aug. 10, 1956, ch. 1041, § 53, 70A Stat. 741, and is now covered by section 6973 of Title 10, Armed Forces.

Section 2 of the Act of August 8, 1946 (60 Stat. 924; 5 U.S.C. 393), referred to in subsec. j(6), was repealed by Pub. L. 86–682, § 12(c), Sept. 2, 1960, 74 Stat. 708.

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 201(a)(1)(B), added par. (3).

Subsec. (b). Pub. L. 91–172, § 201(a)(1)(B), (h)(1), increased the general limitation on the charitable contributions deduction for individual taxpayers from 30 percent of adjusted gross income to 50 percent of his contribution base and provided that where a taxpayer makes a contribution to a public charity of property which has appreciated in value the taxpayer could deduct such contributions of property under the 50 per cent limitation if he elects to take the unrealized appreciation in value into account for the tax purposes, the unlimited charitable deduction is phased out over a 5-year period and contributions to a private operating foundation and contributions to a private nonoperating foundation distributing such contributions to public charities or private operating foundations within two and half months following the year of receipt are also subjected to 50 percent limitation (30 percent in the case of gifts of appreciated property), and, in par. (1)(C), added provisions relating to the determination of the amount of charitable contributions and taxes paid by a married individual who previously filed a joint return with a former deceased spouse.

Subsec. (c). Pub. L. 91–172, § 201(a)(1)(B), struck out references to "Territory" in pars. (1) and (2)(A), and inserted reference to participation in or intervention in any political campaign on behalf of any candidate for public office in par. (2)(D).

Subsec. (d). Pub. L. 91–172, § 201(a)(1)(B), added subsec. (d) consisting of provisions substantially transferred from subsec. (b) in the general amendment of subsec. (b) by Pub. L. 91–172. Former subsec. (d) redesignated as subsec. (b).

Subsec. (e). Pub. L. 91–172, §§ 201(a)(1)(B), substituted provisions covering certain contributions of ordinary income and capital gain property for provisions setting out a special rule for charitable contributions.

Subsec. (f). Pub. L. 91–172, § 201(a)(1)(B), substituted provisions for the disallowance of the deduction in specified cases for provision covering future interests in tangible personal property.

Subsec. (g). Pub. L. 91–172, § 201(a)(2)(A), substituted "subsection (d)(1)" for "subsection (b)(5)" in two places in par. (1) and struck out par. (2) (B) covering contributions to organizations substantially more than half of the assets and the total income were devoted to charitable purposes.

Subsec. (h). Pub. L. 91–172, § 201(a)(1)(A), redesignated subsec. (d) as (h). Former subsec. (h) redesignated (i).

Subsec. (i). Pub. L. 91–172, §§ 101(j)(2), 201(a)(1)(A), redesignated former subsec. (h) as (i), and, in subsec. (i) as so redesignated struck out former par. (1) covering disallowance of deductions for gifts to charitable organizations engaging in prohibited transactions, and removed the par. (2) designation from the provisions covering disallowance of deductions for use of communist controlled organizations. Former subsec. (i) redesignated as subsec. (j).

Subsec. (j). Pub. L. 91–172, § 201(a)(1)(A), redesignated former subsec. (i) as (j).

1966—Subsec. (e). Pub. L. 89–570 included reference to section 617(d)(1).

1964—Subsec. (b)(1)(A)(v), (vi), (2), (5). Pub. L. 88–272, § 209(a), (c)(1), (d)(1), added clauses (v) and (vi) in par. (1)(A), and par. (5), and in par. (2), extended the 2-year carryforward of unused charitable contributions to 5 years and changed the method of computation by including the aggregate of the excess contributions made in taxable years before the contribution year, in clause (1), and the references to the third, fourth or fifth succeeding years in clause (ii).

Subsec. (e). Pub. L. 88–272, § 231(b)(1), substituted "certain property" for "section 1245 property" in the subsection catchline, and inserted the reference to section 1250(a) in the text.

Subsec. (f). Pub. L. 88–272, § 209(e), added subsec.(f). Former subsec. (f) redesignated (h).

Subsec. (g). Pub. L. 88–272, § 209(b), added subsec. (g). Former subsec. (g) redesignated (l).

Subsec. (h). Pub. L. 88–272, 209(e), redesignated former subsec. (f)(as (h).

Subsec. (i). Pub. L. 88–272, § 209(e), redesignated former subsec. (g) as (i).

1962—Subsec. (b)(1)(A)(iv). Pub. L. 87–858, § 2(a), added clause (iv).

Subsec. (b)(1)(B). Pub. L. 87–858, § 2(b), substituted "any charitable contributions described in subparagraph (A)" for "any charitable contributions to the organizations described in clauses (i), (ii), and (iii)."

Subsec. (e). Pub. L. 87–834 added subsec. (e) and redesignated former subsec. (e) as (f).

Subsecs. (f), (g). Pub. L. 87–834 redesignated former subsecs. (e) and (f) as (f) and (g), respectively.

1960—Subsec. (c). Pub. L. 86–779, § 7(a)(1), added the sentence additionally defining the term "charitable contribution" for the purposes of the section.

Subsec. (d). Pub. L. 86–779, § 7(a)(2), added subsec. (d). Former subsec. (d) redesignated (e).

Subsecs. (e) and (f). Pub. L. 86–779, § 7(a)(2), redesignated former subsecs. (d) and (e) as (e) and (f).

1958—Subsec. (b)(1)(C). Pub. L. 85–866, § 10(a), added sentence allowing substitution, in lieu of amount of tax paid during year, amount of tax paid in respect of such year, provided amount so included in the year in respect of which payment was made be not included in any other year.

Subsec. (b)(3). Pub. L. 85–866, § 11, added subsec. (b)(3).

Subsec. (b)(4). Pub. L. 85–866, § 12, added subsec. (b)(4).

1956—Subsec. (b)(1)(A)(iii). Act Aug. 7, 1956, § 1, provided for the allowance, as deductions, of contributions to medical research organizations.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 201(g) of Pub. L. 91–172 provided that:

"(1)(A) Except as provided in subparagraphs (B) and (C), the amendments made by subsection (a) [amending this section and sections 545, 556 and 809 of this title] shall apply to taxable years beginning after December 31, 1969.

"(B) Subsections (e) and (f)(1) of section 170 of the Internal Revenue Code of 1954 [subsecs. (c) and (f)(1) of this section] (as amended by subsection (a)) shall apply to contributions paid after December 31, 1969, except that, with respect to a letter or memorandum or similar property described in section 1221(3) of such Code [section 1221(3) of this title] (as amended by section 514 of this Act), such subsection (e) shall apply to contributions paid after July 25, 1969.

"(C) Paragraphs (2), (3), and (4) of section 170(f) of such Code [subsecs. (f)(2), (3), and (4) of this section] (as amended by subsection (a)) shall apply to transfers in trust and contributions made after July 31, 1969.

"(D) For purposes of applying section 170(d) of such Code [subsec. (d) of this section] (as amended by subsection (a)) with respect to contributions paid in a taxable year beginning before January 1, 1970, subsection (b)(1)(D), subsection (e), and paragraphs (1), (2), (3), and (4) of subsection (f) of section 170 of such Code [subsec. (b)(1), (d), (e), and (f)(1), (a), (3), and (4) of this section] shall not apply.

"(2) The amendments made by subsection (b) [amending section 642(c) of this title] shall apply with respect to amounts paid, permanently set aside, or to be used for a charitable purpose in taxable years beginning after December 31, 1969, except that section 642(c)(5) of the Internal Revenue Code of 1954 [section 642(c)(5) of this title] (as added by subsection (b)) shall apply to transfers in trust made after July 31, 1969.

"(3) The amendment made by subsection (c) [amending section 673 of this title] shall apply to transfers in trust made after April 22, 1969.

"(4)(A) Except as provided in subparagraphs (B) and (C), the amendments made by paragraphs (1) and (2) of subsection (d) [amending sections 2055(e) and 2126 of this title] shall apply in the case of decedents dying after December 31, 1969.

"(B) Such amendments shall not apply in the case of property passing under the terms of a will executed on or before October 9, 1969—

"(i) if the decedent dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise,

"(ii) if the decedent at no time after October 9, 1969, had the right to change the portions of the will which pertain to the passing of the property to, or for the use of, an organization described in section 2055(a) [section 2055(a) of this title], or

"(iii) if the will is not republished by codicil or otherwise before October 9, 1972, and the decedent is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise.

"(C) Such amendments shall not apply in the case of property transferred in trust on or before October 9, 1969—

"(i) if the decedent dies before October 9, 1972, without having amended after October 9, 1969, the instrument governing the disposition of the property,

"(ii) if the property transferred was an irrevocable interest to, or for the use of, an organization described in section 2055(a), or

"(iii) if the instrument governing the disposition of the property was not amended by the decedent before October 9, 1972, and the decedent is on such date and at all times thereafter under a mental disability to change the disposition of the property.

"(D) The amendment made by paragraph (3) of subsection (d) [amending section 2522(c) of this title] shall apply to gifts made after December 31, 1969, except that the amendments made to section 2522(c)(2) of the Internal Revenue Code of 1954 [section 2522(c)(2) of this title] shall apply to gifts made after July 31, 1969.

"(E) The amendments made by paragraph (4) of subsection (d) [amending sections 2055(a)(2), 2055(a)(3), 2106(a)(2)(A), 2522(a)(2), and 2522(b)(2), (3), of this title] shall apply to gifts and transfers made after December 31, 1969.

"(5) The amendment made by subsection (e) [enacting section 664 of this title] shall apply to transfers in trust made after July 31, 1969.

"(6) The amendments made by subsection (f) [amending section 1011(a) of this title] shall apply with respect to sales made after December 19, 1969."

Section 201(h)(2) of Pub. L. 91–172 provided that: "The amendment made by this subsection [amending subsec. (b)(1)(C) of this section] shall apply to taxable years beginning after December 31, 1968."

Amendment of section by section 101(j)(2) of Pub. L. 91–172 to take effect on Jan. 1, 1970, see section 101(k)(1) of Pub. L. 91–172, set out as a note under section 4940 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 89–570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 209(f) of Pub. L. 88–272 provided that:

"(1) The amendments made by subsections (a), (b), and (c) [to this section, and sections 545(b)(2) and 556(b)(2) of this title], shall apply with respect to contributions which are paid in taxable years beginning after December 31, 1963.

"(2) The amendments made by subsection (d) [to subsec. (b)(2) of this section, and section 381 of this title] shall apply to taxable years beginning after December 31, 1963, with respect to contributions which are paid (or treated as paid under section 170(a)(2) of the Internal Revenue Code of 1954) in taxable years beginning after December 31, 1961.

"(3) The amendments made by subsection (e) [to subsec. (f) of this title] shall apply to transfers of future interests made after December 31, 1963, in taxable years ending after such date, except that such amendments shall not apply to any transfer of a future interest made before July 1, 1964, where—

"(A) the sole intervening interest or right is a nontransferable life interest reserved by the donor, or

"(B) in the case of a joint gift by husband and wife, the sole intervening interest or right is a nontransferable life interest reserved by the donors which expires not later than the death of whichever of such donors dies later.

For purposes of the exception contained in the preceding sentence, a right to make a transfer of the reserved life interest to the donee of the future interest shall not be treated as making a life interest transferable."

Amendment of subsec. (e) by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 231(c) of Pub. L. 88–272, set out as a note under section 1250 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Section 2(c) of Pub. L. 87–858 provided that: "The amendments made by subsections (a) and (b) [to subsec. (b)(1) (A) and (B) of this section] shall apply to taxable years beginning after December 31, 1960."

Subsec. (e) of this section applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable with respect to taxable years beginning after Dec. 31, 1959, see section 7(c) of Pub. L. 86–779, set out as a note under section 162 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 10 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (b) (1) (C) of this section] shall apply with respect to taxable years beginning after December 31, 1957."

Subsec. (b)(3) of this section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 12 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [which added subsec. (b) (4) of this section] shall apply to taxable years ending after December 31, 1957, but only with respect to charitable contributions made after such date."

EFFECTIVE DATE OF 1956 AMENDMENT

Section 2 of act Aug. 7, 1956, provided that: "The amendment made by this Act [to subsec. (b) (1) (A) (iii)] shall apply only with respect to taxable years beginning after December 31, 1955."

DEDUCTION OF CONTRIBUTIONS TO CERTAIN ORGANIZATIONS FOR JUDICIAL REFORM

Section 29 of Pub. L. 87–834 provided that:

"For purposes of section 170 of the Internal Revenue Code of 1954 [this section] (relating to deduction for charitable, etc., contributions and gifts), a contribution or gift made after December 31, 1961, with respect to a referendum occurring during the calendar year 1962 to or for the use of any nonprofit organization created and operated exclusively—

"(1) to consider proposals for the reorganization of the judicial branch of the government of any State of the United States or political subdivision of such State, and

"(2) to provide information, make recommendations, and seek public support or opposition as to such proposals,

shall be treated as a charitable contribution if no part of the net earnings of such organization inures to the benefit of any private shareholder or individual. The provisions of the preceding sentence shall not apply to any organization which participates in, or intervenes in, any political campaign on behalf of any candidate for public office."

CROSS REFERENCES

Application of subsec. (b)(5) of this section to charitable contributions paid in a taxable year in which taxpayer elects to compute income from an employment under former sections 1301 and 1307 of the Internal Revenue Code of 1954, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

Charitable and similar gifts deductible from amount of gift, see section 2522 of this title.

Charitable deduction for nonresident alien individual, see section 873 of this title.

Contributions and gifts excepted as business expense, see section 162 (b) of this title.

Contributions by employer to employees' pension plan, see section 404 of this title.

Gifts and bequests accepted by Secretary of Commerce under Bureau of Standards Act as gifts and bequests to United States, see section 1522 of Title 15, Commerce and Trade.

Taxable year deduction to be taken, see section 461 of this title.

Transfers to charitable uses deductible from gross estate, see section 2106 (a) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 79, 101, 162, 381, 501, 507, 508, 509, 512, 514, 535, 542, 545, 556, 584, 642, 664, 677, 702, 703, 809, 832, 873, 882, 931, 1011, 2039, 2517, 4057, 4221, 4251, 4294, 4942, 4944, 4945, 4947, 4948, 5214, 6033 of this title; title 16 section 1285; title 20 section 954.

§ 171. Amortizable bond premium.

(a) General rule.

In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond:

(1) Interest wholly or partially taxable.

In the case of a bond (other than a bond the interest on which is excludable from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as a deduction.

(2) Interest wholly tax-exempt.

In the case of any bond the interest on which is excludable from gross income, no deduction shall be allowed for the amortizable bond premium for the taxable year.

(3) Adjustment of credit or deduction for interest partially tax-exempt.

(A) Individuals.

In the case of any bond the interest on which is allowable as a credit under section 35, the amount which would otherwise be taken into account in computing such credit shall be reduced by the amount of the amortizable bond premium for the taxable year.

(B) Corporations.

In the case of any bond the interest on which is allowable as a deduction under section 242, such deduction shall be reduced by the amount of the amortizable bond premium for the taxable year.

(4) Cross reference.

For adjustment to basis on account of amortizable bond premium, see section 1016 (a) (5).

(b) Amortizable bond premium.

(1) Amount of bond premium.

For purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined—

(A) with reference to the amount of the basis (for determining loss on sale or exchange) of such bond,

(B) (i) with reference to the amount payable on maturity or on earlier call date, in the case of any bond other than a bond to which clause (ii) or (iii) applies,

(ii) with reference to the amount payable on maturity (or if it results in a smaller amortizable bond premium attributable to the period to earlier call date, with reference to the amount payable on earlier call date), in the case of any bond described in subsection (c) (1) (B) which is acquired after December 31, 1957, or

(iii) with reference to the amount payable on maturity, in the case of any bond described in subsection (c) (1) (B) which was acquired after January 22, 1954, and before January 1, 1958, but only if such bond was issued after January 22, 1951, and has a call date not more than 3 years after the date of such issue, and

(C) with adjustments proper to reflect unamortized bond premium, with respect to the bond, for the period before the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

In no case shall the amount of bond premium on a convertible bond include any amount attributable to the conversion features of the bond.

(2) Amount amortizable.

The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year. In the case of a bond to which paragraph (1) (B) (ii) or (iii) applies and which has a call date, the amount of bond premium attributable to the taxable year in which the bond is called shall include an amount equal to the excess of the amount of the adjusted basis (for determining loss on sale or exchange) of such bond as of the beginning of the taxable year over the amount received on redemption of the bond or (if greater) the amount payable on maturity.

(3) Method of determination.

The determinations required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium prescribed by the Secretary or his delegate.

(c) Election as to taxable and partially taxable bonds.

(1) Eligibility to elect; bonds with respect to which election permitted.

This section shall apply with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer has elected to have this section apply:

(A) Partially tax-exempt.

In the case of a taxpayer other than a corporation, bonds with respect to the interest on which the credit provided in section 35 is allowable; and

(B) Wholly taxable.

In the case of any taxpayer, bonds the interest on which is not excludable from gross income but with respect to which the credit provided in section 35, or the deduction provided in section 242, is not allowable.

(2) Manner and effect of election.

The election authorized under this subsection shall be made in accordance with such regulations as the Secretary or his delegate shall prescribe. If such election is made with respect to any bond (described in paragraph (1)) of the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent taxable years with respect to all such bonds of the taxpayer, unless, on application by the taxpayer, the Secretary or his delegate permits him, subject to such conditions as the Secretary or his delegate deems necessary, to revoke such election. In the case of bonds held by a common trust fund, as defined in section 584 (a), or by a foreign personal holding company, as defined in section 552, the election authorized under this subsection shall be exercisable with respect to such bonds only by the common trust fund or foreign personal holding company. In case of bonds held by an estate or trust, the election authorized under this subsection shall be exercisable with respect to such bonds only by the fiduciary.

(d) Bond defined.

For purposes of this section, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof), but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(e) Dealers in tax-exempt securities.

For special rules applicable, in the case of dealers in securities, with respect to premium attributable to certain wholly tax-exempt securities, see section 75.

(Aug. 16, 1954, ch. 736, 68A Stat. 61; Sept. 2, 1958, Pub. L. 85-866, title I, § 13 (a), 72 Stat. 1610.)

AMENDMENTS

1958—Subsec. (b)(1)(B). Pub. L. 85-866, § 13(a)(1), substituted ", in the case of any bond other than a bond to which clause (ii) or (iii) applies" for "(but in the case of bonds described in subsection (c)(1)(B) issued after January 22, 1951, and acquired after January 22, 1954, only if such earlier call date is a date more than 3 years after the date of such issue), and", designated such provision as cl. (i), and added cl. (ii) and (iii).

Subsec. (b)(2). Pub. L. 85-866, § 13(a)(2), substituted "In the case of a bond to which paragraph (1)(B) (ii) or (iii) applies and which has a call date," for "In the case of a bond described in subsection (c)(1)(B) issued after January 22, 1951, and acquired after January 22, 1954, which has a call date not more than 3 years after the date of such issue," in the second sentence.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 13 (b) of Pub. L. 85-866 provided that: "The amendments made by subsection (a) [to subsecs. (b) (1) (B), (2) of this section] shall apply with respect to taxable years ending after December 31, 1957."

CROSS REFERENCES

Partially tax-exempt interest received by individuals as credit, see section 35 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 35, 57, 75, 163, 263, 551, 584, 642, 702, 809, 818, 822, 1016 of this title.

§ 172. Net operating loss deduction.

(a) Deduction allowed.

There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of

(1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) Net operating loss carrybacks and carryovers.

(1) Years to which loss may be carried.

(A) (i) Except as provided in clause (ii) and in subparagraphs (D), (E), (F), and (G), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

(ii) In the case of a taxpayer with respect to a taxable year ending on or after December 31, 1962, for which a certification has been issued under section 317 of the Trade Expansion Act of 1962, a net operating loss for such taxable year shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.

(B) Except as provided in subparagraphs (C), (D), and (E), a net operating loss for any taxable year ending after December 31, 1955, shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(C) In the case of a taxpayer which is a regulated transportation corporation (as defined in subsection (j)(1)), a net operating loss for any taxable year ending after December 31, 1955, shall (except as provided in subsection (j)) be a net operating loss carryover to each of the 7 taxable years following the taxable year of such loss.

(D) In the case of a taxpayer which has a foreign expropriation loss (as defined in subsection (k)) for any taxable year ending after December 31, 1958, the portion of the net operating loss for such year attributable to such foreign expropriation loss shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 10 taxable years following the taxable year of such loss (or, with respect to that portion of the net operating loss for such year attributable to a Cuban expropriation loss, to each of the 15 taxable years following the taxable year of such loss).

(E) In the case of a taxpayer which is a domestic corporation qualifying under paragraph (3)(E), a net operating loss for any taxable year ending after December 31, 1966, and prior to January 1, 1969, shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 3 taxable years following the taxable year of such loss.

(F) In the case of a financial institution to which section 585, 586, or 593 applies, a net operating loss for any taxable year beginning after December 31, 1975, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(G) In the case of a Bank for Cooperatives (organized and chartered pursuant to section 2 of the Farm Credit Act of 1933 (12 U.S.C. 1134)), a net operating loss for any taxable year beginning after December 31, 1969, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(2) Amount of carrybacks and carryovers.

Except as provided in subsections (i) and (j), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction—

(i) without regard to the net operating loss for the loss year or for any taxable year thereafter, and

(ii) without regard to that portion, if any, of a net operating loss for a taxable year attributable to a foreign expropriation loss, if such portion may not, under paragraph (1)(D), be carried back to such prior taxable year,

and the taxable income so computed shall not be considered to be less than zero. For purposes of this paragraph, if a portion of the net operating loss for the loss year is attributable to a foreign expropriation loss to which paragraph (1)(D) applies, such portion shall be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss, and, if a portion of a foreign expropriation loss for the loss year is attributable to a Cuban expropriation loss, such portion shall be considered to be a separate foreign expropriation loss for such year to be applied after the other portion of such foreign expropriation loss.

(3) Special rules.

(A) Paragraph (1)(A)(ii) shall apply only if—

(i) there has been filed, at such time and in such manner as may be prescribed by the Secretary or his delegate, a notice of filing of the application under section 317 of the Trade Expansion Act of 1962 for tax assistance, and, after its issuance, a copy of the certification under such section, and

(ii) the taxpayer consents in writing to the assessment, within such period as may be agreed upon with the Secretary or his delegate, of any deficiency for any year to the extent attributable to the disallowance of a deduction previously allowed with respect to such net operating loss, even though at the time of filing such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

(B) In the case of—

(i) a partnership and its partners, or

(ii) an electing small business corporation under subchapter S and its shareholders,

paragraph (1)(A)(ii) shall apply as determined under regulations prescribed by the Secretary or his delegate. Such paragraph shall apply to a net operating loss of a partner or such a shareholder only if it arose predominantly from losses in respect of which certifications under section 317 of the Trade Expansion Act of 1962 were filed under this section.

(C) Paragraph (1)(D) shall apply only if—

(i) the foreign expropriation loss (as defined in subsection (k)) for the taxable year equals or exceeds 50 percent of the net operating loss for the taxable year,

(ii) in the case of a foreign expropriation loss for a taxable year ending after December 31, 1963, the taxpayer elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) to have paragraph (1)(D) apply, and

(iii) in the case of a foreign expropriation loss for a taxable year ending after December 31, 1958, and before January 1, 1964, the taxpayer elects (in such manner as the Secretary or his delegate by regulations prescribes) on or before December 31, 1965, to have paragraph (1)(D) apply.

(D) If a taxpayer makes an election under subparagraph (C)(iii), then (notwithstanding any law or rule of law), with respect to any taxable year ending before January 1, 1964, affected by the election—

(i) the time for making or changing any choice or election under subpart A of part III of subchapter N (relating to foreign tax credit) shall not expire before January 1, 1966,

(ii) any deficiency attributable to the election under subparagraph (C)(iii) or to the application of clause (i) of this subparagraph may be assessed at any time before January 1, 1969, and

(iii) refund or credit of any overpayment attributable to the election under subparagraph (C)(iii) or to the application of clause (i) of this subparagraph may be made or allowed if claim therefor is filed before January 1, 1969.

(E) Paragraph (1)(E) shall apply only if—

(i) the amount of the taxpayer's net operating loss for the taxable year exceeds the sum of the taxable income (computed as provided in paragraph (2)) for each of the 3 preceding taxable years of the taxpayer,

(ii) the amount of the taxpayer's net operating loss for the taxable year, increased by the amount of the taxpayer's net operating loss for the preceding taxable year or decreased by the amount of the taxpayer's taxable income for such preceding year, exceeds 15 percent of the sum of the money and other property (in an amount equal to its adjusted basis for determining gain) of the taxpayer, determined as of the close of the taxable year of such loss without regard to any refund or credit of any overpayment of tax to which the taxpayer may be entitled under paragraph (1)(E),

(iii) the aggregate unadjusted basis of property described in section 1231(b)(1) (without regard to any holding period therein provided), the basis for which was determined under section 1012, which was acquired by the taxpayer during the period beginning with the first day of its fifth taxable year preceding the taxable year of such loss and ending with the last day of the taxable year of such loss, equals or exceeds the aggregate adjusted basis of property of such description of the taxpayer on, and determined as of, the first day of the fifth preceding taxable year, and

(iv) the taxpayer derived 50 percent or more of its gross receipts (other than gross receipts derived from the conduct of a lending or finance business), for the taxable year of such loss and for each of its 5 preceding taxable years, from the manufacture and production of units within the same single class of products, and 3 or fewer United States persons (including as one person an affiliated group as defined in section 1504(a)) other than the taxpayer manufactured and produced in the United States, in the calendar year ending in or with the taxable year of such loss, 85 percent or more of the total number of all units within such class of products manufactured and produced in the United States in such calendar year.

(F) For purposes of subparagraph (E)(iv)—

(i) the term "class of products" means any of the categories designated and numbered as a "class of products" in the 1963 Census of Manufactures compiled and published by the Secretary of Commerce under title 13 of the United States Code, and

(ii) information compiled or published by the Secretary of Commerce, as part of or in connection with the Statistical Abstract of the United States or the census of manufactures, regarding the number of units of a class of products manufactured and produced in the United States during a calendar year, or, if such information should not be available, information so compiled or published regarding the number of such units shipped or sold by such manufacturers during a calendar year, shall constitute prima facie evidence of the total number of all units of such class

of products manufactured and produced in the United States in such calendar year.

(c) Net operating loss defined.

For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) Modifications.

The modifications referred to in this section are as follows:

(1) Net operating loss deduction.

No net operating loss deduction shall be allowed.

(2) Capital gains and losses of taxpayers other than corporations.

In the case of a taxpayer other than a corporation—

(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets; and

(B) the deduction for long-term capital gains provided by section 1202 shall not be allowed.

(3) Deduction for personal exemptions.

No deduction shall be allowed under section 151 (relating to personal exemptions). No deduction in lieu of any such deduction shall be allowed.

(4) Nonbusiness deductions of taxpayers other than corporations.

In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) any gain or loss from the sale or other disposition of—

(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) real property used in the trade or business,

shall be treated as attributable to the trade or business;

(B) the modifications specified in paragraphs (1), (2) (B), and (3) shall be taken into account;

(C) any deduction allowable under section 165 (c) (3) (relating to casualty losses) shall not be taken into account; and

(D) any deduction allowed under section 404 or section 405(c) to the extent attributable to contributions which are made on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall not be treated as attributable to the trade or business of such individual.

(5) Special deductions for corporations.

No deduction shall be allowed under section 242 (relating to partially tax-exempt interest) or under section 922 (relating to Western Hemisphere trade corporations).

(6) Computation of deduction for dividends received, etc.

The deductions allowed by sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246 (b) (relating to limitation on aggregate amount of deductions); and the deduction allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities) shall be computed without regard to subsection (a) (1) (B) of such section.

(e) Law applicable to computations.

In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

(f) Taxable years beginning in 1953 and ending in 1954.

In the case of a taxable year beginning in 1953 and ending in 1954—

(1) In lieu of the amount specified in subsection (c), the net operating loss for such year shall be the sum of—

(A) that portion of the net operating loss for such year computed without regard to this subsection which the number of days in the loss year after December 31, 1953, bears to the total number of days in such year, and

(B) that portion of the net operating loss for such year computed under section 122 of the Internal Revenue Code of 1939 as if this section had not been enacted which the number of days in the loss year before January 1, 1954, bears to the total number of days in such year.

(2) The amount of any net operating loss for such year which shall be carried to the second preceding taxable year is the amount which bears the same ratio to such net operating loss as the number of days in the loss year after December 31, 1953, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the reduction for the second taxable year preceding the loss year shall not exceed the portion of the net operating loss which is carried to the second preceding taxable year.

(3) The net operating loss deduction for such year shall be, in lieu of the amount specified in section 122 (c) of the Internal Revenue Code of 1939, the sum of—

(A) that portion of the net operating loss deduction for such year, computed as if subsection (a) of this section were applicable to the taxable year, which the number of days in such year after December 31, 1953, bears to the total number of days in such year, and

(B) that portion of the net operating loss deduction for such year, computed under section 122 (c) of the Internal Revenue Code of 1939 as if this paragraph had not been enacted, which the number of days in such year before January 1, 1954, bears to the total number of days in such year.

(4) For purposes of the second sentence of subsection (b) (2), the taxable income for such year shall be the sum of—

(A) that portion of the net income for such year, computed without regard to this paragraph, which the number of days in such year before January 1, 1954, bears to the total number of days in such year, and

(B) that portion of the net income for such year, computed—

(i) without regard to paragraphs (1) and (2) of section 122 (d) of the Internal Revenue Code of 1939, and

(ii) by allowing as a deduction an amount equal to the sum of the credits provided in subsections (b) and (h) of section 26 of such Code,

which the number of days in such year after December 31, 1953, bears to the total number of days in such year.

(g) Special transitional rules.

(1) Losses for taxable years ending before January 1, 1954.

For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939.

(2) Losses for taxable years ending after December 31, 1953.

For purposes of section 122 of the Internal Revenue Code of 1939—

(A) the determination of the taxable years ending before January 1, 1954, to which a net operating loss for any taxable year ending after December 31, 1953, may be carried shall be made under subsection (b) (1) (A) of this section; and

(B) in determining the amount of the carryback to the first taxable year preceding the first taxable year ending after December 31, 1953, the portion of the net operating loss carried to such year shall be such net operating loss reduced by—

(i) the net income for the second preceding taxable year computed as if the second sentence of section 122 (b) (2) (B) of the Internal Revenue Code of 1939 applied, or

(ii) if smaller, the portion of the net operating loss which by reason of subsection (f) of this section is carried to the second preceding taxable year.

(3) Taxable years beginning after December 31, 1953, and ending before August 17, 1954.

In the case of a taxable year which begins after December 31, 1953, and ends before August 17, 1954—

(A) the net operating loss deduction for such year shall be computed as if subsection (a) of this section applied to such taxable year, and

(B) for purposes of the second sentence of subsection (b) (2), the taxable income for such taxable year shall be the net income for such taxable year, computed—

(i) without regard to paragraphs (1) and (2) of section 122 (d) of the Internal Revenue Code of 1939, and

(ii) by allowing as a deduction an amount equal to the sum of the credits provided in subsections (b) and (h) of section 26 of such Code.

(4) Excess profits tax not affected.

For purposes of subchapter D of chapter 1 of the Internal Revenue Code of 1939, excess profits net income shall be computed as if this section had not been enacted and as if section 122 of such Code continued to apply to taxable years to which this subtitle applies.

(h) Disallowance of net operating loss of electing small business corporations.

In determining the amount of the net operating loss deduction under subsection (a) of any corporation, there shall be disregarded the net operating loss of such corporation for any taxable year for which such corporation is an electing small business corporation under subchapter S.

(i) Carryback of net operating loss for taxable years beginning in 1957 and ending in 1958.

In the case of a taxable year beginning in 1957 and ending in 1958, the amount of any net operating loss for such year which shall be carried to the third preceding taxable year is the amount which bears the same ratio to such net operating loss as the number of days in the loss year after December 31, 1957, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the reduction for the third taxable year preceding the loss year shall not exceed the portion of the net operating loss which is carried to the third preceding taxable year.

(j) Carryover of net operating loss for certain regulated transportation corporations.

(1) Definition

For purposes of subsection (b) (1) (C), the term "regulated transportation corporation" means a corporation—

(A) 80 percent or more of the gross income of which (computed without regard to dividends and capital gains and losses) for the taxable year is derived from the furnishing or sale of transportation described in subparagraph (A), (C) (i), (E), or (F) of section 7701(a) (33) and taken into account for purposes of the limitation contained in the last two sentences of section 7701(a) (33),

(B) which is described in subparagraph (G) or (H) of section 7701(a) (33), or

(C) which is a member of a regulated transportation system.

(2) Regulated transportation system.

For purposes of this subsection, a corporation shall be treated as a member of a regulated transportation system for a taxable year if—

(A) it is a member of an affiliated group of corporations making a consolidated return for such taxable year, and

(B) 80 percent or more of the aggregate gross income of the members of such affiliated group (computed without regard to dividends and capital gains and losses) for such taxable year is derived from sources described in paragraph (1)(A).

For purposes of subparagraph (B), income derived by a corporation described in subparagraph (G) or (H) of section 7701(a)(33) from leases described in subparagraph (G) thereof shall be considered as derived from sources described in paragraph (1)(A).

(3) Limitation.

For purposes of subsection (b)(1)(C)—

(A) a net operating loss may not be a net operating loss carryover to the 6th taxable year following the loss year unless the taxpayer is a regulated transportation corporation for such 6th taxable year; and

(B) a net operating loss may not be a net operating loss carryover to the 7th taxable year following the loss year unless the taxpayer is a regulated transportation corporation for the 6th taxable year following the loss year and for such 7th taxable year.

(4) Taxable years beginning in 1955 and ending in 1956.

In the case of a net operating loss for a taxable year beginning in 1955 and ending in 1956, the amount of such loss which may be carried—

(A) to the 6th taxable year following the loss year shall be the amount which bears the same ratio to the amount which (but for this paragraph) would be carried to such 6th taxable year as the number of days in the loss year after December 31, 1955, bears to the total number of days in the loss year, and

(B) to the 7th taxable year following the loss year shall be the amount (if any) by which (i) the amount carried to the 6th taxable year (determined under subparagraph (A)), exceeds (ii) the taxable income (computed as provided in subsection (b)(2)) for such 6th taxable year.

(k) Foreign expropriation loss defined.

For purposes of subsection (b)—

(1) The term "foreign expropriation loss" means, for any taxable year, the sum of the losses sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. For purposes of the preceding sentence, a debt which becomes worthless shall, to the extent of any deduction allowed under section 166(a), be treated as a loss.

(2) The portion of the net operating loss for any taxable year attributable to a foreign expropriation loss is the amount of the foreign expropriation loss for such year (but not in excess of the net operating loss for such year).

(3) The term "Cuban expropriation loss" means, for any taxable year, a foreign expropriation loss sustained by reason of the expropriation, intervention, seizure, or similar taking of property, before January 1, 1964, by the government of Cuba, any political subdivision thereof, or any agency or instrumentality of the foregoing. The portion of a foreign expropriation loss for any taxable year attributable to a Cuban expropriation loss is the amount of the Cuban expropriation loss.

(l) Cross references.

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

(Aug. 16, 1954, ch. 736, 68A Stat. 63; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 14(a), (b), 64(b), title II, § 203(a), (b), 72 Stat. 1611, 1656, 1678; Sept. 27, 1962, Pub. L. 87–710, § 1, 76 Stat. 648; Oct. 10, 1962, Pub. L. 87–792, § 7(f), 76 Stat. 829; Oct. 11, 1962, Pub. L. 87–794, title III, § 317(b), 76 Stat. 889; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 210(a), (b), 234(b)(5), 78 Stat. 47, 48, 115; Dec. 27, 1967, Pub. L. 90–225, § 3(a), 81 Stat. 732; Dec. 30, 1969, Pub. L. 91–172, title IV, § 431(b), 83 Stat. 619; Jan. 12, 1971, Pub. L. 91–677, § 2(a)–(c), 84 Stat. 2061.)

REFERENCES IN TEXT

Section 317 of the Trade Expansion Act of 1962, referred to in subsec. (b), probably means section 317(a) of Pub. L. 87–794, which is classified to section 1917 of Title 19, Customs Duties.

Section 2 of the Farm Credit Act of 1933 (12 U.S.C. 1134), referred to in subsec. (b)(1)(G), is classified to section 1134 of Title 12, Banks and Banking.

AMENDMENTS

1971—Subsec. (b)(1)(D). Pub. L. 91–677, § 2(a), added "(or, with respect to that portion of the net operating loss for such year attributable to a Cuban expropriation loss, to each of the 15 taxable years following the taxable year of such loss)" following "the 10 taxable years following the taxable year of such loss".

Subsec. (b)(2). Pub. L. 91–677, § 2(b), added the provisions relating to the treatment of Cuban expropriation losses.

Subsec. (k)(3). Pub. L. 91–677, § 2(c), added subsec. (k)(3).

1969—Subsec. (b)(1). Pub. L. 91–172 substituted "(E), (F), and (G)", for "and (E)" in subparagraph (A)(i) and added subpars. (F) and (G).

1967—Subsec. (b)(1). Pub. L. 90–225, § 3(a)(1)—(3) added reference to subpar. (E) in subpars. (A)(i) and (B), and added subpar. (E).

Subsec. (b)(3). Pub. L. 90–225, § 3(a)(4), added subpars. (E) and (F).

1964—Subsec. (b). Pub. L. 88–272, § 210(a)(1)—(4), (b), inserted subpar. (D) in par. (1), references to such subpar. (D) in par. (1)(A)(i) and (1)(B), subpars. (C) and (D) in par. (3), provided that the net operating loss deduction in par. (2) (B) be determined without regard to that portion of a net operating loss due to a foreign expropriation loss, if such portion may not, under par. (1)(D), be carried back to such prior taxable year, and that if a portion of the net operating loss is attributable to foreign expropriation to which par. (1)(D) applied, such portion shall be considered a separate loss for such year to be applied after the other portion of such net operating loss.

Subsec. (j)(1), (2), Pub. L. 88–272, § 234(b)(5), substituted references to section 7701(a)(33) for references to section 1503(c)(1) or (2), wherever appearing.

Subsec. (k). Pub. L. 88–272, § 210(a)(5), added subsec. (k). Former subsec. (k) redesignated (l).

Subsec. (*l*). Pub. L. 88-272, § 210(a)(5), redesignated former subsec. (k) as (*l*).

1962—Subsec. (b)(1). Pub. L. 87-794 designated existing provisions as cl. (A)(i) and eliminated provisions therefrom which authorized a net operating loss for any taxable year ending after Dec. 31, 1957, to be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss, and added cls. (A)(ii), (B), and (C).

Subsec. (b)(2). Pub. L. 87-794 inserted the reference to subsection (j), and substituted "shall be carried to the earliest of the taxable years to which (by reason of paragraph (1))" for "shall be carried to the earliest of the 8 taxable years to which (by reason of subparagraphs (A) and (B) of paragraph (1))", and "each of the other taxable years" for "each of the other 7 taxable years."

Subsec. (b)(3). Pub. L. 87-794 added subsec. (b)(3).

Pub. L. 87-710, § 1(a), authorized a carryover of a net operating loss for any taxable year ending after Dec. 31, 1955, to each of the 5 taxable years following the taxable year of loss, or when such loss occurs in the case of regulated transportation corporation, except as provided in subsec. (j), then to each of the 7 taxable years following the taxable year of loss, and eliminated provisions authorizing a net operating loss for any taxable years ending Dec. 31, 1957, to be carried over to each of the 5 taxable years following the taxable year of such loss, in par. (1), and inserted the reference to subsec. (j) in par. (2).

Subsec. (d)(4). Pub. L. 87-792 added subpar. (D).

Subsec. (j). Pub. L. 87-710, § 1(b), added subsec. (j). Former subsec. (j) redesignated (k).

Subsec. (k). Pub. L. 87-710, § 1(b), redesignated former subsec. (j) as (k).

1958—Subsec. (b). Pub. L. 85-866, § 203(a), substituted "1957" for "1953", and "3" for "2" in par. (1), and substituted "subsection (l)" for "subsection (f)", "8" for "7", and "7" for "6" in par. (2).

Subsecs. (f) (3), (4). Pub. L. 85-866, § 14(a), added subsecs. (f) (3). (4).

Subsec. (g)(3). Pub. L. 85-866, § 14(b), added subsec. (g)(3) and redesignated former subsec. (g)(3) as (g)(4).

Subsec. (g)(4). Pub. L. 85-866, § 14(b), redesignated former subsec. (g)(3) as (g)(4).

Subsec. (h). Pub. L. 85-866, § 64(b), added subsec. (h) and redesignated former subsec. (h) as (i).

Subsec. (i). Pub. L. 85-866, § 203(b), added subsec. (i) and redesignated former subsec. (i) as redesignated by § 64(b) as (j).

Subsec. (j). Pub. L. 85-866, § 203(b), redesignated former subsec. (l) as (j).

EFFECTIVE DATE OF 1971 AMENDMENT

Section 2(d) of Pub. L. 91-677 provided that: "The amendments made by this section [amending subsecs. (b) and (k) of this section] shall apply in respect of foreign expropriation losses sustained in taxable years ending after December 31, 1958."

EFFECTIVE DATE OF 1967 AMENDMENT

Section 3(b) of Pub. L. 90-225 provided that: "No interest shall be paid or allowed with respect to any overpayment of tax resulting from the application of the amendments made by subsection (a) [amending subsec. (b) of this section] for any period prior to the date of the enactment of this Act [Dec. 27, 1967]."

Section 3(c) of Pub. L. 90-225 provided that: "The amendments made by subsection (a) [amending subsec. (b) of this section] shall apply with respect to net operating losses sustained in taxable years ending after December 31, 1966."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 210(c) of Pub. L. 88-272 provided that: "The amendments made by this section [adding subsec. (k), redesignating former subsec. (k) as (*l*), and amending subsec. (b) of this section] shall apply in respect of foreign expropriation losses (as defined in section 172(k) of the Internal Revenue Code of 1954, as amended by subsection (a)(5) of this section), sustained in taxable years ending after December 31, 1958."

Amendment of subsec. (j) of this section by Pub. L. 88-272 applicable to taxable years beginning after Dec. 31, 1963, see section 234(c) of Pub. L. 88-272, set out as a note under section 1503 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Section 317(b) of Pub. L. 87-794 provided in part that the amendment of subsec. (b) of this section by Pub. L. 87-794 shall be effective with respect to net operating losses for taxable years ending after Dec. 31, 1955.

Amendment of section by Pub. L. 87-792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87-792, set out as a note under section 37 of this title.

Section 2 of Pub. L. 87-710 provided that: "The amendments made by the first section of this Act [to this section] shall apply only with respect to net operating losses for taxable years ending after December 31, 1955."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 203 (c) of Pub. L. 85-866 provided that: "The amendments made by subsections (a) and (b) [to subsecs. (b) (1), (2), and (j) of this section] shall apply in respect of net operating losses for taxable years ending after December 31, 1957."

Subsecs. (f) (3), (4), and (g) (3) of this section as applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85-866, set out as a note under section 165 of this title.

Section 64 (e) of Pub. L. 85-866 provided that: "The amendments made by this section [adding sections 1016, (a) (18), 1371—1377, 1504 (b) (8) and 6037 of this title, amending subsecs. (h) and (l) of this section and renumbering former section 6037 as 6038 of this title] shall apply only with respect to taxable years beginning after December 31, 1957".

REFUND OR CREDIT OF OVERPAYMENT; LIMITATIONS; INTEREST

Section 14 (c) of Pub. L. 85-866 provided that: "If refund or credit of any overpayment resulting from the application of the amendment made by subsection (a) [to subsecs. (f) (3) and (f) (4) of this section] or (b) [to subsecs. (g) (3) and (g) 4) of this section] is prevented on the date of the enactment of this Act [Sept. 2, 1958], or within 6 months after such date, by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954, relating to closing agreements, and other than section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within 6 months after such date. No interest shall be paid or allowed on any overpayment resulting from the application of the amendment made by subsection (a) or (b)."

INTEREST ATTRIBUTABLE TO NET OPERATING LOSS CARRYBACK FOR CERTAIN TAXABLE YEARS ENDING IN 1954

See note set out under section 6601 of this title.

CROSS REFERENCES

Adjustments required by changes in method of accounting, see section 481(b)(3)(A) of this title.

Losses generally, see section 165 of this title.

Net operating loss—

Amount and method of adjustment, see section 1314 of this title.

Extension of time for payment of taxes by corporations expecting carrybacks under this section, see section 6164 of this title.

Partnership not allowed deduction, see section 703 of this title.

Net operating loss carryover on termination of estate or trust, see section 642 of this title.

Special limitations on net operating loss carryovers, see section 382 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 56, 165, 170, 186, 246, 381, 382, 481, 512, 535, 545, 556, 584, 642, 703, 804,

809, 822, 823, 844, 852, 857, 1212, 1242, 1244, 1247, 1314, 1341, 1351, 1373, 1374, 1402, 6164, 6411, 6501 of this title; title 19 section 1917.

§ 173. Circulation expenditures.

Notwithstanding section 263, all expenditures (other than expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical) to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical shall be allowed as a deduction; except that the deduction shall not be allowed with respect to the portion of such expenditures as, under regulations prescribed by the Secretary or his delegate, is chargeable to capital account if the taxpayer elects, in accordance with such regulations, to treat such portion as so chargeable. Such election, if made, must be for the total amount of such portion of the expenditures which is so chargeable to capital account, and shall be binding for all subsequent taxable years unless, upon application by the taxpayer, the Secretary or his delegate permits a revocation of such election subject to such conditions as he deems necessary. (Aug. 16, 1954, ch. 736, 68A Stat. 65.)

CROSS REFERENCES

Capital expenditures not deductible, see section 263 of this title.

Trade or business expenses deductible, see section 162 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 174. Research and experimental expenditures.

(a) Treatment as expenses.

(1) In general.

A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

(2) When method may he adopted.

(A) Without consent.

A taxpayer may, without the consent of the Secretary or his delegate, adopt the method provided in this subsection for his first taxable year—

(i) which begins after December 31, 1953, and ends after the date on which this title is enacted, and

(ii) for which expenditures described in paragraph (1) are paid or incurred.

(B) With consent.

A taxpayer may, with the consent of the Secretary or his delegate, adopt at any time the method provided in this subsection.

(3) Scope.

The method adopted under this subsection shall apply to all expenditures described in paragraph (1). The method adopted shall be adhered to in computing taxable income for the taxable year and for all subsequent taxable years unless, with the approval of the Secretary or his delegate, a change to a different method is authorized with respect to part or all of such expenditures.

(b) Amortization of certain research and experimental expenditures.

(1) In general.

At the election of the taxpayer, made in accordance with regulations prescribed by the Secretary or his delegate, research or experimental expenditures which are—

(A) paid or incurred by the taxpayer in connection with his trade or business,

(B) not treated as expenses under subsection (a), and

(C) chargeable to capital account but not chargeable to property of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion),

may be treated as deferred expenses. In computing taxable income, such deferred expenses shall be allowed as a deduction ratably over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures). Such deferred expenses are expenditures properly chargeable to capital account for purposes of section 1016 (a) (1) (relating to adjustments to basis of property).

(2) Time for and scope of election.

The election provided by paragraph (1) may be made for any taxable year beginning after December 31, 1953, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The method so elected, and the period selected by the taxpayer, shall be adhered to in computing taxable income for the taxable year for which the election is made and for all subsequent taxable years unless, with the approval of the Secretary or his delegate, a change to a different method (or to a different period) is authorized with respect to part or all of such expenditures. The election shall not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election.

(c) Land and other property.

This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section allowances under section 167, and allowances under section 611, shall be considered as expenditures.

(d) Exploration expenditures.

This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(e) Cross reference.

For adjustments to basis of property for amounts allowed as deductions as deferred expenses under subsection (b), see section 1016 (a) (14).

(Aug. 16, 1954, ch. 736, 68A Stat. 66.)

CROSS REFERENCES

Exception from denial of deduction for capital expenditures, see section 263 (a) (1) (B) of this title.

Trade or business expenses deductible, see section 162 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 263, 1016 of this title.

§ 175. Soil and water conservation expenditures.

(a) In general.

A taxpayer engaged in the business of farming may treat expenditures which are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming, as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

(b) Limitation.

The amount deductible under subsection (a) for any taxable year shall not exceed 25 percent of the gross income derived from farming during the taxable year. If for any taxable year the total of the expenditures treated as expenses which are not chargeable to capital account exceeds 25 percent of the gross income derived from farming during the taxable year, such excess shall be deductible for succeeding taxable years in order of time; but the amount deductible under this section for any one such succeeding taxable year (including the expenditures actually paid or incurred during the taxable year) shall not exceed 25 percent of the gross income derived from farming during the taxable year.

(c) Definitions.

For purposes of subsection (a)—

(1) The term "expenditures which are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming" means expenditures paid or incurred for the treatment or moving of earth, including (but not limited to) leveling, grading and terracing, contour furrowing, the construction, control, and protection of diversion channels, drainage ditches, earthen dams, watercourses, outlets, and ponds, the eradication of brush, and the planting of windbreaks. Such term does not include—

(A) the purchase, construction, installation, or improvement of structures, appliances, or facilities which are of a character which is subject to the allowance for depreciation provided in section 167, or

(B) any amount paid or incurred which is allowable as a deduction without regard to this section.

Notwithstanding the preceding sentences, such term also includes any amount, not otherwise allowable as a deduction, paid or incurred to satisfy any part of an assessment levied by a soil or water conservation or drainage district to defray expenditures made by such district (i) which, if paid or incurred by the taxpayer, would without regard to this sentence constitute expenditures deductible under this section, or (ii) for property of a character subject to the allowance for depreciation provided in section 167 and used in the soil or water conservation or drainage district's business as such (to the extent that the taxpayer's share of the assessment levied on the members of the district for such property does not exceed 10 percent of such assessment).

(2) The term "land used in farming" means land used (before or simultaneously with the expenditures described in paragraph (1)) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

(d) When method may be adopted.

(1) Without consent.

A taxpayer may, without the consent of the Secretary or his delegate, adopt the method provided in this section for his first taxable year—

(A) which begins after December 31, 1953, and ends after the date on which this title is enacted, and

(B) for which expenditures described in subsection (a) are paid or incurred.

(2) With consent.

A taxpayer may, with the consent of the Secretary or his delegate, adopt at any time the method provided in this section.

(e) Scope.

The method adopted under this section shall apply to all expenditures described in subsection (a). The method adopted shall be adhered to in computing taxable income for the taxable year and for all subsequent taxable years unless, with the approval of the Secretary or his delegate, a change to a different method is authorized with respect to part or all of such expenditures.

(f) Rules applicable to assessments for depreciable property.—

(1) Amounts treated as paid or incurred over 9-year period.

In the case of an assessment levied to defray expenditures for property described in clause (ii) of the last sentence of subsection (c)(1), if the amount of such assessment paid or incurred by the taxpayer during the taxable year (determined without the application of this paragraph) is in excess of an amount equal to 10 percent of the aggregate amounts which have been and will be assessed as the taxpayer's share of the expenditures by the district for such property, and if such excess is more than $500, the entire excess shall be treated as paid or incurred ratably over each of the 9 succeeding taxable years.

(2) Disposition of land during 9-year period.

If paragraph (1) applies to an assessment and the land with respect to which such assessment was made is sold or otherwise disposed of by the taxpayer (other than by the reason of his death) during the 9 succeeding taxable years, any amount of the excess described in paragraph (1) which has not been treated as paid or incurred for a tax-

able year ending on or before the sale or other disposition shall be added to the adjusted basis of such land immediately prior to its sale or other disposition and shall not thereafter be treated as paid or incurred ratably under paragraph (1).

(3) Disposition by reason of death.

If paragraph (1) applies to an assessment and the taxpayer dies during the 9 succeeding taxable years, any amount of the excess described in paragraph (1) which has not been treated as paid or incurred for a taxable year ending before his death shall be treated as paid or incurred in the taxable year in which he dies.

(Aug. 16, 1954, ch. 736, 68A Stat. 67; Oct. 22, 1968, Pub. L. 90–630, § 5(a), (b), 82 Stat. 1329.)

AMENDMENTS

1968—Subsec. (c)(1). Pub. L. 90–630, § 5(a), in the material following subpar. (B), designated as cl. (i) existing provisions covering amounts which, if paid or incurred by the taxpayer, would wthout regard to the exception constitute deductible expenditures, and added cl. (ii).

Subsec. (f). Pub. L. 90–630, § 5(b), added subsec. (f).

EFFECTIVE DATE OF 1968 AMENDMENT

Section 5(c) of Pub. L. 90–630 provided that: "The amendments made by subsections (a) and (b) [amending subsec. (c)(1) and adding subsec. (f) of this section] shall apply to assessments levied after the date of the enactment of this Act [Oct. 22, 1968] in taxable years ending after such date."

CROSS REFERENCES

Exception from denial of deduction for capital expenditures, see section 263 (a) (1) (c) of this title.

Trade or business expenses deductible, see section 162 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 263, 1251, 1252 of this title.

§ 176. Payments with respect to employees of certain foreign corporations.

In the case of a domestic corporation, there shall be allowed as a deduction amounts (to the extent not compensated for) paid or incurred pursuant to an agreement entered into under section 3121 (*l*) with respect to services performed by United States citizens employed by foreign subsidiary corporations. Any reimbursement of any amount previously allowed as a deduction under this section shall be included in gross income for the taxable year in which received. (Added Sept. 1, 1954, ch. 1206, title II, § 210 (a), 68 Stat. 1096.)

§ 177. Trademark and trade name expenditures.

(a) Election to amortize.

Any trademark or trade name expenditure paid or incurred during a taxable year beginning after December 31, 1955, may, at the election of the taxpayer (made in accordance with regulations prescribed by the Secretary or his delegate), be treated as a deferred expense. In computing taxable income, all expenditures paid or incurred during the taxable year which are so treated shall be allowed as a deduction ratably over such period of not less than 60 months (beginning with the first month in such taxable year) as may be selected by the taxpayer in making such election. The expenditures so treated are expenditures properly chargeable to capital account for purposes of section 1016 (a) (1) (relating to adjustments to basis of property).

(b) Trademark and trade name expenditures defined.

For purposes of subsection (a), the term "trademark or trade name expenditure" means any expenditure which—

(1) is directly connected with the acquisition, protection, expansion, registration (Federal, State, or foreign), or defense of a trademark or trade name;

(2) is chargeable to capital account; and

(3) is not part of the consideration paid for a trademark, trade name, or business.

(c) Time for and scope of election.

The election provided by subsection (a) shall be made within the time prescribed by law (including extensions thereof) for filing the return for the taxable year during which the expenditure is paid or incurred. The period selected by the taxpayer under subsection (a) with respect to the expenditures paid or incurred during the taxable year which are treated as deferred expenses shall be adhered to in computing his taxable income for the taxable year for which the election is made and all subsequent years.

(d) Cross reference.

For adjustments to basis of property for amounts allowed as deductions for expenditures treated as deferred expenses under this section, see section 1016 (a) (16).

(Added June 29, 1956, ch. 464, § 4 (a), 70 Stat. 406.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 178. Depreciation or amortization of improvements made by lessee on lessor's property.

(a) General rule.

Except as provided in subsection (b), in determining the amount allowable to a lessee as a deduction for any taxable year for exhaustion, wear and tear, obsolescence, or amortization—

(1) in respect of any building erected (or other improvement made) on the leased property, if the portion of the term of the lease (excluding any period for which the lease may subsequently be renewed, extended, or continued pursuant to an option exercisable by the lessee) remaining upon the completion of such building or other improvement is less than 60 percent of the useful life of such building or other improvement, or

(2) in respect of any cost of acquiring the lease, if less than 75 percent of such cost is attributable to the portion of the term of the lease (excluding any period for which the lease may subsequently be renewed, extended, or continued pursuant to an option exercisable by the lessee) remaining on the date of its acquisition,

the term of the lease shall be treated as including any period for which the lease may be renewed, extended, or continued pursuant to an option exercisable by the lessee, unless the lessee establishes that (as of the close of the taxable year) it is more probable that the lease will not be renewed, extended, or continued for such period than that the lease will be so renewed, extended, or continued.

(b) Related lessee and lessor.

(1) General rule.

If a lessee and lessor are related persons (as determined under paragraph (2)) at any time

during the taxable year then, in determining the amount allowable to the lessee as a deduction for such taxable year for exhaustion, wear and tear, obsolescence, or amortization in respect of any building erected (or other improvement made) on the leased property, the lease shall be treated as including a period of not less duration than the remaining useful life of such improvement.

(2) Related persons defined.

For purposes of paragraph (1), a lessor and lessee shall be considered to be related persons if—

(A) the lessor and the lessee are members of an affiliated group (as defined in section 1504), or

(B) the relationship between the lessor and lessee is one described in subsection (b) of section 267, except that, for purposes of this subparagraph, the phrase "80 percent or more" shall be substituted for the phrase "more than 50 percent" each place it appears in such subsection.

For purposes of determining the ownership of stock in applying subparagraph (B), the rules of subsection (c) of section 267 shall apply, except that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

(c) Reasonable certainty test.

In any case in which neither subsection (a) nor subsection (b) applies, the determination as to the amount allowable to a lessee as a deduction for any taxable year for exhaustion, wear and tear, obsolescence, or amortization—

(1) in respect of any building erected (or other improvement made) on the leased property, or

(2) in respect of any cost of acquiring the lease,

shall be made with reference to the term of the lease (excluding any period for which the lease may subsequently be renewed, extended, or continued pursuant to an option exercisable by the lessee), unless the lease has been renewed, extended, or continued or the facts show with reasonable certainty that the lease will be renewed, extended, or continued. (Added Pub. L. 85–866, title I, § 15 (a), Sept. 2, 1958, 72 Stat. 1612.)

EFFECTIVE DATE

Section 15 (c) of Pub. L. 85–866 provided that: "The amendments made by this section [which added this section and amended analysis preceding section 161 of this title] shall apply with respect to costs of acquiring a lease incurred, and improvements begun, after July 28, 1958 (other than improvements which, on July 28, 1958, and at all times thereafter, the lessee was under a binding legal obligation to make)."

§ 179. Additional first-year depreciation allowance for small business.

(a) General rule.

In the case of section 179 property, the term "reasonable allowance" as used in section 167 (a) may, at the election of the taxpayer, include an allowance, for the first taxable year for which a deduction is allowable under section 167 to the taxpayer with respect to such property, of 20 percent of the cost of such property.

(b) Dollar limitation.

If in any one taxable year the cost of section 179 property with respect to which the taxpayer may elect an allowance under subsection (a) for such taxable year exceeds $10,000, then subsection (a) shall apply with respect to those items selected by the taxpayer, but only to the extent of an aggregate cost of $10,000. In the case of a husband and wife who file a joint return under section 6013 for the taxable year, the limitation under the preceding sentence shall be $20,000 in lieu of $10,000.

(c) Election.

(1) In general.

The election under this section for any taxable year shall be made within the time prescribed by law (including extensions thereof) for filing the return for such taxable year. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe.

(2) Election irrevocable.

Any election made under this section may not be revoked except with the consent of the Secretary or his delegate.

(d) Definitions and special rules.

(1) Section 179 property.

For purposes of this section, the term "section 179 property" means tangible personal property—

(A) of a character subject to the allowance for depreciation under section 167,

(B) acquired by purchase after December 31, 1957, for use in a trade or business or for holding for production of income, and

(C) with a useful life (determined at the time of such acquisition) of 6 years or more.

(2) Purchase defined.

For purposes of paragraph (1), the term "purchase" means any acquisition of property, but only if—

(A) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707 (b) (but, in applying section 267 (b) and (c) for purposes of this section, paragraph (4) of section 267 (c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants),

(B) the property is not acquired by one component member of a controlled group from another component member of the same controlled group, and

(C) the basis of the property in the hands of the person acquiring it is not determined—

(i) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(ii) under section 1014 (a) (relating to property acquired from a decedent).

(3) Cost.

For purposes of this section, the cost of property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the person acquiring such property.

(4) Section not to apply to trusts.

This section shall not apply to trusts.

(5) Estates.

In the case of an estate, any amount apportioned to an heir, legatee, or devisee under section 167(h) shall not be taken into account in applying subsection (b) of this section to section 179 property of such heir, legatee, or devisee not held by such estate.

(6) Dollar limitation of controlled group.

For purposes of subsection (b) of this section—

(A) all component members of a controlled group shall be treated as one taxpayer, and

(B) the Secretary or his delegate shall apportion the dollar limitation contained in such subsection (b) among the component members of such controlled group in such manner as he shall by regulations prescribe.

(7) Controlled group defined.

For purposes of paragraphs (2) and (6), the term "controlled group" has the meaning assigned to it by section 1563(a); except that, for such purposes, the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

(8) Adjustment to basis; when made.

In applying section 167(g), the adjustment under section 1016 (a) (2) resulting by reason of an election made under this section with respect to any section 179 property shall be made before any other deduction allowed by section 167 (a) is computed.

(e) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section. (Added Pub. L. 85–866, title II, § 204(a), Sept. 2, 1958, 72 Stat. 1679, and amended Pub. L. 87–834, § 13(c)(2), Oct. 16, 1962, 76 Stat. 1034; Pub. L. 91–172, title IV, § 401(f), Dec. 30, 1969, 83 Stat. 603.)

AMENDMENTS

1969—Subsec. (d). Pub. L. 91–172 substituted reference to component members of a controlled group for reference to members of an affiliated group in pars. (2)(B) and (b), and substituted definition of controlled group for definition of affiliated group in par. (7).

1962—Subsec. (d)(5). Pub. L. 87–834, § 13(c)(2)(A), substituted "section 167(h)" for "section 167(g)."

Subsec. (d)(8). Pub. L. 87–834, § 13(c)(2)(B), substituted "section 167(g)" for "section 167(f)."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsecs. (d)(2)(B), (d)(6) and (7) of this section by section 401(f) of Pub. L. 91–172 applicable with respect to taxable years ending on or after Dec. 31, 1970, see section 401(h)(3) of Pub. L. 91–172, set out as a note under section 1561 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (d) (5), (8) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec. 31, 1961, and ending after Oct. 16, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

EFFECTIVE DATE

Section 204 (c) of Pub. L. 85–866 provided that: "The amendments made by this section [which added this section and amended analysis prec. § 161 of this title] shall apply with respect to taxable years ending after June 30, 1958."

SHORT TITLE

Section as part of the Small Business Tax Revision Act of 1958, see section 201 of Pub. L. 85–866, set out as a note under section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 48 of this title.

§ 180. Expenditures by farmers for fertilizer, etc.

(a) In general.

A taxpayer engaged in the business of farming may elect to treat as expenses which are not chargeable to capital account expenditures (otherwise chargeable to capital account) which are paid or incurred by him during the taxable year for the purchase or acquisition of fertilizer, lime, ground limestone, marl, or other materials to enrich, neutralize, or condition land used in farming, or for the application of such materials to such land. The expenditures so treated shall be allowed as a deduction.

(b) Land used in farming.

For purposes of subsection (a), the term "land used in farming" means land used (before or simultaneously with the expenditures described in subsection (a)) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

(c) Election.

The election under subsection (a) for any taxable year shall be made within the time prescribed by law (including extensions thereof) for filing the return for such taxable year. Such election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. Such election may not be revoked except with the consent of the Secretary or his delegate. (Added Pub. L. 86–779, § 6(a), Sept. 14, 1960, 74 Stat. 1001.)

EFFECTIVE DATE

Section 6(d) of Pub. L. 86–779 provided that: "The amendments made by subsections (a), (b), and (c) [adding this section and item 180 to table of sections for Part VI and amending section 263(a)(1) of this title] shall apply to taxable years beginning after December 31, 1959."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 263 of this title.

§ 181. Repealed. Pub. L. 88–272, title II, § 203(a)(3)(B), Feb. 26, 1964, 78 Stat. 34.

Section, Pub. L. 87–834, § 2(c), Oct. 16, 1962, 76 Stat. 970, related to a deduction for unused investment credit.

EFFECTIVE DATE OF REPEAL

Repeal of section applicable in case of property placed in service after Dec. 31, 1963, with respect to taxable years ending after such date, and in case of property placed in service before Jan. 1, 1964, with respect to taxable years beginning after Dec. 31, 1963, see section 203(a)(4) of Pub. L. 88–272, set out as a note under section 48 of this title.

§ 182. Expenditures by farmers for clearing land.

(a) In general.

A taxpayer engaged in the business of farming may elect to treat expenditures which are paid or incurred by him during the taxable year in the clearing of land for the purpose of making such land suitable for use in farming as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

(b) Limitation.

The amount deductible under subsection (a) for any taxable year shall not exceed whichever of the following amounts is the lesser:

(1) $5,000, or

(2) 25 percent of the taxable income derived from farming during the taxable year.

For purposes of paragraph (2), the term "taxable income derived from farming" means the gross income derived from farming reduced by the deductions allowed by this chapter (other than by this section) which are attributable to the business of farming.

(c) Definitions.

For purposes of subsection (a)—

(1) The term "clearing of land" includes (but is not limited to) the eradication of trees, stumps, and brush, the treatment or moving of earth, and the diversion of streams and watercourses.

(2) The term "land suitable for use in farming" means land which as a result of the activities described in paragraph (1) is suitable for use by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

(d) Exceptions, etc.

(1) Exceptions.

The expenditures to which subsection (a) applies shall not include—

(A) the purchase, construction, installation, or improvement of structures, appliances, or facilities which are of a character which is subject to the allowance for depreciation provided in section 167, or

(B) any amount paid or incurred which is allowable as a deduction without regard to this section.

(2) Certain property used in the clearing of land.

(A) Allowance for depreciation.

The expenditures to which subsection (a) applies shall include a reasonable allowance for depreciation with respect to property of the taxpayer which is used in the clearing of land for the purpose of making such land suitable for use in farming and which, if used in a trade or business, would be property subject to the allowance for depreciation provided by section 167.

(B) Treatment as depreciation deduction.

For purposes of this chapter, any expenditure described in subparagraph (A) shall, to the extent allowed as a deduction under subsection (a), be treated as an amount allowed under section 167 for exhaustion, wear and tear, or obsolescence of the property which is used in the clearing of land.

(e) Election.

The election under subsection (a) for any taxable year shall be made within the time prescribed by law (including extensions thereof) for filing the return for such taxable year. Such election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. Such election may not be revoked except with the consent of the Secretary or his delegate. (Added Pub. L. 87–834, § 21(a), Oct. 16, 1962, 76 Stat. 1063.)

EFFECTIVE DATE

Section 21(d) of Pub. L. 87–834 provided that: "The amendments made by this section [enacting this section and amending section 263(a) of this title] shall apply with respect to taxable years beginning after December 31, 1962."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 263, 1251, 1252 of this title.

§ 183. Activities not engaged in for profit.

(a) General rule.

In the case of an activity engaged in by an individual or an electing small business corporation (as defined in section 1371(b)), if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) Deductions allowable.

In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed—

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) Activity not engaged in for profit defined.

For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212.

(d) Presumption.

If the gross income derived from an activity for 2 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity (determined without regard to whether or not such activity is engaged in for profit), then, unless the Secretary or his delegate establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit. In the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, the preceding sentence shall be applied by substituting the period of 7 consecutive taxable years for the period of 5 consecutive taxable years. (Added Pub. L. 91–172, title II, § 213(a), Dec. 30, 1969, 83 Stat. 571.)

EFFECTIVE DATE

Section 213(d) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section, amending section 6504 of this title, and repealing section 270 of this title] shall apply to taxable years beginning after December 31, 1969."

§ 184. Amortization of certain railroad rolling stock.

(a) Allowance of deduction.

Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any qualified railroad rolling stock (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the qualified railroad rolling stock at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction provided by this section with respect to any qualified railroad rolling stock for any month shall be in lieu of the depreciation deduction with respect to such rolling stock for such month provided by section 167. The 60-month period shall begin, as to any qualified railroad rolling stock, at the election of the taxpayer, with the month following the month in which such rolling stock was placed in service or with the succeeding taxable year.

(b) Election of amortization.

The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the qualified railroad rolling stock was placed in service, or with the taxable year succeeding the taxable year in which such rolling stock is placed in service, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

(c) Termination of amortization deduction.

A taxpayer which has elected under subsection (b) to take the amortization deduction provided by subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction under this section with respect to such rolling stock.

(d) Qualified railroad rolling stock.

Except as provided in subsection (e)(4), the term "qualified railroad rolling stock" means, for purposes of this section, rolling stock of the type used by a common carrier engaged in the furnishing or sale of transportation by railroad and subject to the jurisdiction of the Interstate Commerce Commission if—

(1) such rolling stock is—

(A) used by a domestic common carrier by railroad on a full-time basis, or on a part-time basis if its only additional use is an incidental use by a Canadian or Mexican common carrier by railroad on a per diem basis, or

(B) owned and used by a switching or terminal company all of whose stock is owned by one or more domestic common carriers by railroad, and

(2) the original use of such rolling stock commences with the taxpayer after December 31, 1968.

(e) Special rules.

(1) In general.

Except as otherwise provided in this subsection, this section shall apply to qualified railroad rolling stock placed in service after 1968 and before 1975.

(2) Placed in service in 1969.

If any qualified railroad rolling stock is placed in service in 1969—

(A) the month as to which the amortization period shall begin with respect to such rolling stock shall be determined as if such rolling stock were placed in service on December 31, 1969, and

(B) subsections (a) and (b) shall be applied by substituting "48" for "60" each place that it appears in such subsections.

This section shall not apply to any qualified railroad rolling stock placed in service in 1969 and owned by any person who is not a domestic common carrier by railroad, or a corporation at least 95 percent of the stock of which is owned by one or more such common carriers.

(3) Placed in service in 1970.

If any qualified railroad rolling stock is placed in service in 1970 by a domestic common carrier by rail or by a corporation at least 95 percent of the stock of which is owned by one or more such common carriers, then subsection (a) shall be applied, without regard to paragraph (2), as if such rolling stock were placed in service on December 31, 1969.

(4) Railroad rolling stock not in short supply.

The Secretary or his delegate shall determine (with the assistance of the Secretary of Transportation) which types of railroad rolling stock are not in short supply and shall prescribe regulations designating such types. The term "qualified railroad rolling stock" shall not include any rolling stock which—

(A) is of the type of rolling stock designated by such regulations as not in short supply, and

(B) is placed in service after (i) 1972, or (ii) 30 days after the date on which such regulations are promulgated, whichever is later.

(5) Adjusted basis.

(A) The adjusted basis of any qualified railroad rolling stock, with respect to which an election has been made under this section, shall not be increased, for purposes of this section, for amounts chargeable to capital account for additions or improvements after the amortization period has begun.

(B) Costs incurred in connection with a used unit of railroad rolling stock which are properly chargeable to capital account shall be treated as a separate unit of railroad rolling stock for purposes of this section.

(C) The depreciation deduction provided by section 167 shall, despite the provisions of subsection (a), be allowed with respect to the portion of the adjusted basis which is not taken into account in applying this section.

(6) Construction termination.

If at any time during the amortization period any qualified railroad rolling stock ceases to meet the requirements of subsection (d)(1), the taxpayer shall be deemed to have terminated under subsection (c) his election under this section. Such termination shall be effective beginning with the month following the month in which such cessation occurs.

(7) Method of accounting for date placed in service.

For purposes of subsections (a) and (b), in the case of qualified railroad rolling stock placed in service after December 31, 1969, and before January 1, 1975, the taxpayer may elect (unless paragraph (3) is applicable) to begin the 60-month period with the date when such rolling stock is treated as having been placed in service under a method of accounting for acquisitions and retirements of property which—

(A) prescribes a date when property is placed in service, and

(B) is consistently followed by the taxpayer.

(f) Life tenant and remainderman.

In the case of qualified railroad rolling stock leased to a domestic common carrier, and held by one person for life with remainder to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the property and shall be allowable to the life tenant.

(g) Cross reference.

For treatment of certain gain derived from the disposition of property the adjusted basis of which is determined with regard to this section, see section 1245.

(Added Pub. L. 91–172, title VII, § 705(a), Dec. 30, 1969, 83 Stat. 670.)

EFFECTIVE DATE

Section 705(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section and section 185 of this title] shall apply with respect to taxable years beginning after December 31, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 157, 642, 1082, 1245 of this title.

§ 185. Amortization of railroad grading and tunnel bores.

(a) General rule.

In the case of a domestic common carrier by railroad, the taxpayer shall, at his election, be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of his qualified railroad grading and tunnel bores. The amortization deduction provided by this section with respect to such property shall be in lieu of any depreciation deduction, or other amortization deduction, with respect to such property for any taxable year to which the election applies.

(b) Amount of deduction.

(1) In general.

The deduction allowable under subsection (a) for any taxable year shall be an amount determined by amortizing ratably over a period of 50 years the adjusted basis (for determining gain) of the qualified railroad grading and tunnel bores of the taxpayer. Such 50-year period shall commence with the first taxable year for which an election under this section is effective.

(2) Special rule.

In the case of qualified railroad grading and tunnel bores placed in service after the beginning of the first taxable year for which an election under this section is effective, the 50-year period with respect to such property shall begin with the year following the year the property is placed in service.

(c) Election of amortization.

The election of the taxpayer to take the amortization deduction provided in subsection (a) may be made for any taxable year beginning after December 31, 1969. Such election shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election. The election shall remain in effect for all taxable years subsequent to the first year for which it is effective and shall apply to all qualified railroad grading and tunnel bores of the taxpayer, unless, on application by the taxpayer, the Secretary or his delegate permits him, subject to such conditions as the Secretary or his delegate deems necessary to revoke such election.

(d) Definitions.

For purposes of this section—

(1) Railroad grading and tunnel bores.

The term "railroad grading and tunnel bores" means all improvements resulting from excavations (including tunneling), construction of embankments, clearings, diversions of roads and streams, sodding of slopes, and from similar work necessary to provide, construct, reconstruct, alter, protect, improve, replace, or restore a roadbed or right-of-way for railroad track. If expenditures for improvements described in the preceding sentence are incurred with respect to an existing roadbed or right-of-way for railroad track, such expenditures shall be considered, in applying this section, as costs for railroad grading or tunnel bores placed in service in the year in which such costs are incurred.

(2) Qualified railroad grading and tunnel bores.

The term "qualified railroad grading and tunnel bores" means railroad grading and tunnel bores the original use of which commences after December 31, 1968.

(e) Treatment upon retirement.

If any qualified railroad grading or tunnel bore is retired or abandoned during a taxable year for which an election under this section is in effect, no deduction shall be allowed on account of such retirement or abandonment and the amortization deduction under this section shall continue with respect to such property. This subsection shall not apply if the retirement or abandonment is attributable primarily to fire, storm, or other casualty.

(f) Investment credit not to be allowed.

Property eligible to be amortized under this section shall not be treated as section 38 property within the meaning of section 48(a).

(g) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section.

(h) Cross reference.

For special rule with respect to certain gain derived from the disposition of property the adjusted basis of which is determined with regard to this section, see section 1245.

(Added Pub. L. 91–172, title VII, § 705(a), Dec. 30, 1969, 83 Stat. 672.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1969, see section 705(c) of Pub. L. 91–172, set out as a note under section 184 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1082, 1245, 1250 of this title.

§ 186. Recoveries of damages for antitrust violations, etc.

(a) Allowance of deduction.

If a compensatory amount which is included in gross income is received or accrued during the taxable year for a compensable injury, there shall be allowed as a deduction for the taxable year an amount equal to the lesser of—

(1) the amount of such compensatory amount, or

(2) the amount of the unrecovered losses sustained as a result of such compensable injury.

(b) Compensable injury.

For purposes of this section, the term "compensable injury" means—

(1) injuries sustained as a result of an infringement of a patent issued by the United States,

(2) injuries sustained as a result of a breach of contract or a breach of fiduciary duty or relationship, or

(3) injuries sustained in business, or to property, by reason of any conduct forbidden in the antitrust laws for which a civil action may be brought under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914 (commonly known as the Clayton Act).

(c) Compensatory amount.

For purposes of this section, the term "compensatory amount" means the amount received or accrued during the taxable year as damages as a result of an award in, or in settlement of, a civil action for recovery for a compensable injury, reduced by any amounts paid or incurred in the taxable year in securing such award or settlement.

(d) Unrecovered losses.

(1) In general.

For purposes of this section, the amount of any unrecovered loss sustained as a result of any compensable injury is—

(A) the sum of the amount of the net operating losses (as determined under section 172) for each taxable year in whole or in part within the injury period, to the extent that such net operating losses are attributable to such compensable injury, reduced by

(B) the sum of—

(i) the amount of the net operating losses described in subparagraph (A) which were allowed for any prior taxable year as a deduction under section 172 as a net operating loss carryback or carryover to such taxable year, and

(ii) the amounts allowed as a deduction under subsection (a) for any prior taxable year for prior recoveries of compensatory amounts for such compensable injury.

(2) Injury period.

For purposes of paragraph (1), the injury period is—

(A) with respect to any infringement of a patent, the period in which such infringement occurred,

(B) with respect to a breach of contract or breach of fiduciary duty or relationship, the period during which amounts would have been received or accrued but for the breach of contract or breach of fiduciary duty or relationship, and

(C) with respect to injuries sustained by reason of any conduct forbidden in the antitrust laws, the period in which such injuries were sustained.

(3) Net operating losses attributable to compensable injuries.

For purposes of paragraph (1)—

(A) a net operating loss for any taxable year shall be treated as attributable to a compensable injury to the extent of the compensable injury sustained during such taxable year, and

(B) if only a portion of a net operating loss for any taxable year is attributable to a compensable injury, such portion shall (in applying section 172 for purposes of this section) be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss.

(e) Effect on net operating loss carryovers.

If for the taxable year in which a compensatory amount is received or accrued any portion of a net operating loss carryover to such year is attributable to the compensable injury for which such amount is received or accrued, such portion of such net operating loss carryover shall be reduced by an amount equal to—

(1) the deduction allowed under subsection (a) with respect to such compensatory amount, reduced by

(2) any portion of the unrecovered losses sustained as a result of the compensable injury with respect to which the period for carryover under section 172 has expired.

(Added Pub. L. 91–172, title IX, § 904(a), Dec. 30, 1969, 83 Stat. 711.)

EFFECTIVE DATE

Section 904(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1968."

§ 187. Amortization of certain coal mine safety equipment.

(a) Allowance of deduction.

Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any certified coal mine safety equipment (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the certified coal mine safety equipment at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction provided by this section with respect to any certified coal mine safety equipment for any month shall be in lieu of the depreciation deduction with respect to such equipment for such month provided by section 167. The 60-month period shall begin, as to any certified coal mine safety equipment, at the election of the taxpayer, with the month following the month in which such equipment was placed in service or with the succeeding taxable year.

(b) Election of amortization.

The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the certified coal mine safety equipment was placed in service, or with the taxable year succeeding the taxable year in which such equipment is placed in service, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

(c) Termination of amortization deduction.

A taxpayer which has elected under subsection (b) to take the amortization deduction provided by subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction under this section with respect to such equipment.

(d) Certified coal mine safety equipment.

For purposes of this section, the term "certified coal mine safety equipment" means property which—

(1) is electric face equipment (within the meaning of section 305 of the Federal Coal Mine Health and Safety Act of 1969) required in order to meet the requirements of section 305(a)(2) of such Act,

(2) the Secretary of the Interior certifies is permissible within the meaning of such section 305(a)(2), and

(3) is placed in service before January 1, 1975.

For purposes of this section, any property placed in service in connection with any used electric face equipment which the Secretary of the Interior certifies makes such electric face equipment permissible shall be treated as a separate item of certified coal mine safety equipment.

(e) Special rules.

(1) The adjusted basis of any certified coal mine safety equipment, with respect to which an election is made under this section, shall not be increased, for purposes of this section, for amounts chargeable to capital account for additions or improvements after the amortization period has begun.

(2) The depreciation deduction provided by section 167 shall, despite the provisions of subsection (a), be allowed with respect to the portion of the adjusted basis which is not taken into account in applying this section.

(Added Pub. L. 91–172, title VII, § 707(a), Dec. 30, 1969, 83 Stat. 674.)

EFFECTIVE DATE

Section 707(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years ending after December 31, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 642, 1082, 1245 of this title.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

Sec.
211. Allowance of deductions.
212. Expenses for production of income.
213. Medical, dental, etc., expenses.
214. Expenses for care of certain dependents.
215. Alimony, etc., payments.
216. Deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholder.
217. Moving expenses.
218. Cross references.

AMENDMENTS

1964—Pub. L. 88–272, title II, § 213(a)(2), Feb. 26, 1964, 78 Stat. 52, redesignated former item 217 as 218, and added item 217.

1962—Pub. L. 87–834, § 28(b), Oct. 16, 1962, 76 Stat. 1068, substituted "Deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholder" for "Amounts representing taxes and interest paid to cooperative housing corporation" in item 216.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 703 of this title.

§ 211. Allowance of deductions.

In computing taxable income under section 63(a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (section 261 and following, relating to items not deductible). (Aug. 16, 1954, ch. 736, 68A Stat. 69.)

§ 212. Expenses for production of income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

(Aug. 16, 1954, ch. 736, 68A Stat. 69.)

CROSS REFERENCES

Adjusted gross income as gross income minus, among others, expenses for production of income, see section 62 of this title.

Trade or business expenses deductible, see section 162 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 62, 163, 164, 183, 263, 265, 267, 274, 404, 691 of this title.

§ 213. Medical, dental, etc., expenses.

(a) Allowance of deduction.

There shall be allowed as a deduction the following amounts, not compensated for by insurance or otherwise—

(1) the amount by which the amount of the expenses paid during the taxable year (reduced by any amount deductible under paragraph (2)) for medical care of the taxpayer, his spouse, and dependents (as defined in section 152) exceeds 3 percent of the adjusted gross income, and

(2) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.

(b) Limitation with respect to medicine and drugs.

Amounts paid during the taxable year for medicine and drugs which (but for this subsection) would be taken into account in computing the deduction under subsection (a) shall be taken into account only to the extent that the aggregate of such amounts exceeds 1 percent of the adjusted gross income.

(c) Repealed. Pub. L. 89-97, title I, § 106(d)(1), July 30, 1965, 79 Stat. 337.

(d) Special rule for decedents.

(1) Treatment of expenses paid after death.

For purposes of subsection (a), expenses for the medical care of the taxpayer which are paid out of his estate during the 1-year period beginning with the day after the date of his death shall be treated as paid by the taxpayer at the time incurred.

(2) Limitation.

Paragraph (1) shall not apply if the amount paid is allowable under section 2053 as a deduction in computing the taxable estate of the decedent, but this paragraph shall not apply if (within the time and in the manner and form prescribed by the Secretary or his delegate) there is filed—

(A) a statement that such amount has not been allowed as a deduction under section 2053, and

(B) a waiver of the right to have such amount allowed at any time as a deduction under section 2053.

(e) Definitions.

For purposes of this section—

(1) The term "medical care" means amounts paid—

(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,

(B) for transportation primarily for and essential to medical care referred to in subparagraph (A), or

(C) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act relating to supplementary medical care referred to in subparagraphs (A) and (B).

(2) In the case of an insurance contract under which amounts are payable for other than medical care referred to in subparagraphs (A) and (B) of paragraph (1)—

(A) no amount shall be treated as paid for insurance to which paragraph (1)(C) applies unless the charge for such insurance is either separately stated in the contract, or furnished to the policyholder by the insurance company in a separate statement,

(B) the amount taken into account as the amount paid for such insurance shall not exceed such charge, and

(C) no amount shall be treated as paid for such insurance if the amount specified in the contract (or furnished to the policyholder by the insurance company in a separate statement) as the charge for such insurance is unreasonably large in relation to the total charges under the contract.

(3) Subject to the limitations of paragraph (2), premiums paid during the taxable year by a taxpayer before he attains the age of 65 for insurance covering medical care (within the meaning of subparagraphs (A) and (B) of paragraph (1)) for the taxpayer, his spouse, or a dependent after the taxpayer attains the age of 65 shall be treated as expenses paid during the taxable year for insurance which constitutes medical care if premiums for such insurance are payable (on a level payment basis) under the contract for a period of 10 years or more or until the year in which the taxpayer attains the age of 65 (but in no case for a period of less than 5 years).

(4) The determination of whether an individual is married at any time during the taxable year shall be made in accordance with the provisions of section 6013 (d) (relating to determination of status as husband and wife).

(f) Exclusion of amounts allowed for care of certain dependents.

Any expense allowed as a deduction under section 214 shall not be treated as an expense paid for medical care. (Aug. 16, 1954, ch. 736, 68A Stat. 69; Sept. 2, 1958, Pub. L. 85-866, title I, §§ 16, 17 (a), (b), 72 Stat.

1613, 1614; May 14, 1960, Pub. L. 86-470, § 3(a), 74 Stat. 133; Oct. 23, 1962, Pub. L. 87-863, § 1 (a), (b), 76 Stat. 1141; Feb. 26, 1964, Pub. L. 88-272, title II, § 211(a), 78 Stat. 49; July 30, 1965, Pub. L. 89-97, title I, § 106(a)—(d)(1), 79 Stat. 336, 337.)

AMENDMENTS

1965—Subsec. (a). Pub. L. 89-97, § 106(a), substituted "There shall be allowed as a deduction the following amounts, not compensated for by insurance or otherwise—

"(1) the amount by which the amount of the expenses paid during the taxable year (reduced by any amount deductible under paragraph (2)) for medical care of the taxpayer, his spouse, and dependents (as defined in section 152) exceeds 3 percent of the adjusted gross income, and

"(2) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents." for

"There shall be allowed as a deduction the following amounts of the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in section 152):

"(1) If neither the taxpayer nor his spouse has attained the age of 65 before the close of the taxable year—

"(A) the amount of such expenses for the care of any dependent who—

"(i) is the mother or father of the taxpayer or of his spouse, and

"(ii) has attained the age of 65 before the close of the taxable year, and

"(B) the amount by which such expenses for the care of the taxpayer, his spouse, and such dependents (other than any dependent described in subparagraph (A)) exceed 3 percent of the adjusted gross income.

"(2) If either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year—

"(A) the amount of such expenses for the care of the taxpayer and his spouse.

"(B) the amount of such expenses for the care of any dependent described in paragraph (1) (A), and

"(C) the amount by which such expenses for the care of such dependents (other than any dependent described in paragraph (1)(A)) exceed 3 percent of the adjusted gross income."

Subsec. (b). Pub. L. 89-97, § 106(b), repealed the second sentence which had provided: "The preceding sentence shall not apply to amounts paid for the care of—

"(1) the taxpayer and his spouse, if either of them has attained the age of 65 before the close of the taxable year, or

"(2) any dependent described in subsection (a)(1)(A)."

Subsec. (c). Pub. L. 89-97, § 106(d)(1), struck out maximum limitations provisions.

Subsec. (e). Pub. L. 89-97, § 106(c), deleted from par. (1)(A) "including amounts paid for accident or health insurance" following "function of the body", added pars. (1)(C), (2), and (3), and renumbered former par. (2) as (4).

Subsec. (g). Pub. L. 89-97, § 106(d)(1), struck out provisions relating to maximum limitation if taxpayer or spouse has attained age 65 and is disabled, special rule, amounts taken into account, meaning of disabled, and determination of status.

1964—Subsec. (b). Pub. L. 88-272 excluded persons attaining age 65 before the close of the taxable year from the limitation, whether they are the taxpayer and his spouse, or the mother or father of the taxpayer and his spouse.

1962—Subsec. (c). Pub. L. 87-863, § 1(a), substituted "$5,000" for "$2,500", "$10,000" for "$5,000", and "$20,000" for "$10,000."

Subsec. (g). Pub. L. 87-863, § 1(b), substituted "$20,000" for "$15,000" in three instances, and "$40,000" for "$30,000."

1960—Subsec. (a). Pub. L. 86-470 authorized a taxpayer to deduct medical care expenses for dependent parents of the taxpayer or his spouse who have attained the age of 65 before the close of the taxable year without applying the three percent limitation.

1958—Subsec. (c). Pub. L. 85-866, § 17(b), substituted "Except as provided in subsection (g), the" for "The".

Subsec. (d)(2)(A). Pub. L. 85-866, § 16, eliminated "claimed or" preceding "allowed".

Subsec. (g). Pub. L. 85-866, § 17(A), added subsec. (g).

EFFECTIVE DATE OF 1965 AMENDMENT

Section 106(e) of Pub. L. 89-97 provided that: "The amendments made by this section [to sections 72, 79, 213, 401, and 405 of this title] shall apply to taxable years beginning after December 31, 1966."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 211(b) of Pub. L. 88-272 provided that: "The amendment made by subsection (a) [to subsec (b) of this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 1(c) of Pub. L. 87-863 provided that: "The amendments made by subsections (a) and (b) [to subsecs. (c) and (g) of this section] shall apply only with respect to taxable years beginning after December 31, 1961."

EFFECTIVE DATE OF 1960 AMENDMENT

Section 3(b) of Pub. L. 86-470 provided that: "The amendment made by subsection (a) [to subsec. (a) of this section] shall apply to taxable years beginning after December 31, 1959."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (d) (2) (A) of this section by Pub. L. 85-866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85-866, set out as a note under section 165 of this title.

Section 17 (c) of Pub. L. 85-866 provided that: "The amendments made by subsections (a) [which added subsec. (g) of this section] and (b) [to subsec. (c) of this section] shall apply only with respect to taxable years beginning after December 31, 1957."

CROSS REFERENCES

Amounts received under accident and health plans excludible from gross income, see section 105 of this title.

Compensation for injuries or sickness excludible from gross income, see section 104 of this title.

Personal, living and family expenses not deductible, see section 262 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 104, 105 of this title.

§ 214. Expenses for care of certain dependents.

(a) General rule.

There shall be allowed as a deduction expenses paid during the taxable year by a taxpayer who is a woman or widower, or is a husband whose wife is incapacitated or is institutionalized, for the care of one or more dependents (as defined in subsection (d)(1)), but only if such care is for the purpose of enabling the taxpayer to be gainfully employed.

(b) Limitations.

(1) Dollar limit.

(A) Except as provided in subparagraph (B), the deduction under subsection (a) shall not exceed $600 for any taxable year.

(B) The $600 limit of subparagraph (A) shall be increased (to an amount not above $900) by the amount of expenses incurred by the taxpayer for any period during which the taxpayer had 2 or more dependents.

(2) Working wives and husbands with incapacitated wives.—

In the case of a woman who is married and in the case of a husband whose wife is incapacitated, the deduction under subsection (a)—

(A) shall not be allowed unless the taxpayer and his spouse file a joint return for the taxable year, and

(B) shall be reduced by the amount (if any) by which the adjusted gross income of the taxpayer and his spouse exceeds $6,000.

This paragraph shall not apply, in the case of a woman who is married, to expenses incurred while her husband is incapable of self-support because mentally or physically defective, or, in the case of a husband whose wife is incapacitated, to expenses incurred while his wife is institutionalized if such institutionalization is for a period of at least 90 consecutive days (whether or not within one taxable year) or a shorter period if terminated by her death.

(3) Certain payments not taken into account.

Subsection (a) shall not apply to any amount paid to an individual with respect to whom the taxpayer is allowed for his taxable year a deduction under section 151 (relating to deduction for personal exemptions).

(c) Special rule where wife is incapacitated or institutionalized.

In the case of a husband whose wife is incapacitated or is institutionalized, the deduction under subsection (a) shall be allowed only for expenses incurred while the wife was incapacitated or institutionalized (as the case may be) for a period of at least 90 consecutive days (whether or not within one taxable year) or a shorter period if terminated by her death.

(d) Definitions.

For purposes of this section—

(1) Dependent.

The term "dependent" means a person with respect to whom the taxpayer is entitled to an exemption under section 151(e)(1)—

(A) who has not attained the age of 13 years and who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer; or

(B) who is physically or mentally incapable of caring for himself.

(2) Widower.

The term "widower" includes an unmarried individual who is legally separated from his spouse under a decree of divorce or of separate maintenance.

(3) Incapacitated wife.

A wife shall be considered incapacitated only (A) while she is incapable of caring for herself because mentally or physically defective, or (B) while she is institutionalized.

(4) Institutionalized wife.

A wife shall be considered institutionalized only while she is, for the purpose of receiving medical care or treatment, an inpatient, resident, or inmate of a public or private hospital, sanitarium, or other similar institution.

(5) Determination of status.

A woman shall not be considered as married if—

(A) she is legally separated from her spouse under a decree of divorce or of separate maintenance at the close of the taxable year, or

(B) she has been deserted by her spouse, does not know his whereabouts (and has not known his whereabouts at any time during the taxable year), and has applied to a court of competent jurisdiction for appropriate process to compel him to pay support or otherwise to comply with the law or a judicial order, as determined under regulations prescribed by the Secretary or his delegate.

(Aug. 16, 1954, ch. 736, 68A Stat. 70; Apr. 2, 1963, Pub. L. 88–4, § 1, 77 Stat. 4; Feb. 26, 1964, Pub. L. 88–272, title II, § 212(a), 78 Stat. 49.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272 included a husband whose wife is incapacitated or is institutionalized.

Subsec. (b). Pub. L. 88–272 added par. (1)(B), redesignated former par. (1)(B) as par. (3), inserted provisions relating to husbands with incapacitated wives in par. (2) wherever appearing, and increased the gross income figure in par. (2)(B) from $4,500 to $6,000.

Subsec. (c). Pub. L. 88–272 added subsec. (c). Former subsec. (c) redesignated (d).

Subsec. (d). Pub. L. 88–272 redesignated former subsec. (c) as (d), amended subsec. (d) by redefining "dependent" as a person who has not attained age 13, instead of one who has not attained age 12, and added the definitions of "Incapacitated" and "Institutionalized" wives.

1963—Subsec. (c)(3). Pub. L. 88–4 designated existing provisions following "as married if" as "(A)", and added clause "(B)".

EFFECTIVE DATE OF 1964 AMENDMENT

Section 212(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1963 AMENDMENT

Section 2 of Pub. L. 88–4 provided that: "The amendments made by the first section of this Act [to subsec. (c)(3) of this section] shall apply only with respect to taxable years ending after the date of the enactment of this Act [Apr. 2, 1963]."

CROSS REFERENCES

Deductions for dependents generally, see section 151 et seq. of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 213 of this title.

§ 215. Alimony, etc., payments.

(a) General rule.

In the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year. No deduction shall be allowed under the preceding sentence with respect to any payment if, by reason of section 71 (d) or 682, the amount thereof is not includible in the husband's gross income.

(b) Cross reference.

For definitions of "husband" and "wife," see section 7701 (a) (17).

(Aug. 16, 1954, ch. 736, 68A Stat. 71.)

CROSS REFERENCES

Alimony and separate maintenance payments as income to wife, see section 71 of this title.

Husband and wife, definition of, see section 7701 (a) (17) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 71, 7701 of this title.

§ 216. Deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholder.

(a) Allowance of deduction.

In the case of a tenant-stockholder (as defined in subsection (b) (2)), there shall be allowed as a deduction amounts (not otherwise deductible) paid or accrued to a cooperative housing corporation within the taxable year, but only to the extent that such amounts represent the tenant-stockholder's proportionate share of—

(1) the real estate taxes allowable as a deduction to the corporation under section 164 which are paid or incurred by the corporation on the houses or apartment building and on the land on which such houses (or building) are situated, or

(2) the interest allowable as a deduction to the corporation under section 163 which is paid or incurred by the corporation on its indebtedness contracted—

(A) in the acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building, or

(B) in the acquisition of the land on which the houses (or apartment building) are situated.

(b) Definitions.

For purposes of this section—

(1) Cooperative housing corporation.

The term "cooperative housing corporation" means a corporation—

(A) having one and only one class of stock outstanding,

(B) each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation,

(C) no stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except on a complete or partial liquidation of the corporation, and

(D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred is derived from tenant-stockholders.

(2) Tenant-stockholder.

The term "tenant-stockholder" means an individual who is a stockholder in a cooperative housing corporation, and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Secretary or his delegate as bearing a reasonable relationship to the portion of the value of the corporation's equity in the houses or apartment building and the land on which situated which is attributable to the house or apartment which such individual is entitled to occupy.

(3) The term "tenant-stockholder's proportionate share" means that proportion which the stock of the cooperative housing corporation owned by the tenant-stockholder is of the total outstanding stock of the corporation (including any stock held by the corporation).

(4) Stock owned by governmental units.

For purposes of this subsection, in determining whether a corporation is a cooperative housing corporation, stock owned and apartments leased by the United States or any of its possessions, a State or any political subdivision thereof, or any agency or instrumentality of the foregoing empowered to acquire shares in a cooperative housing corporation for the purpose of providing housing facilities, shall not be taken into account.

(c) Treatment as property subject to depreciation.

So much of the stock of a tenant-stockholder in a cooperative housing corporation as is allocable, under regulations prescribed by the Secretary or his delegate, to a proprietary lease or right of tenancy in property subject to the allowance for depreciation under section 167(a) shall, to the extent such proprietary lease or right of tenancy is used by such tenant-stockholder in a trade or business or for the production of income, be treated as property subject to the allowance for depreciation under section 167(a). (Aug. 16, 1954, ch. 736, 68A Stat. 71; Oct. 16, 1962, Pub. L. 87–834, § 28(a), 76 Stat. 1068; Dec. 30, 1969, Pub. L. 91–172, title IX, § 913(a), 83 Stat. 723.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91–172 added par. (4).

1962—Pub. L. 87–834 substituted "Deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholders" for "Amounts representing taxes and interest paid to cooperative housing corporation" in section catchline, and added subsec. (c).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 913(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding par. (4) to subsec. (b) of this section] shall apply to taxable years beginning after December 31, 1969."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 28(c) of Pub. L. 87–834 provided that: "The amendments made by subsection (a) [amending section catchline and adding subsec. (c) of this section] shall be effective with respect to taxable years beginning after December 31, 1961."

CROSS REFERENCES

Interest deductible, see section 163 of this title.

Taxes deductible, see section 164 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 121, 1034 of this title.

§ 217. Moving expenses.

(a) Deduction allowed.

There shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual, at a new principal place of work.

(b) Definition of moving expenses.

(1) In general.

For purposes of this section, the term "moving expenses" means only the reasonable expenses—

(A) of moving household goods and personal effects from the former residence to the new residence,

(B) of traveling (including meals and lodging) from the former residence to the new place of residence,

(C) of traveling (including meals and lodging), after obtaining employment, from the former residence to the general location of the new principal place of work and return, for the principal purpose of searching for a new residence,

(D) of meals and lodging while occupying temporary quarters in the general location of the new principal place of work during any period of 30 consecutive days after obtaining employment, or

(E) constituting qualified residence sale, purchase, or lease expenses.

(2) Qualified residence sale, etc., expenses.

For purposes of paragraph (1)(E), the term "qualified residence sale, purchase, or lease expenses" means only reasonable expenses incident to—

(A) the sale or exchange by the taxpayer or his spouse of the taxpayer's former residence (not including expenses for work performed on such residence in order to assist in its sale) which (but for this subsection and subsection (e)) would be taken into account in determining the amount realized on the sale or exchange,

(B) the purchase by the taxpayer or his spouse of a new residence in the general location of the new principal place of work which (but for this subsection and subsection (e)) would be taken into account in determining—

(i) the adjusted basis of the new residence, or

(ii) the cost of a loan (but not including any amounts which represent payments or prepayments of interest),

(C) the settlement of an unexpired lease held by the taxpayer or his spouse on property used by the taxpayer as his former residence, or

(D) the acquisition of a lease by the taxpayer or his spouse on property used by the taxpayer as his new residence in the general location of the new principal place of work (not including amounts which are payments or prepayments of rent).

(3) Limitations.

(A) Dollar limits.

The aggregate amount allowable as a deduction under subsection (a) in connection with a commencement of work which is attributable to expenses described in subparagraph (C) or (D) of paragraph (1) shall not exceed $1,000. The aggregate amount allowable as a deduction under subsection (a) which is attributable to qualified residence sale, purchase, or lease expenses shall not exceed $2,500, reduced by the aggregate amount so allowable which is attributable to expenses described in subparagraph (C) or (D) of paragraph (1).

(B) Husband and wife.

If a husband and wife both commence work at a new principal place of work within the same general location, subparagraph (A) shall be applied as if there was only one commencement of work. In the case of a husband and wife filing separate returns, subparagraph (A) shall be applied by substituting "$500" for "$1,000", and by substituting "$1,250" for "$2,500".

(C) Individuals other than taxpayer.

In the case of any individual other than the taxpayer, expenses referred to in subparagraphs (A) through (D) of paragraph (1) shall be taken into account only if such individual has both the former residence and the new residence as his principal place of abode and is a member of the taxpayer's household.

(c) Conditions for allowance.

No deduction shall be allowed under this section unless—

(1) the taxpayer's new principal place of work—

(A) is at least 50 miles farther from his former residence than was his former principal place of work, or

(B) if he had no former principal place of work, is at least 50 miles from his former residence, and

(2) either—

(A) during the 12-month period immediately following his arrival in the general location of his new principal place of work, the taxpayer is a full-time employee, in such general location, during at least 39 weeks, or

(B) during the 24-month period immediately following his arrival in the general location of his new principal place of work, the taxpayer is a full-time employee or performs services as a self-employed individual on a full-time basis, in such general location, during at least 78 weeks, of which not less than 39 weeks are during the 12-month period referred to in subparagraph (A).

For purposes of paragraph (1), the distance between two points shall be the shortest of the more commonly traveled routes between such two points.

(d) Rules for application of subsection (c)(2).

(1) The condition of subsection (c)(2) shall not apply if the taxpayer is unable to satisfy such condition by reason of—

(A) death or disability, or

(B) involuntary separation (other than for willful misconduct) from the service of, or transfer for the benefit of, an employer after obtaining full-time employment in which the taxpayer could reasonably have been expected to satisfy such condition.

(2) If a taxpayer has not satisfied the condition of subsection (c)(2) before the time prescribed by law (including extensions thereof) for filing the return for the taxable year during which he paid or incurred moving expenses which would otherwise be deductible under this section, but may still satisfy such condition, then such expenses may (at the election of the taxpayer) be deducted for such taxable year notwithstanding subsection (c)(2).

(3) If—

(A) for any taxable year moving expenses have been deducted in accordance with the rule provided in paragraph (2), and

(B) the condition of subsection (c)(2) cannot be satisfied at the close of a subsequent taxable year,

then an amount equal to the expenses which were so deducted shall be included in gross income for the first such subsequent taxable year.

(e) Denial of double benefit.

The amount realized on the sale of the residence described in subparagraph (A) of subsection (b)(2) shall not be decreased by the amount of any expenses described in such subparagraph which are allowed as a deduction under subsection (a), and the basis of a residence described in subparagraph (B) of subsection (b)(2) shall not be increased by the amount of any expenses described in such subparagraph which are allowed as a deduction under subsection (a). This subsection shall not apply to any expenses with respect to which an amount is included in gross income under subsection (d)(3).

(f) Rules for self-employed individuals.

(1) Definition.

For purposes of this section, the term "self-employed individual" means an individual who performs personal services—

(A) as the owner of the entire interest in an unincorporated trade or business, or

(B) as a partner in a partnership carrying on a trade or business.

(2) Rule for application of subsections (b)(1)(C) and (D).

For purposes of subparagraphs (C) and (D) of subsection (b)(1), an individual who commences work at a new principal place of work as a self-employed individual shall be treated as having obtained employment when he has made substantial arrangements to commence such work.

(g) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section. (Added Pub. L. 88-272, title II, § 213(a)(1), Feb. 26, 1964, 78 Stat. 50, and amended Pub. L. 91-172, title II, § 231(a), Dec. 30, 1969, 83 Stat. 577.)

AMENDMENTS

1969—Pub. L. 91-172 substantially reenacted existing provisions and extended the coverage to self-employed persons working at the new location for 78 weeks, made it a requirement that the new principal place of work be located 50 miles from the former residence, and redefined the deduction to include costs of house-hunting trips, temporary living expenses prior to locating a new home, and expenses of selling an old home or buying a new one.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 231(d) of Pub. L. 91-172, as amended by Pub. L. 91-642, § 2, Dec. 31, 1970, 84 Stat. 1880, provided that:

"The amendments made by this section [enacting section 82 of this title and amending this section and sections 1001 and 1016(c) of this title] shall apply to taxable years beginning after December 31, 1969, except that—

"(1) section 217 of the Internal Revenue Code of 1954 (as amended by subsection (a)) shall not apply to any item to the extent that the taxpayer received or accrued reimbursement or other expense allowance for such item in a taxable year beginning on or before December 31, 1969, which was not included in his gross income; and

"(2) the amendments made by this section shall not apply (at the election of the taxpayer made at such time and manner as the Secretary of the Treasury or his delegate prescribes) with respect to moving expenses paid or incurred before January 1, 1971, in connection with the commencement of work by the taxpayer as an employee at a new principal place of work of which the taxpayer had been notified by his employer on or before December 19, 1969."

EFFECTIVE DATE

Section applicable to expenses incurred after Dec. 31, 1963, in taxable years ending after such date, see section 213(d) of Pub. L. 88-272, set out as a note under section 62 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 62, 3121, 3306, 3401 of this title; title 42 section 409.

§ 218. Cross references.

(1) For deduction for long-term capital gains in the case of a taxpayer other than a corporation, see section 1202.

(2) For deductions in respect of a decedent, see section 691.

(Aug. 16, 1954, ch. 736, 68A Stat. 72, formerly § 217, renumbered § 218, Feb. 26, 1964, Pub. L. 88-272, title II, § 213(a)(1), 78 Stat. 50.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1402 of this title.

PART VIII.—SPECIAL DEDUCTIONS FOR CORPORATIONS

Sec.
241. Allowance of special deductions.
242. Partially tax-exempt interest.
243. Dividends received by corporations.
244. Dividends received on certain preferred stock.
245. Dividends received from certain foreign corporations.
246. Rules applying to deductions for dividends received.
247. Dividends paid on certain preferred stock of public utilities.
248. Organizational expenditures.
249. Limitation on deduction of bond premium on repurchase.
250. Certain payments to the National Railroad Passenger Corporations.

AMENDMENTS

1970—Pub. L. 91-518, title IX, § 901(b), Oct. 30, 1970, 84 Stat. 1342, added item 250.

1969—Pub. L. 91-172, title IV, § 414(b), Dec. 30, 1969, 83 Stat. 613, added item 249.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in sections 822, 832 of this title.

§ 241. Allowance of special deductions.

In addition to the deductions provided in part VI (sec. 161 and following), there shall be allowed as deductions in computing taxable income the items specified in this part. (Aug. 16, 1954, ch. 736, 68A Stat. 72.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 535, 832 of this title.

§ 242. Partially tax-exempt interest.

(a) Allowance of deduction.

There shall be allowed to a corporation as a deduction the amount received as interest on obligations of the United States or on obligations of corporations organized under Act of Congress which are instrumentalities of the United States, but only if—

(1) such interest is included in gross income; and

(2) such interest is exempt from normal tax under the Act authorizing the issuance of such obligations. No deduction shall be allowed under this section for purposes of any surtax imposed by this subtitle.

(b) Cross reference.

For reduction of deduction under subsection (a) on account of amortizable bond premium, see section 171.

(Aug. 16, 1954, ch. 736, 68A Stat. 72; Feb. 26, 1964, Pub. L. 88–272, title I, § 123(c), 78 Stat. 30.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272 inserted "No deduction shall be allowed under this section for purposes of any surtax imposed by this subtitle."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

CROSS REFERENCES

Consolidated return of corporations computed without regard to this section, see section 1503 (a) of this title.

Life insurance companies entitled to deduction under this section, see section 804 of this title.

Mutual insurance companies entitled to deduction under this section, see section 822 (c) (7) of this title.

Net operating loss deduction to corporations for deductions under this section, see section 172 (d) (5) of this title.

Partner entitled to separate deduction under this section, see section 702 (a) (7) of this title.

Surtax of corporation computed without regard to this section, see section 11 (c) of this title.

United States obligations and evidence of ownership issued after March 27, 1942, as subject to Federal taxation, see section 742a of Title 31, Money and Finance.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 171, 172, 551, 584, 702, 804, 809, 815, 822, 832, 852, 857, 1244 of this title.

§ 243. Dividends received by corporations.

(a) General rule.

In the case of a corporation, there shall be allowed as a deduction an amount equal to the following percentages of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter:

(1) 85 percent, in the case of dividends other than dividends described in paragraph (2) or (3);

(2) 100 percent, in the case of dividends received by a small business investment company operating under the Small Business Investment Act of 1958; and

(3) 100 percent, in the case of qualifying dividends (as defined in subsection (b)(1)).

(b) Qualifying dividends.

(1) Definition.

For purposes of subsection (a)(3), the term "qualifying dividends" means dividends received by a corporation which, at the close of the day the dividends are received, is a member of the same affiliated group of corporations (as defined in paragraph (5)) as the corporation distributing the dividends, if—

(A) such affiliated group has made an election under paragraph (2) which is effective for the taxable years of its members which include such day, and

(B) such dividends are distributed out of earnings and profits of a taxable year of the distributing corporation ending after December 31, 1963—

(i) on each day of which the distributing corporation and the corporation receiving the dividends were members of such affiliated group, and

(ii) for which an election under section 1562 (relating to election of multiple surtax exemptions) is not effective.

(2) Election.

An election under this paragraph shall be made for an affiliated group by the common parent corporation, and shall be made for any taxable year of the common parent corporation at such time and in such manner as the Secretary or his delegate by regulations prescribes. Such election may not be made for an affiliated group for any taxable year of the common parent corporation for which an election under section 1562 is effective. Each corporation which is a member of such group at any time during its taxable year which includes the last day of such taxable year of the common parent corporation must consent to such election at such time and in such manner as the Secretary or his delegate by regulations prescribes. An election under this paragraph shall be effective—

(A) for the taxable year of each member of such affiliated group which includes the last day of the taxable year of the common parent corporation with respect to which the election is made (except that in the case of a taxable year of a member beginning in 1963 and ending in 1964, if the election is effective for the taxable year of the common parent corporation which includes the last day of such taxable year of such member, such election shall be effective for such taxable year of such member, if such member consents to such election with respect to such taxable year), and

(B) for the taxable year of each member of such affiliated group which ends after the last day of such taxable year of the common parent corporation but which does not include such date, unless the election is terminated under paragraph (4).

(3) Effect of election.

If an election by an affiliated group is effective with respect to a taxable year of the common parent corporation, then under regulations prescribed by the Secretary or his delegate—

(A) no member of such affiliated group may consent to an election under section 1562 for such taxable year,

(B) the members of such affiliated group shall be treated as one taxpayer for purposes of making the elections under section 901(a) (re-

lating to allowance of foreign tax credit) and section 904(b)(1) (relating to election of overall limitation), and

(C) the members of such affiliated group shall be limited to one—

(i) $100,000 minimum accumulated earnings credit under section 535(c)(2) or (3),

(ii) $100,000 limitation for exploration expenditures under section 615 (a) and (b),

(iii) $400,000 limitation for exploration expenditures under sections 615(c)(1) and 617(h)(1),

(iv) $25,000 limitation on small business deduction of life insurance companies under sections 804(a)(4) and 809(d)(10), and

(v) surtax exemption, and one amount under sections 6154(c)(2) and (3) and sections 6655(e)(2) and (3), for purposes of estimated tax payment requirements under section 6154 and the addition to the tax under section 6655 for failure to pay estimated tax.

(4) Termination.

An election by an affiliated group under paragraph (2) shall terminate with respect to the taxable year of the common parent corporation and with respect to the taxable years of the members of such affiliated group which include the last day of such taxable year of the common parent corporation if—

(A) Consent of members.

Such affiliated group files a termination of such election (at such time and in such manner as the Secretary or his delegate by regulations prescribes) with respect to such taxable year of the common parent corporation, and each corporation which is a member of such affiliated group at any time during its taxable year which includes the last day of such taxable year of the common parent corporation consents to such termination, or

(B) Refusal by new member to consent.

During such taxable year of the common parent corporation such affiliated group includes a member which—

(i) was not a member of such group during such common parent corporation's immediately preceding taxable year, and

(ii) such member files a statement that it does not consent to the election at such time and in such manner as the Secretary or his delegate by regulations prescribes.

(5) Definition of affiliated group.

For purposes of this subsection, the term "affiliated group" has the meaning assigned to it by section 1504(a), except that for such purposes sections 1504(b)(2) and 1504(c) shall not apply.

(6) Special rules for insurance companies.

If an election under this subsection is effective for the taxable year of an insurance company subject to taxation under section 802 or 821—

(A) part II of subchapter B of chapter 6 (relating to certain controlled corporations) shall be applied without regard to section 1563(a)(4) (relating to certain insurance companies) and section 1563(b)(2)(D) (relating to certain excluded members) with respect to such company and the other corporations which are members of the controlled group of corporations (as determined under section 1563 without regard to subsections (a)(4) and (b)(2)(D)) of which such company is a member, and

(B) for purposes of paragraph (1), a distribution by such company out of earnings and profits of a taxable year for which an election under this subsection was not effective, and for which such company was not a component member of a controlled group of corporations within the meaning of section 1563 solely by reason of section 1563(b)(2)(D), shall not be a qualifying dividend.

(c) Special rules for certain distributions.

For purposes of subsection (a)—

(1) Any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.) shall not be treated as a dividend.

(2) A dividend received from a regulated investment company shall be subject to the limitations prescribed in section 854.

(3) Any dividend received from a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (section 856 and following) shall not be treated as a dividend.

(4) Any dividend received which is described in section 244 (relating to dividends received on preferred stock of a public utility) shall not be treated as a dividend.

(d) Certain dividends from foreign corporations.

For purposes of subsection (a) and for purposes of section 245, any dividend from a foreign corporation from earnings and profits accumulated by a domestic corporation during a period with respect to which such domestic corporation was subject to taxation under this chapter (or corresponding provisions of prior law) shall be treated as a dividend from a domestic corporation which is subject to taxation under this chapter. (Aug. 16, 1954, ch. 736, 68A Stat. 73; Sept. 2, 1958, Pub. L. 85–866, title I, § 57(b), 72 Stat. 1645; Sept. 14, 1960, Pub. L. 86–779, §§ 3(a), 10(g), 74 Stat. 998, 1009; Feb. 26, 1964, Pub. L. 88–272, title II, § 214(a), 78 Stat. 52; June 28, 1968, Pub. L. 90–364, title I, § 103(e)(2), 82 Stat. 264; Dec. 30, 1969, Pub. L. 91–172, title V, § 504(c)(1), 83 Stat. 633.)

REFERENCES IN TEXT

Small Business Investment Act of 1958, referred to in subsec. (a)(2), is classified to chapter 14B of Title 15, Commerce and Trade.

AMENDMENTS

1969—Subsec. (b)(3)(C)(iii). Pub. L. 91–172 substituted "sections 615(c)(1) and 617(h)(1)" for "section 615(c)(1)."

1968—Subsec. (b)(3)(C)(v). Pub. L. 90–364 substituted "surtax exemption, and one amount under section 6154(c)(2) and (3) and sections 6655(e)(2) and (3), for purposes of estimated tax payment requirements under section 6154" for "$100,000 exemption for purposes of estimated tax filing requirements under section 6016".

1964—Subsec. (a). Pub. L. 88–272 substituted provisions permitting a deduction for 85 percent of dividends

received except that it shall be 100 percent when received by a small business investment company operating under the Small Business Investment Act of 1958, and 100 percent in case of qualifying dividends, for provisions permitting an 85 percent deduction for corporations other than one operating under the Small Business Investment Act of 1958, and for other than dividends described in section 244(1) of this title.

Subsec. (b). Pub. L. 88–272 added subsec. (b) and omitted a prior subsec. (b) which allowed a 100 percent deduction of dividends received by a small business investment company operating under the Small Business Investment Act of 1958, other than dividends described in section 244(1) of this title.

Subsec. (c). Pub. L. 88–272 substituted "subsection (a)" for "subsections (a) and (b)", and added par. (4).

Subsec. (d). Pub. L. 88–272 substituted "subsection (a)" for "subsections (a) and (b)."

1960—Subsec. (c)(3). Pub. L. 86–779, § 10(g), added par. (3).

Subsec. (d). Pub. L. 86–779, § 3(a), added subsec. (d).

1958—Subsec. (a). Pub. L. 85–866, § 57 (b) (1), inserted "(other than a small business investment company operating under the Small Business Investment Act of 1958)".

Subsec. (b). Pub. L. 85–866, § 57 (b) (2), added subsec. (b) and redesignated former subsec. (b) as (c).

Subsec. (c). Pub. L. 85–866, § 57 (b) (2), (3), redesignated former subsec. (b) as (c) and substituted "subsections (a) and (b)" for "subsection (a)".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to exploration expenditures paid or incurred after Dec. 31, 1969, see section 504(d)(1) of Pub. L. 91–172, set out as a note under section 615 of this title.

EFFECTIVE DATE OF 1968 AMENDMENT

Amendment by Pub. L. 90–364 applicable with respect to taxable years beginning after Dec. 31, 1967, except as provided by section 104 of Pub. L. 90–364, set out as notes under sections 51 and 6154 of this title, see section 103(f) of Pub. L. 90–364, set out as a note under section 6154 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 214(c) of Pub. L. 88–272 provided that: "The amendments made by subsections (a) [to this section] and (b) [to sections 244, 246(b), 804(a)(5) and 809(d)(8)(B) of this title] shall apply with respect to dividends received in taxable years ending after December 31, 1963."

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of subsec. (c)(3) by Pub. L. 86–779, § 10(g) applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

Section 3(c) of Pub. L. 86–779 provided that: "The amendments made by subsections (a) and (b) [adding subsec. (d) of this section and amending section 861(a)(2) of this title] shall apply to dividends received after December 31, 1959, in taxable years ending after such date."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 57 (d) of Pub. L. 85–866 provided that: "The amendments [adding sections 165 (h) (3), (4) 1242 and 1243 and amending section 246 (b) (1) of this title and subsecs. (a)—(c) of this section] made by this section shall apply with respect to taxable years beginning after the date of the enactment of this Act [Sept. 2, 1958]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 172, 245, 246, 301, 596, 804, 809, 812, 815, 854, 857, 861, 1111, 1244, 1564 of this title.

§ 244. Dividends received on certain preferred stock.

(a) General rule.

In the case of a corporation, there shall be allowed as a deduction an amount computed as follows:

(1) First determine the amount received as dividends on the preferred stock of a public utility which is subject to taxation under this chapter and with respect to which the deduction provided in section 247 for dividends paid is allowable.

(2) Then multiply the amount determined under paragraph (1) by the fraction—

(A) the numerator of which is 14 percent, and

(B) the denominator of which is that percentage which equals the sum of the normal tax rate and the surtax rate for the taxable year prescribed by section 11.

(3) Finally ascertain the amount which is 85 percent of the excess of—

(A) the amount determined under paragraph (1), over

(B) the amount determined under paragraph (2).

(b) Exception.

If the dividends described in subsection (a)(1) are qualifying dividends (as defined in section 243 (b)(1), but determined without regard to section 243 (c)(4))—

(1) subsection (a) shall be applied separately to such qualifying dividends, and

(2) for purposes of subsection (a)(3), the percentage applicable to such qualifying dividends shall be 100 percent in lieu of 85 percent.

(Aug. 16, 1954, ch. 736, 68A Stat. 73; Feb. 26, 1964, Pub. L. 88–272, title II, § 214(b)(1), 78 Stat. 55.)

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–272 designated existing provisions as subsec. (a), and added subsec. (b).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to dividends received in taxable years ending after Dec. 31, 1963, see section 214(c) of Pub. L. 88–272, set out as a note under section 243 of this title.

CROSS REFERENCES

Definition of public utility, see section 247 (b) (1) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 57, 172, 243, 246, 247, 301, 596, 804, 809, 812, 815, 1111, 1244, 1562 of this title.

§ 245. Dividends received from certain foreign corporations.

(a) General rule.

In the case of dividends received from a foreign corporation (other than a foreign personal holding company) which is subject to taxation under this chapter, if, for an uninterrupted period of not less than 36 months ending with the close of such foreign corporation's taxable year in which such dividends are paid (or, if the corporation has not been in existence for 36 months at the close of such taxable year, for the period the foreign corporation has been in existence as of the close of such taxable year) such foreign corporation has been engaged in trade or business within the United States and if 50 percent or more of the gross income of such corporation from all sources for such period is effectively con-

nected with the conduct of a trade or business within the United States, there shall be allowed as a deduction in the case of a corporation—

(1) An amount equal to the percent (specified in section 243 for the taxable year) of the dividends received out of its earnings and profits specified in paragraph (2) of the first sentence of section 316(a), but such amount shall not exceed an amount which bears the same ratio to such percent of such dividends received out of such earnings and profits as the gross income of such foreign corporation for the taxable year which is effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources for such taxable year, and

(2) An amount equal to the percent (specified in section 243 for the taxable year) of the dividends received out of that part of its earnings and profits specified in paragraph (1) of the first sentence of section 316 (a) accumulated after the beginning of such uninterrupted period, but such amount shall not exceed an amount which bears the same ratio to such percent of such dividends received out of such accumulated earnings and profits as the gross income of such foreign corporation, which is effectively connected with the conduct of a trade or business within the United States, for the portion of such uninterrupted period ending at the beginning of such taxable year bears to its gross income from all sources for such portion of such uninterrupted period.

For purposes of this subsection, the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States. For purposes of paragraph (2), there shall not be taken into account any taxable year within such uninterrupted period if, with respect to dividends paid out of the earnings and profits of such year, the deduction provided by subsection (b) would be allowable.

(b) Certain dividends received from wholly owned foreign subsidiaries.

(1) In general.

In the case of dividends described in paragraph (2) received from a foreign corporation by a domestic corporation which, for its taxable year in which such dividends are received, owns (directly or indirectly) all of the outstanding stock of such foreign corporation, there shall be allowed as a deduction (in lieu of the deduction provided by subsection (a)) an amount equal to 100 percent of such dividends.

(2) Eligible dividends.

Paragraph (1) shall apply only to dividends which are paid out of the earnings and profits of a foreign corporation for a taxable year during which—

(A) all of its outstanding stock is owned (directly or indirectly) by the domestic corporation to which such dividends are paid; and

(B) all of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

(3) Exception.

Paragraph (1) shall not apply to any dividends if an election under section 1562 is effective for either—

(A) the taxable year of the domestic corporation in which such dividends are received, or

(B) the taxable year of the foreign corporation out of the earnings and profits of which such dividends are paid.

(c) Property distributions.

For purposes of subsections (a) and (b), the amount of any distribution of property other than money shall be the amount determined by applying section 301(b)(1)(B). (Aug. 16, 1954, ch. 736, 68A Stat. 73; Oct. 16, 1962, Pub. L. 87–834, § 5(c), 76 Stat. 977; Nov. 13, 1966, Pub. L. 89–809, title I, § 104 (d), (e), 80 Stat. 1558.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809, § 104(d), (e)(2), substituted "and if 50 percent or more of the gross income of such corporation from all sources for such period is effectively connected with the conduct of a trade or business within the United States" for "and has derived 50 percent or more of its gross income from sources within the United States" in the material preceding par. (1), "which is effectively connected with the conduct of a trade or business within the United States" for "from sources within the United States" in par. (1), ", which is effectively connected with the conduct of a trade or business within the United States," for "from sources within the United States" in par. (2), and added material following par. (2).

Subsec. (b). Pub. L. 89–809, § 104(e)(1), added subsec. (b) and redesignated former subsec. (b) as (c).

Subsec. (c). Pub. L. 89–809, § 104(e)(1), (3), redesignated former subsec. (b) as (c), and substituted therein "subsections (a) and (b)" for "subsection (a)."

1962—Pub. L. 87–834 designated existing provisions as subsec. (a), inserting therein the subsection catchline, and added subsec. (b).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–834 applicable to distributions made after Dec. 31, 1962, see section 5(d) of Pub. L. 87–834, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 73, 172, 243, 246, 301, 596, 804, 809, 812, 815, 861, 1111, 1244 of this title.

§ 246. Rules applying to deductions for dividends received.

(a) Deduction not allowed for dividends from certain corporations.

The deductions allowed by sections 243, 244, and 245 shall not apply to any dividend from—

(1) a corporation organized under the China Trade Act, 1922 (see sec. 941); or

(2) a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is—

(A) a corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations); or

(B) a corporation to which section 931 (relating to income from sources within possessions of the United States) applies.

(b) Limitation on aggregate amount of deductions.

(1) General rule.

Except as provided in paragraph (2), the aggregate amount of the deductions allowed by sections 243(a)(1), 244(a), and 245 shall not exceed 85 percent of the taxable income computed without regard to the deductions allowed by sections 172, 243(a)(1), 244(a), 245, and 247, and without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

(2) Effect of net operating loss.

Paragraph (1) shall not apply for any taxable year for which there is a net operating loss (as determined under section 172).

(c) Exclusion of certain dividends.

(1) In general.

No deduction shall be allowed under section 243, 244, or 245, in respect of any dividend on any share of stock—

(A) which is sold or otherwise disposed of in any case in which the taxpayer has held such share for 15 days or less, or

(B) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make corresponding payments with respect to substantially identical stock or securities.

(2) 90-day rule in the case of certain preference dividends.

In the case of any stock having preference in dividends, the holding period specified in paragraph (1) (A) shall be 90 days in lieu of 15 days if the taxpayer receives dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days.

(3) Determination of holding periods.

For purposes of this subsection, in determining the period for which the taxpayer has held any share of stock—

(A) the day of disposition, but not the day of acquisition, shall be taken into account.

(B) there shall not be taken into account any day which is more than 15 days (or 90 days in the case of stock to which paragraph (2) applies) after the date on which such share becomes ex-dividend, and

(C) paragraph (4) of section 1223 shall not apply.

The holding periods determined under the preceding provisions of this paragraph shall be appropriately reduced (in the manner provided in regulations prescribed by the Secretary or his delegate) for any period (during such holding periods) in which the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities.

(d) Cross reference.

For special rule relating to mutual savings banks, etc., to which section 593 applies, see section 596.

(Aug. 16, 1954, ch. 736, 68A Stat. 74; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 18(a), 57(c)(2), 72 Stat. 1614, 1646; Feb. 26, 1964, Pub. L. 88–272, title II, § 214(b)(2), 78 Stat. 55; Dec. 30, 1969, Pub. L. 91–172, title IV, § 434(b)(1), title V, § 512(f)(3), 83 Stat. 625, 641.)

REFERENCES IN TEXT

The China Trade Act, 1922, referred to in subsec. (a)(1), is classified to section 141 et seq. of Title 15, Commerce and Trade.

AMENDMENTS

1969—Subsec. (b)(1). Pub. L. 91–172, § 512(f)(3), substituted "and 247, and without regard to any capital loss carryback to the taxable year under section 1212(a)(1)" for "and 247."

Subsec. (d). Pub. L. 91–172, § 434(b)(1), added subsec. (d).

1964—Subsec. (b). Pub. L. 88–272 substituted "243(a)(1), 244(a)" for "243(a), 244" wherever appearing.

1958—Subsec. (b)(1). Pub. L. 85–866, § 57(c)(2), substituted "243(a)" for "243" wherever appearing.

Subsec. (c). Pub. L. 85–866, § 18(a), added subsec. (c).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (b)(1) of this section by section 512(f)(3) of Pub. L. 91–172 applicable with respect to net capital losses sustained in taxable years beginning after Dec. 31, 1969, see section 512(g) of Pub. L. 91–172, set out as a note under section 1212 of this title.

Subsec. (d) of this section applicable to taxable years beginning after July 11, 1969, see section 434(c) of Pub. L. 91–172, set out as a note under section 596 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to dividends received in taxable years ending after Dec. 31, 1963, see section 214(c) of Pub. L. 88–272, set out as a note under section 243 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (b)(1) applicable with respect to taxable years beginning after Sept. 2, 1958, see section 57 (d) of Pub. L. 85–866, set out as a note under section 243 of this title.

Section 18 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [which added subsec. (c) of this section] shall apply with respect to taxable years ending after December 31, 1957, but only with respect to shares of stock acquired or short sales made after December 31, 1957."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 172, 804, 809, 812, 822, 852, 857 of this title.

§ 247. Dividends paid on certain preferred stock of public utilities.

(a) Amount of deduction.

In the case of a public utility, there shall be allowed as a deduction an amount computed as follows:

(1) First determine the amount which is the lesser of—

(A) the amount of dividends paid during the taxable year on its preferred stock, or

(B) the taxable income for the taxable year (computed without the deduction allowed by this section).

(2) Then multiply the amount determined under paragraph (1) by the fraction—

(A) the numerator of which is 14 percent, and

(B) the denominator of which is that percentage which equals the sum of the normal tax rate and the surtax rate for the taxable year specified in section 11.

For purposes of the deduction provided in this section, the amount of dividends paid shall not include any amount distributed in the current taxable year with respect to dividends unpaid and accumulated in any taxable year ending before October 1, 1942. Amounts distributed in the current taxable year with respect to dividends unpaid and accumulated for a prior taxable year shall for purposes of this subsection be deemed to be distributed with respect to the earliest year or years for which there are dividends unpaid and accumulated.

(b) Definitions.

For purposes of this section and section 244—

(1) Public utility.

The term "public utility" means a corporation engaged in the furnishing of telephone service or in the sale of electrical energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(2) Preferred stock.

The term "preferred stock" means stock issued before October 1, 1942, which during the whole of the taxable year (or the part of the taxable year after its issue) was stock the dividends in respect of which were cumulative, limited to the same amount, and payable in preference to the payment of dividends on other stock. Stock issued on or after October 1, 1942, shall be deemed for purposes of this paragraph to have been issued before October 1, 1942, if it was issued (including issuance either by the same or another corporation in a transaction which is a reorganization (as defined in section 368 (a)), a transaction to which section 371 (relating to insolvency reorganizations) applies, or a transaction subject to part VI of subchapter O (relating to exchanges in SEC obedience orders), or the respectively corresponding provisions of the Internal Revenue Code of 1939) to refund or replace bonds or debentures issued before October 1, 1942, or to refund or replace other preferred stock (including stock which is preferred stock by reason of this sentence), but only to the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds or debentures issued before October 1, 1942, or the other preferred stock, which such new stock is issued to refund or replace. The determination of whether stock was issued to refund or replace bonds or debentures issued before October 1, 1942, or to refund or replace other preferred stock, shall be made under regulations prescribed by the Secretary or his delegate.

(Aug. 16, 1954, ch. 736, 68A Stat. 75.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 172, 244, 1562 of this title.

§ 248. Organizational expenditures.

(a) Election to amortize.

The organizational expenditures of a corporation may, at the election of the corporation (made in accordance with regulations prescribed by the Secretary or his delegate), be treated as deferred expenses. In computing taxable income, such deferred expenses shall be allowed as a deduction ratably over such period of not less than 60 months as may be selected by the corporation (beginning with the month in which the corporation begins business).

(b) Organizational expenditures defined.

The term "organizational expenditures" means any expenditure which—

(1) is incident to the creation of the corporation;

(2) is chargeable to capital account; and

(3) is of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over such life.

(c) Time for and scope of election.

The election provided by subsection (a) may be made for any taxable year beginning after December 31, 1953, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The period so elected shall be adhered to in computing the taxable income of the corporation for the taxable year for which the election is made and all subsequent taxable years. The election shall apply only with respect to expenditures paid or incurred on or after the date of enactment of this title. (Aug. 16, 1954, ch. 736, 68A Stat. 76.)

CROSS REFERENCES

Capital expenditures not deductible, see section 263 of this title.

Time for filing returns, see sections 6072, 6081 of this title.

Trade or business expenses deductible, see section 162 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 535, 822, 1247, 1373, 1374 of this title.

§ 249. Limitation on deduction of bond premium on repurchase.

(a) General rule.

No deduction shall be allowed to the issuing corporation for any premium paid or incurred upon the repurchase of a bond, debenture, note, or certificate or other evidence of indebtedness which is convertible into the stock of the issuing corporation, or a corporation in control of, or controlled by, the issuing corporation, to the extent the repurchase price exceeds an amount equal to the adjusted issue price plus a normal call premium on bonds or other evidences of indebtedness which are not convertible. The preceding sentence shall not apply to the extent that the corporation can demonstrate to the satisfaction of the Secretary or his delegate that such excess is attributable to the cost of borrowing and is not attributable to the conversion feature.

(b) Special rules.

For purposes of subsection (a)—

(1) Adjusted issue price.

The adjusted issue price is the issue price (as defined in section 1232(b)) increased by any amount of discount deducted before repurchase, or, in the case of bonds or other evidences of indebtedness issued after February 28, 1913, decreased by any amount of premium included in gross income before repurchase by the issuing corporation.

(2) Control.

The term "control" has the meaning assigned to such term by section 368(c).

(Added Pub. L. 91–172, title IV, § 414(a), Dec. 30, 1969, 83 Stat. 612.)

EFFECTIVE DATE

Section 414(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section] shall apply to a convertible bond or other convertible evidence of indebtedness repurchased after April 22, 1969, other than such a bond or other evidence of indebtedness repurchased pursuant to a binding obligation incurred on or before April 22, 1969, to repurchase such bond or other evidence of indebtedness at a specified call premium, but no inference shall be drawn from the fact that section 249 of the Internal Revenue Code of 1954 [this section] (as added by subsection (a) of this section) does not apply to the repurchase of such convertible bond or other convertible evidence of indebtedness."

§ 250. Certain payments to the National Railroad Passenger Corporation.

(a) General rule.

If—

(1) any corporation which is a common carrier by railroad (as defined in section 1(3) of the Interstate Commerce Act (49 U.S.C. 1(3)) makes a payment in cash, rail passenger equipment, or services to the National Railroad Passenger Corporation (hereinafter in this section referred to as the "Passenger Corporation") pursuant to a contract entered into under section 401(a) of the Rail Passenger Service Act of 1970, and

(2) no stock in the Passenger Corporation is issued at any time to such corporation in connection with any contract entered into under such section 401(a),

then the amount of such payment shall (subject to subsection (c)) be allowed as a deduction for the taxable year in which it is made.

(b) When payment is made.

Under regulations prescribed by the Secretary or his delegate, a payment in rail passenger equipment shall be treated as made when title to the equipment is transferred, and a payment in services shall be treated as made when the services are rendered.

(c) Effect of certain subsequent acquisitions of stock.

(1) Disallowance of deductions.

If any deduction has been allowed under subsection (a) to a corporation and such corporation (or a successor corporation) acquires any stock in the Passenger Corporation (other than in a transaction described in section 374 or 381) before the close of the 36-month period which begins with the day on which the last payment is made to the Passenger Corporation pursuant to the contract entered into under such section 401(a), then such deduction shall be disallowed (as of the close of the taxable year for which it was allowed under subsection (a)).

(2) Collection of deficiency.

If any deduction is disallowed by reason of paragraph (1), then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment and the collection by levy or a proceeding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting from such a disallowance, include one year following the date on which the person acquiring the stock which results in the disallowance (in accordance with regulations prescribed by the Secretary or his delegate) notifies the Secretary or his delegate of such acquisition; and such assessment and collection may be made notwithstanding any provision of law or rule of law which otherwise would prevent such assessment and collection.

(d) Members of controlled group.

Under regulations prescribed by the Secretary or his delegate, if a corporation is a member of a controlled group of corporations (within the meaning of section 1563), subsections (a)(2) and (c) shall be applied by treating all members of such controlled group as one corporation. (Added Pub. L. 91–518, title IX, § 901(a), Oct. 30, 1970, 84 Stat. 1341.)

REFERENCES IN TEXT

Section 1(3) of the Interstate Commerce Act, referred to in subsec. (a)(1), is section 1(3) of Title 49, Transportation.

Section 401(a) of the Rail Passenger Service Act of 1970, referred to in subsec. (a)(1), is classified to section 561(a) of Title 45, Railroads.

EFFECTIVE DATE

Section 901(c) of Pub. L. 91–518 provided that: "The amendments made by this section [adding this section] shall apply to taxable years ending after the date of the enactment of this Act [October 30, 1970]."

PART IX.—ITEMS NOT DEDUCTIBLE

Sec.
261. General rule for disallowance of deductions.
262. Personal, living, and family expenses.
263. Capital expenditures.
264. Certain amounts paid in connection with insurance contracts.
265. Expenses and interest relating to tax-exempt income.
266. Carrying charges.
267. Losses, expenses, and interest with respect to transactions between related taxpayers.
268. Sale of land with unharvested crop.
269. Acquisitions made to evade or avoid income tax.
271. Debts owed by political parties, etc.
272. Disposal of coal or domestic iron ore.
273. Holders of life or terminable interest.
274. Disallowance of certain entertainment, etc., expenses.
275. Certain taxes.
276. Certain indirect contributions to political parties.
277. Deductions incurred by certain membership organizations in transactions with members.
278. Capital expenditures incurred in planting and developing citrus and almond groves.
279. Interest on indebtedness incurred by corporation to acquire stock or assets of another corporation.

AMENDMENTS

1971—Pub. L. 91–680, § 1(c), Jan. 12, 1971, 84 Stat. 2064, added "and almond" following "citrus" in item 278.

1969—Pub. L. 91–172, title I, § 121(b)(3)(B), title II, §§ 213(c)(2), 216(b), title IV, § 411(b), Dec. 30, 1969, 83

Stat. 541, 572, 574, 608, struck out item 270, limitation on deductions allowable to individuals in certain cases, and added items 277 to 279.

1966—Pub. L. 89-368, title III, § 301(b), Mar. 15, 1966, 80 Stat. 67, added item 276.

1964—Pub. L. 88-272, title II, §§ 207(b)(3)(B), 227(b)(4), Feb. 26, 1964, 78 Stat. 42, 98, inserted "or domestic iron ore" in item 272, and added item 275.

1962—Pub. L. 87-834, § 4(a)(2), Oct. 16, 1962, 76 Stat. 976, added item 274.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in sections 161, 211 of this title.

§ 261. General rule for disallowance of deductions.

In computing taxable income no deduction shall in any case be allowed in respect of the items specified in this part. (Aug. 16, 1954, ch. 736, 68A Stat. 76.)

§ 262. Personal, living, and family expenses.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses. (Aug. 16, 1954, ch. 736, 68A Stat. 76.)

CROSS REFERENCES

Additional exemption for students, see section 151 (e) of this title.

Expenses for care of dependents deductible, see section 214 of this title.

Medical and dental expenses deductible, see section 213 of this title.

Non-trade or non-business expenses deductible, see section 212 of this title.

Trade or business expenses deductible, see section 162 of this title.

Traveling expenses including meals and lodging deductible, see section 162 (a) (2) of this title.

§ 263. Capital expenditures.

(a) General rule.

No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180, or

(E) expenditures by farmers for clearing land deductible under section 182.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

(3) Except as provided in subsection (d), any amount paid as tax under section 4911 (relating to imposition of interest equalization tax).

(b) Expenditures for advertising and good will.

If a corporation has, for the purpose of computing its excess profits tax credit under chapter 2E or subchapter D of chapter 1 of the Internal Revenue Code of 1939 claimed the benefits of the election provided in section 733 or section 451 of such code, as the case may be, no deduction shall be allowable under section 162 to such corporation for expenditures for advertising or the promotion of good will which, under the rules and regulations prescribed under section 733 or section 451 of such code, as the case may be, may be regarded as capital investments.

(c) Intangible drilling and development costs in the case of oil and gas wells.

Notwithstanding subsection (a), regulations shall be prescribed by the Secretary or his delegate under this subtitle corresponding to the regulations which granted the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells and which were recognized and approved by the Congress in House Concurrent Resolution 50, Seventy-ninth Congress.

(d) Reimbursement of interest equalization tax.

The deduction allowed by section 162(a) or 212 (whichever is appropriate) shall include any amount paid or accrued in the taxable year or a preceding taxable year as tax under section 4911 (relating to imposition of interest equalization tax) to the extent that any amount attributable to the amount paid or accrued as tax is included in gross income for the taxable year. Under regulations prescribed by the Secretary or his delegate, the preceding sentence shall not apply with respect to any amount attributable to that part of the tax so paid or accrued which is attributable to an amount for which a deduction has been claimed for the taxable year or a preceding taxable year under section 171 (relating to amortization of bond premium).

(e) Expenditures in connection with certain railroad rolling stock.

In the case of expenditures in connection with the rehabilitation of a unit of railroad rolling stock (except a locomotive) used by a domestic common carrier by railroad which would, but for this subsection, be properly chargeable to capital account, such expenditures, if during any 12-month period they do not exceed an amount equal to 20 percent of the basis of such unit in the hands of the taxpayer, shall be treated (notwithstanding subsection (a)) as deductible repairs under section 162 or 212. (Aug. 16, 1954, ch. 736, 68A Stat. 77; Sept. 14, 1960, Pub. L. 86-779, § 6(c), 74 Stat. 1001; Oct. 16, 1962, Pub. L. 87-834, §21(b), 76 Stat. 1064; Sept. 2, 1964, Pub. L. 88-563, § 4, 78 Stat. 845; Oct. 9, 1965, Pub. L. 89-243, § 4(p)(1), (2), 79 Stat. 964; Dec. 30, 1969, Pub. L. 91-172, title VII, § 706(a), 83 Stat. 674.)

AMENDMENTS

1969—Subsec. (e). Pub. L. 91-172 added subsec. (e).

1965—Subsec. (a)(3). Pub. L. 89-243, § 4(p)(1), inserted "Except as provided in subsection (d)", and deleted "except to the extent that any amount attributable to the amount paid as tax is included in gross income for the taxable year" following the parenthetical material.

Subsec. (d). Pub. L. 89-243, § 4(p)(2), added subsec. (d).

1964—Subsec. (a). Pub. L. 88-563 added par. (3).

1962—Subsec. (a)(1)(E). Pub. L. 87-834 added subsec. (a)(1)(E).

1960—Subsec. (a)(1)(D). Pub. L. 86-779 added subpar. (D).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 706(b) of Pub. L. 91-172 provided that: "The amendment made by subsection (a) [amending this section] shall apply with respect to taxable years beginning after December 31, 1969."

EFFECTIVE DATE OF 1965 AMENDMENT

Section 4(p)(3) of Pub. L. 89-243 provided that: "The amendments made by this subsection [to this section] shall apply to taxable years ending after September 2, 1964."

Amendment of section by section 4 of Pub. L. 89-243 applicable with respect to acquisitions of stock and debt obligations made after Feb. 10, 1965, except as otherwise specifically provided in said section 4 of Pub. L. 89-243 and in the amendments made by such section, see section 4(q) of Pub. L. 89-243, set out as a note under section 4914 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87-834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 21(d) of Pub. L. 87-834, set out as a note under section 182 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86-779 applicable to taxable years beginning after Dec. 31, 1959, see section 6(d) of Pub. L. 86-779, set out as a note under section 180 of this title.

EFFECT OF 1965 AMENDMENT ON EX. ORD. NO. 11198

Ex. Ord. No. 11198, set out as a note under section 4931 of this title, deemed modified by the amendment made by section 4 of Pub. L. 89-243 to this section to the extent such Ex. Ord. is inconsistent with such amendment, see section 4(g) of Pub. L. 89-243, set out as a note under section 4931 of this title.

CROSS REFERENCES

Non-trade or non-business expenses deductible, see section 212 of this title.

Reasonable allowance for exhaustion, see section 167 of this title.

Trade or business expenses deductible, see section 162 of this title.

§ 264. Certain amounts paid in connection with insurance contracts.

(a) General rule.

No deduction shall be allowed for—

(1) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

(2) Any amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract.

(3) Except as provided in subsection (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise).

Paragraph (2) shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954. Paragraph (3) shall apply only in respect of contracts purchased after August 6, 1963.

(b) Contracts treated as single premium contracts.

For purposes of subsection (a)(2), a contract shall be treated as a single premium contract—

(1) if substantially all the premiums on the contract are paid within a period of 4 years from the date on which the contract is purchased, or

(2) if an amount is deposited after March 1, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

(c) Exceptions.

Subsection (a)(3) shall not apply to any amount paid or accrued by a person during a taxable year on indebtedness incurred or continued as part of a plan referred to in subsection (a)(3)—

(1) if no part of 4 of the annual premiums due during the 7-year period (beginning with the date the first premium on the contract to which such plan relates was paid) is paid under such plan by means of indebtedness,

(2) if the total of the amounts paid or accrued by such person during such taxable year for which (without regard to this paragraph) no deduction would be allowable by reason of subsection (a)(3) does not exceed $100,

(3) if such amount was paid or accrued on indebtedness incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in his financial obligations, or

(4) if such indebtedness was incurred in connection with his trade or business.

For purposes of applying paragraph (1), if there is a substantial increase in the premiums on a contract, a new 7-year period described in such paragraph with respect to such contract shall commence on the date the first such increased premium is paid. (Aug. 16, 1954, ch. 736, 68A Stat. 77; Feb. 26, 1964, Pub. L. 88-272, title II, § 215 (a), (b), 78 Stat. 55.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 86-272 inserted par. (3), and provided that it shall apply only to contracts purchased after August 6, 1963.

Subsec. (c). Pub. L. 88-272 added subsec. (c).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 215(c) of Pub. L. 88-272 provided that: "The amendments made by this section [to this section] shall apply with respect to amounts paid or accrued in taxable years beginning after December 31, 1963."

CROSS REFERENCES

Interest paid deductible, see section 163 of this title.

§ 265. Expenses and interest relating to tax-exempt income.

No deduction shall be allowed for—

(1) Expenses.

Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.

(2) Interest.

Interest on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from the taxes imposed by this subtitle.

In applying the preceding sentence to a financial institution (other than a bank) which is a face-amount certificate company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 and following) and which is subject to the banking laws of the State in which such institution is incorporated, interest on face-amount certificates (as defined in section 2(a)(15) of such Act) issued by such institution, and interest on amounts received for the purchase of such certificates to be issued by such institution, shall not be considered as interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by this subtitle, to the extent that the average amount of such obligations held by such institution during the taxable year (as determined under regulations prescribed by the Secretary or his delegate) does not exceed 15 percent of the average of the total assets held by such institution during the taxable year (as so determined).

(Aug. 16, 1954, ch. 736, 68A Stat. 78; Feb. 26, 1964, Pub. L. 88–272, title II, § 216(a), 78 Stat. 56.)

REFERENCES IN TEXT

Section 2(a)(15) of such Act, referred to in par. (2), is classified to section 80a–2 of Title 15, Commerce and Trade.

AMENDMENTS

1964—Par. (2). Pub. L. 88–272 provided that interest on face-amount certificates issued by a face-amount certificate company, and interest on amounts received for the purchase of such certificates to be issued by such institution, shall not be considered interest on indebtedness to purchase or carry obligations the interest on which is wholly exempt from the taxes under this subtitle, to the extent the average amount of such obligations held by such institution during the taxable year doesn't exceed 15 percent of the average total assets held by such institution during the taxable year.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 216(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to this section] shall apply with respect to taxable years ending after the date of the enactment of this Act [February 21, 1964]."

CROSS REFERENCES

Double deductions prohibited by certain insurance companies, see section 832 of this title.
Interest paid deductible, see section 163 of this title.
Tax-exempt interest relating to estates and trusts, see section 643 (a) (5) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 643, 861, 4940, 4942 of this title.

§ 266. Carrying charges.

No deduction shall be allowed for amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Secretary or his delegate, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable. (Aug. 16, 1954, ch. 736, 68A Stat. 78.)

CROSS REFERENCES

Adjustment to losses for carrying charges, see section 1016 (a) (1) (A) of this title.
Capital expenditures not deductible, see section 263 of this title.
Interest paid deductible, see section 163 of this title.
Taxes deductible, see section 164 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 267. Losses, expenses, and interest with respect to transactions between related taxpayers.

(a) Deductions disallowed.

No deduction shall be allowed—

(1) Losses.

In respect of losses from sales or exchanges of property (other than losses in cases of distributions in corporate liquidations), directly or indirectly, between persons specified within any one of the paragraphs of subsection (b).

(2) Unpaid expenses and interest.

In respect of expenses, otherwise deductible under section 162 or 212, or of interest, otherwise deductible under section 163,—

(A) If within the period consisting of the taxable year of the taxpayer and 2½ months after the close thereof (i) such expenses or interest are not paid, and (ii) the amount thereof is not includible in the gross income of the person to whom the payment is to be made; and

(B) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(C) If, at the close of the taxable year of the taxpayer or at any time within 2½ months thereafter, both the taxpayer and the person to whom the payment is to be made are persons specified within any one of the paragraphs of subsection (b).

(b) Relationships.

The persons referred to in subsection (a) are:

(1) Members of a family, as defined in subsection (c) (4);

(2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(3) Two corporations more than 50 percent in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(4) A grantor and a fiduciary of any trust;

(5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;

(6) A fiduciary of a trust and a beneficiary of such trust;

(7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

(8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; or

(9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual.

(c) Constructive ownership of stock.

For purposes of determining, in applying subsection (b), the ownership of stock—

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

(d) Amount of gain where loss previously disallowed.

If—

(1) in the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a) (1) (or by reason of section 24 (b) of the Internal Revenue Code of 1939); and

(2) after December 31, 1953, the taxpayer sells or otherwise disposes of such property (or of other property the basis of which in his hands is determined directly or indirectly by reference to such property) at a gain,

then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer. This subsection applies with respect to taxable years ending after December 31, 1953. This subsection shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091 (relating to wash sales) or by reason of section 118 of the Internal Revenue Code of 1939. (Aug. 16, 1954, ch. 736, 68A Stat. 78.)

CROSS REFERENCES

Corporate and individual losses deductible, see section 165 of this title.

Interest paid deductible, see section 163 of this title.

Subsection (c) of this section applicable to unincorporated business enterprises, see section 1361 (g) of this title.

Transaction between partners, see section 707 (b) (1) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 103, 170, 176, 274, 341, 503, 514, 631, 707, 1235, 1237, 1341, 4946 of this title.

§ 268. Sale of land with unharvested crop.

Where an unharvested crop sold by the taxpayer is considered under the provisions of section 1231 as "property used in the trade or business", in computing taxable income no deduction (whether or not for the taxable year of the sale and whether for expenses, depreciation, or otherwise) attributable to the production of such crop shall be allowed. (Aug. 16, 1954, ch. 736, 68A Stat. 80.)

CROSS REFERENCES

Adjustment to basis for deductions disallowed under this section, see section 1016 (a) (11) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 269. Acquisitions made to evade or avoid income tax.

(a) In general.

If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the Secretary or his delegate may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(b) Power of Secretary or his delegate to allow deduction, etc., in part.

In any case to which subsection (a) applies the Secretary or his delegate is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or

allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

(c) Presumption in case of disproportionate purchase price.

The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of subsection (a)), or of the property acquired specified in paragraph (2) of subsection (a); and

(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition,

shall be prima facie evidence of the principal purpose of evasion or avoidance of Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954. (Aug. 16, 1954, ch. 736, 68A Stat. 80; Feb. 26, 1964, Pub. L. 88–272, title II, § 235(c)(2), 78 Stat. 126.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272 substituted "the Secretary or his delegate may disallow such deduction, credit, or other allowance" for "such deduction, credit or other allowance shall not be allowed."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years ending after Dec. 31, 1963, see section 235(d) of Pub. L. 88–272 set out as a note under section 1551 of this title.

CROSS REFERENCES

Disallowance of surtax exemption and accumulated earnings credit, see section 1551 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1551 of this title.

§ 270. Repealed. Pub. L. 91–172, title II, § 213(h), Dec. 30, 1969, 83 Stat. 572.

Section, act Aug. 16, 1954, ch. 736, 68A Stat. 81, related to the limitation on deductions allowable to certain individuals. See section 183 of this title.

EFFECTIVE DATE OF REPEAL

Repeal of section applicable to taxable years beginning after Dec. 31, 1969, see section 213(d) of Pub. L. 91-172, set out as a note under section 183 of this title.

§ 271. Debts owed by political parties, etc.

(a) General rule.

In the case of a taxpayer (other than a bank as defined in section 581) no deduction shall be allowed under section 166 (relating to bad debts) or under section 165 (g) (relating to worthlessness of securities) by reason of the worthlessness of any debt owed by a political party.

(b) Definitions.

(1) Political party.

For purposes of subsection (a), the term "political party" means—

(A) a political party;

(B) a national, State, or local committee of a political party; or

(C) a committee, association, or organization which accepts contributions or makes expenditures for the purpose of influencing or attempting to influence the election of presidential or vice-presidential electors or of any individual whose name is presented for election to any Federal, State, or local elective public office, whether or not such individual is elected.

(2) Contributions.

For purposes of paragraph (1) (C), the term "contributions" includes a gift, subscription, loan, advance, or deposit, of money, or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not legally enforceable.

(3) Expenditures.

For purposes of paragraph (1) (C), the term "expenditures" includes a payment, distribution, loan, advance, deposit, or gift, of money, or anything of value, and includes a contract, promise, or agreement to make an expenditure, whether or not legally enforceable.

(Aug. 16, 1954, ch. 736, 68A Stat. 82.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 276 of this title.

§ 272. Disposal of coal or domestic iron ore.

Where the disposal of coal or iron ore is covered by section 631, no deduction shall be allowed for expenditures attributable to the making and administering of the contract under which such disposition occurs and to the preservation of the economic interest retained under such contract, except that if in any taxable year such expenditures plus the adjusted depletion basis of the coal or iron ore disposed of in such taxable year exceed the amount realized under such contract, such excess, to the extent not availed of as a reduction of gain under section 1231, shall be a loss deductible under section 165 (a). This section shall not apply to any taxable year during which there is no income under the contract. (Aug. 16, 1954, ch. 736, 68A Stat. 82; Feb. 26, 1964, Pub. L. 88–272, title II, § 227 (a)(3), (b)(3), 78 Stat. 98.)

AMENDMENTS

1964—Pub. L. 88–272 inserted "or domestic iron ore" in the section catchline, and "or iron ore" wherever appearing in the text.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 227(c) of Pub. L. 88–272 provided that: "The amendments made by this section [to this section, and sections 631, 1016, 1231, and 1402, and to the analysis preceding sections 261 and 631 of this title, and to section 411 of Title 42, Public Health and Welfare] shall apply with respect to amounts received or accrued in taxable years beginning after December 31, 1963, attributable to iron ore mined in such taxable years."

CROSS REFERENCES

Adjustment to basis for deductions disallowed under this section, see section 1016 (a) (15) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 631, 1016 of this title.

§ 273. Holders of life or terminable interest.

Amounts paid under the laws of a State, a Territory, the District of Columbia, a possession of the United States, or a foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time. (Aug. 16, 1954, ch. 736, 68A Stat. 83.)

§ 274. Disallowance of certain entertainment, etc., expenses.

(a) Entertainment, amusement, or recreation.

(1) In general.

No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) Activity.

With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

(B) Facility.

With respect to a facility used in connection with an activity referred to in subparagraph (A), unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business,

and such deduction shall in no event exceed the portion of such item directly related to, or, in the case of an item described in subparagraph (A) directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), the portion of such item associated with, the active conduct of the taxpayer's trade or business.

(2) Special rules.

For purposes of applying paragraph (1)—

(A) Dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities.

(B) An activity described in section 212 shall be treated as a trade or business.

(b) Gifts.

(1) Limitation.

No deduction shall be allowed under section 162 or section 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, exceeds $25. For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter, but such term does not include—

(A) an item having a cost to the taxpayer not in excess of $4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer,

(B) a sign, display rack, or other promotional material to be used on the business premises of the recipient, or

(C) an item of tangible personal property having a cost to the taxpayer not in excess of $100 which is awarded to an employee by reason of length of service or for safety achievement.

(2) Special rules.

(A) In the case of a gift by a partnership, the limitation contained in paragraph (1) shall apply to the partnership as well as to each member thereof.

(B) For purposes of paragraph (1), a husband and wife shall be treated as one taxpayer.

(c) Certain foreign travel.

(1) In general.

In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary or his delegate, is not allocable to such trade or business or to such activity.

(2) Exception.

Paragraph (1) shall not apply to the expenses of any travel outside the United States away from home if—

(A) such travel does not exceed one week, or

(B) the portion of the time of travel outside the United States away from home which is not attributable to the pursuit of the taxpayer's trade or business or an activity described in section 212 is less than 25 percent of the total time on such travel.

(3) Domestic travel excluded.

For purposes of this subsection, travel outside the United States does not include any travel from one point in the United States to another point in the United States.

(d) Substantiation required.

No deduction shall be allowed—

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, or

(3) for any expense for gifts,

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the

business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

(e) Specific exceptions to application of subsection (a).

Subsection (a) shall not apply to—

(1) Business meals.

Expenses for food and beverages furnished to any individual under circumstances which (taking into account the surroundings in which furnished, the taxpayer's trade, business, or income-producing activity and the relationship to such trade, business, or activity of the persons to whom the food and beverages are furnished) are of a type generally considered to be conducive to a business discussion.

(2) Food and beverages for employees.

Expenses for food and beverages (and facilities used in connection therewith) furnished on the business premises of the taxpayer primarily for his employees.

(3) Expenses treated as compensation.

Expenses for goods, services, and facilities, to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation to an employee on the taxpayer's return of tax under this chapter and as wages to such employee for purposes of chapter 24 (relating to withholding of income tax at source on wages).

(4) Reimbursed expenses.

Expenses paid or incurred by the taxpayer, in connection with the performance by him of services for another person (whether or not such other person is his employer), under a reimbursement or other expense allowance arrangement with such other person, but this paragraph shall apply—

(A) where the services are performed for an employer, only if the employer has not treated such expenses in the manner provided in paragraph (3), or

(B) where the services are performed for a person other than an employer, only if the taxpayer accounts (to the extent provided by subsection (d)) to such person.

(5) Recreational, etc., expenses for employees.

Expenses for recreational, social, or similar activities (including facilities therefor) primarily for the benefit of employees (other than employees who are officers, shareholders or other owners, or highly compensated employees). For purposes of this paragraph, an individual owning less than a 10-percent interest in the taxpayer's trade or business shall not be considered a shareholder or other owner, and for such purposes an individual shall be treated as owning any interest owned by a member of his family (within the meaning of section 267(c)(4)).

(6) Employees, stockholder, etc., business meetings.

Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors.

(7) Meetings of business leagues, etc.

Expenses directly related and necessary to attendance at a business meeting or convention of any organization described in section 501(c)(6) (relating to business leagues, chambers of commerce, real estate boards, and boards of trade) and exempt from taxation under section 501(a).

(8) Items available to public.

Expenses for goods, services, and facilities made available by the taxpayer to the general public.

(9) Entertainment sold to customers.

Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth.

For purposes of this subsection, any item referred to in subsection (a) shall be treated as an expense.

(f) Interest, taxes, casualty losses, etc.

This section shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business (or with his income-producing activity). In the case of a taxpayer which is not an individual, the preceding sentence shall be applied as if it were an individual.

(g) Treatment of entertainment, etc., type facility.

For purposes of this chapter, if deductions are disallowed under subsection (a) with respect to any portion of a facility, such portion shall be treated as an asset which is used for personal, living, and family purposes (and not as an asset used in the trade or business).

(h) Regulatory authority.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section, including regulations prescribing whether subsection (a) or subsection (b) applies in cases where both such subsections would otherwise apply. (Added Pub. L. 87–834, § 4(a)(1), Oct. 16, 1962, 76 Stat. 974, and amended Pub. L. 88–272, title II, § 217(a), Feb. 26, 1964, 78 Stat. 56.)

AMENDMENTS

1964—Subsec. (c). Pub. L. 88–272 limited subsec. (c) to individuals traveling outside the United States.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 217(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to subsec. (c) of this section] shall apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date."

EFFECTIVE DATE

Section applicable with respect to taxable years ending after Dec. 31, 1962, but only in respect of periods after such date, see section 4(c) of Pub. L. 87–834, set out as a note under section 162 of this title.

§ 275. Certain taxes.

(a) General rule.

No deduction shall be allowed for the following taxes:

(1) Federal income taxes, including—

(A) the tax imposed by section 3101 (relating to the tax on employees under the Federal Insurance Contributions Act);

(B) the taxes imposed by sections 3201 and 3211 (relating to the taxes on railroad employees and railroad employee representatives); and

(C) the tax withheld at source on wages under section 3402, and corresponding provisions of prior revenue laws.

(2) Federal war profits and excess profits taxes.

(3) Estate, inheritance, legacy, succession, and gift taxes.

(4) Income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 901 (relating to the foreign tax credit).

(5) Taxes on real property, to the extent that section 164(d) requires such taxes to be treated as imposed on another taxpayer.

(b) Cross reference.

For disallowance of certain other taxes, see section 164(c).

(Added Pub. L. 88–272, title II, § 207(b)(3)(A), Feb. 26, 1964, 78 Stat. 42.)

REFERENCES IN TEXT

The Federal Insurance Contributions Act, referred to in subsec. (a)(1)(A), is classified to chapter 21 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1963, see section 207(c) of Pub. L. 88–272, set out as a note under section 164 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 535, 556, 903 of this title.

§ 276. Certain indirect contributions to political parties.

(a) Disallowance of deduction.

No deduction otherwise allowable under this chapter shall be allowed for any amount paid or incurred for—

(1) advertising in a convention program of a political party, or in any other publication if any part of the proceeds of such publication directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate,

(2) admission to any dinner or program, if any part of the proceeds of such dinner or program directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate, or

(3) admission to an inaugural ball, inaugural gala, inaugural parade, or inaugural concert, or to any similar event which is identified with a political party or a political candidate.

(h) Definitions.

For purposes of this section—

(1) Political party.

The term "political party" means—

(A) a political party;

(B) a National, State, or local committee of a political party; or

(C) a committee, association, or organization, whether incorporated or not, which directly or indirectly accepts contributions (as defined in section 271(b)(2)) or make expenditures (as defined in section 271(b)(3)) for the purpose of influencing or attempting to influence the selection, nomination, or election of any individual to any Federal, State, or local elective public office, or the election of presidential and vice-presidential electors, whether or not such individual or electors are selected, nominated, or elected.

(2) Proceeds inuring to or for the use of political candidates.

Proceeds shall be treated as inuring to or for the use of a political candidate only if—

(A) such proceeds may be used directly or indirectly for the purpose of furthering his candidacy for selection, nomination, or election to any elective public office, and

(B) such proceeds are not received by such candidate in the ordinary course of a trade or business (other than the trade or business of holding elective public office).

(c) Advertising in a convention program of a national political convention.

Subsection (a) shall not apply to any amount paid or incurred for advertising in a convention program of a political party distributed in connection with a convention held for the purpose of nominating candidates for the offices of President and Vice President of the United States, if the proceeds from such program are used solely to defray the costs of conducting such convention (or a subsequent convention of such party held for such purpose) and the amount paid or incurred for such advertising is reasonable in light of the business the taxpayer may expect to receive—

(1) directly as a result of such advertising, or

(2) as a result of the convention being held in an area in which the taxpayer has a principal place of business.

(d) Cross reference.

For disallowance of certain entertainment, etc., expenses, see section 274.

(Added Pub. L. 89–368, title III, § 301(a), Mar. 15, 1966, 80 Stat. 66, and amended Pub. L. 90–364, title I, § 108(a), June 28, 1968, 82 Stat. 269.)

AMENDMENTS

1968—Subsec. (c). Pub. L. 90–364 added subsec. (c). Former subsec. (c) redesignated (d).

Subsec. (d). Pub. L. 90–364 redesignated former subsec. (c) as (d).

EFFECTIVE DATE OF 1968 AMENDMENT

Section 108(b) of Pub. L. 90–364 provided that: "The amendments made by subsection (a) [enacting subsec. (c) of this section] shall apply with respect to amounts paid or incurred on or after January 1, 1968."

EFFECTIVE DATE

Section 301(c) of Pub. L. 89–368 provided that: "The amendments made by subsections (a) and (b) [adding this section] shall apply to taxable years beginning after December 31, 1965, but only with respect to amounts paid or incurred after the date of the enactment of this Act [Mar. 15, 1966]."

PROGRAM ADVERTISING FOR PRESIDENTIAL AND VICE-PRESIDENTIAL NOMINATING CONVENTIONS

Pub. L. 90–346, June 18, 1968, 82 Stat. 183, provided: "That subsection (a) of section 276 of the Internal Revenue Code of 1954 (relating to certain indirect contributions to political parties) [subsec. (a) of this section]

shall not apply to any amount paid or incurred for advertising in a convention program of a political party distributed in connection with a convention held for the purpose of nominating candidates for the offices of President and Vice President of the United States, if the proceeds from such program are used solely to defray the costs of conducting such convention (or a subsequent convention of such party held for such purpose) and the amount paid or incurred for such advertising is reasonable in light of the business the taxpayer may expect to receive—

"(1) directly as a result of such advertising, or

"(2) as a result of the convention being held in an area in which the taxpayer has a principal place of business.

"SEC. 2. The first section of this Act shall apply with respect to amounts paid or incurred on or after January 1, 1968."

§ 277. Deductions incurred by certain membership organizations in transactions with members.

(a) General rule.

In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year.

(b) Exceptions.

Subsection (a) shall not apply to any organization—

(1) which for the taxable year is subject to taxation under subchapter H or L,

(2) which has made an election before October 9, 1969, under section 456(c) or which is affiliated with such an organization, or

(3) which for each day of any taxable year is a national securities exchange subject to regulation under the Securities Exchange Act of 1934 or a contract market subject to regulation under the Commodity Exchange Act.

(Added Pub. L. 91–172, title I, § 121(b)(3)(A), Dec. 30, 1969, 83 Stat. 540.)

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1970, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

§ 278. Capital expenditures incurred in planting and developing citrus and almond groves.

(a) General rule.

Except as provided in subsection (b), any amount (allowable as a deduction without regard to this section), which is attributable to the planting, cultivation, maintenance, or development of any citrus or almond grove (or part thereof), and which is incurred before the close of the fourth taxable year beginning with the taxable year in which the trees were planted, shall be charged to capital account. For purposes of the preceding sentence, the portion of a citrus or almond grove planted in one taxable year shall be treated separately from the portion of such grove planted in another taxable year.

(b) Exceptions.

Subsection (a) shall not apply to amounts allowable as deductions (without regard to this section), and attributable to a citrus or almond grove (or part thereof) which was:

(1) replanted after having been lost or damaged (while in the hands of the taxpayer), by reason of freeze, disease, drought, pests or casualty, or

(2) planted or replanted before—

(A) December 30, 1969, in the case of a citrus grove, or

(B) December 30, 1970, in the case of an almond grove.

(Added Pub. L. 91–172, title II, § 216(a), Dec. 30, 1969, 83 Stat. 573, and amended Pub. L. 91–680, § 1(a), (b), (d), Jan. 12, 1971, 84 Stat. 2064.)

AMENDMENTS

1971—Pub. L. 91–680, § 1(b), added "and almond" following "citrus" in the section catchline.

Subsec. (a). Pub. L. 91–680, § 1(a), added "or almond" following "citrus" wherever appearing therein.

Subsec. (b). Pub. L. 91–680, § 1(a), added "or almond" following "citrus".

Subsec. (b)(2). Pub. L. 91–680, § 1(d), substituted "before (A) December 30, 1969, in the case of a citrus grove, or (B) December 30, 1970, in the case of an almond grove" for "prior to the enactment of this section".

EFFECTIVE DATE OF 1971 AMENDMENT

Section 2 of Pub. L. 91–680 provided that: "The amendments made by the first section of this Act [amending this section] shall apply to taxable years beginning after the date of the enactment of this Act [Jan. 12, 1971]."

EFFECTIVE DATE

Section 216(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1969."

§ 279. Interest on indebtedness incurred by corporation to acquire stock or assets of another corporation.

(a) General rule.

No deduction shall be allowed for any interest paid or incurred by a corportation during the taxable year with respect to its corporate acquisition indebtedness to the extent that such interest exceeds—

(1) $5,000,000, reduced by

(2) the amount of interest paid or incurred by by such corporation during such year on obligations (A) issued after December 31, 1967, to provide consideration for an acquisition described in paragraph (1) of subsection (b), but (B) which are not corporate acquisition indebtedness.

(b) Corporate acquisition indebtedness.

For purposes of this section, the term "corporate acquisition indebtedness" means any obligation evidenced by a bond, debenture, note, or certificate or other evidence of indebtedness issued after October 9, 1969, by a corporation (hereinafter in this section referred to as "issuing corporation") if—

(1) such obligation is issued to provide consideration for the acquisition of—

(A) stock in another corporation (hereinafter in this section referred to as "acquired corporation"), or

(B) assets of another corporation (hereinafter in this section referred to as "acquired corporation") pursuant to a plan under which at least two-thirds (in value) of all the assets (excluding money) used in trades and businesses carried on by such corporation are acquired,

(2) such obligation is either—

(A) subordinated to the claims of trade creditors of the issuing corporation generally, or

(B) expressly subordinated in right of payment to the payment of any substantial amount of unsecured indebtedness, whether outstanding or subsequently issued, of the issuing corporation,

(3) the bond or other evidence of indebtedness is either—

(A) convertible directly or indirectly into stock of the issuing corporation, or

(B) part of an investment unit or other arrangement which includes, in addition to such bond or other evidence of indebtedness, an option to acquire, directly or indirectly, stock in the issuing corporation, and

(4) as of a day determined under subsection (c)(1), either—

(A) the ratio of debt to equlty (as defined in subsection (c)(2)) of the issuing corporation exceeds 2 to 1, or

(B) the projected earnings (as defined in subsection (c)(3)) do not exceed 3 times the annual interest to be paid or incurred (determined under subsection (c)(4)).

(c) Rules for application of subsection (b)(4).

For purposes of subsection (b)(4)—

(1) Time of determination.

Determinations are to be made as of the last day of any taxable year of the issuing corporation in which it issues any obligation to provide consideration for an acquisition described in subsection (b)(1) of stock in, or assets of, the acquired corporation.

(2) Ratio of debt to equity.

The term "ratio of debt to equity" means the ratio which the total indebtedness of the issuing corporation bears to the sum of its money and all its other assets (in an amount equal to their adjusted basis for determining gain) less such total indebtedness.

(3) Projected earnings.

(A) The term "projected earnings" means the "average annual earnings" (as defined in subparagraph (B)) of—

(i) the issuing corporation only, if clause (ii) does not apply, or

(ii) both the issuing corporation and the acquired corporation, in any case where the issuing corporation has acquired control (as defined in section 368(c)), or has acquired substantially all of the properties, of the acquired corporation.

(B) The average annual earnings referred to in subparagraph (A) is, for any corporation, the amount of its earnings and profits for any 3-year period ending with the last day of a taxable year of the issuing corporation described in paragraph (1), computed without reduction for—

(i) interest paid or incurred,

(ii) depreciation or amortization allowed under this chapter,

(iii) liability for tax under this chapter, and

(iv) distributions to which section 301(c)(1) applies (other than such distributions from the acquired to the issuing corporation),

and reduced to an annual average for such 3-year period pursuant to regulations prescribed by the Secretary or his delegate. Such regulations shall include rules for cases where any corporation was not in existence for all of such 3-year period or such period includes only a portion of a taxable year of any corporation.

(4) Annual interest to be paid or incurred.

The term "annual interest to be paid or incurred" means—

(A) if subparagraph (B) does not apply, the annual interest to be paid or incurred by the issuing corporation only, determined by reference to its total indebtedness outstanding, or

(B) if projected earnings are determined under clause (ii) of paragraph (3)(A), the annual interest to be paid or incurred by both the issuing corporation and the acquired corporation, determined by reference to their combined total indebtedness outstanding.

(5) Special rules for banks and lending or finance companies.

With respect to any corporation which is a bank (as defined in section 581) or is primarily engaged in a lending or finance business—

(A) in determining under paragraph (2) the ratio of debt to equity of such corporation (or of the affiliated group of which such corporation is a member), the total indebtedness of such corporation (and the assets of such corporation) shall be reduced by an amount equal to the total indebtedness owed to such corporation which arises out of the banking business of such corporation, or out of the lending or finance business of such corporation, as the case may be;

(B) in determining under paragraph (4) the annual interest to be paid or incurred by such corporation (or by the issuing and acquired corporations referred to in paragraph (4)(B) or by the affiliated group of which such corportation is a member) the amount of such interest (determined without regard to this paragraph) shall be reduced by an amount which bears the same ratio to the amount of such interest as the amount of the reduction for the taxable year under subparagraph (A) bears to the total indebtedness of such corporation; and

(C) in determining under paragraph (3)(B) the average annual earnings, the amount of the earnings and profits for the 3-year period shall be reduced by the sum of the reductions under subparagraph (B) for such period.

For purposes of this paragraph, the term "lending or finance business" means a business of making loans or purchasing or discounting accounts receivable, notes, or installment obligations.

(d) Taxable years to which applicable.

In applying this section—

(1) First year of disallowance.

The deduction of interest on any obligation shall not be disallowed under subsection (a) before the first taxable year of the issuing corporation as of the last day of which the application of either subparagraph (A) or subparagraph (B) of subsection (b)(4) results in such obligation being corporate acquisition indebtedness.

(2) General rule for succeeding years.

Except as provided in paragraphs (3), (4), and (5), if an obligation is determined to be corporate acquisition indebtedness as of the last day of any taxable year of the issuing corporation, it shall be corporate acquisition indebtedness for such taxable year and all subsequent taxable years.

(3) Redetermination where control, etc., is acquired.

If an obligation is determined to be corporate acquisition indebtedness as of the close of a taxable year of the issuing corporation in which clause (i) of subsection (c)(3)(A) applied, but would not be corporate acquisition indebtedness if the determination were made as of the close of the first taxable year of such corporation thereafter in which clause (ii) of subsection (c)(3)(A) could apply, such obligation shall be considered not to be corporate acquisition indebtedness for such later taxable year and all taxable years thereafter.

(4) Special 3-year rule.

If an obligation which has been determined to be corporate acquisition indebtedness for any taxable year would not be such indebtedness for each of any 3 consecutive taxable years thereafter if subsection (b)(4) were applied as of the close of each of such 3 years, then such obligation shall not be corporate acquisition indebtedness for all taxable years after such 3 consecutive taxable years.

(5) 5 percent stock rule.

In the case of obligations issued to provide consideration for the acquisition of stock in another corporation, such obligations shall be corporate acquisition indebtedness for a taxable year only if at some time after October 9, 1969, and before the close of such year the issuing corporation owns 5 percent or more of the total combined voting power of all classes of stock entitled to vote of such other corporation.

(e) Certain nontaxable transactions.

An acquisition of stock of a corporation of which the issuing corporation is in control (as defined in section 368(c)) in a transaction in which gain or loss is not recognized shall be deemed an acquisition described in paragraph (1) of subsection (b) only if immediately before such transaction (1) the acquired corporation was in existence, and (2) the issuing corporation was not in control (as defined in section 368(c)) of such corporation.

(f) Exemption for certain acquisitions of foreign corporations.

For purposes of this section, the term "corporate acquisition indebtedness" does not include any indebtedness issued to any person to provide consideration for the acquisition of stock in, or assets of, any foreign corporation substantially all of the income of which, for the 3-year period ending with the date of such acquisition or for such part of such period as the foreign corporation was in existence, is from sources without the United States.

(g) Affiliated groups.

In any case in which the issuing corporation is a member of an affiliated group, the application of this section shall be determined, pursuant to regulations prescribed by the Secretary or his delegate, by treating all of the members of the affiliated group in the aggregate as the issuing corporation, except that the ratio of debt to equity of, projected earnings of, and annual interest to be paid or incurred by any corporation (other than the issuing corporation determined without regard to this subsection) shall be included in the determinations required under subparagraphs (A) and (B) of subsection (b)(4) as of any day only if such corporation is a member of the affiliated group on such day, and, in determining projected earnings of such corporation under subsection (c)(3), there shall be taken into account only the earnings and profits of such corporation for the period during which it was a member of the affiliated group. For purposes of the preceding sentence, the term "affiliated group" has the meaning assigned to such term by section 1504(a), except that all corporations other than the acquired corporation shall be treated as includible corporations (without any exclusion under section 1504(b)) and the acquired corporation shall not be treated as an includible corporation.

(h) Changes in obligation.

For purposes of this section—

(1) Any extension, renewal, or refinancing of an obligation evidencing a preexisting indebtedness shall not be deemed to be the issuance of a new obligation.

(2) Any obligation which is corporate acquisition indebtedness of the issuing corporation is also corporate acquisition indebtedness of any corporation which becomes liable for such obligation as guarantor, endorser, or indemnitor or which assumes liability for such obligation in any transaction.

(i) Certain obligations issued after October 9, 1969.

For purposes of this section, an obligation shall not be corporate acquisition indebtedness if issued after October 9, 1969, to provide consideration for the acquisition of—

(1) stock or assets pursuant to a binding written contract which was in effect on October 9, 1969, and at all times thereafter before such acquisition, or

(2) stock in any corporation where the issuing corporation, on October 9, 1969, and at all times thereafter before such acquisition, owned at least 50 percent of the total combined voting power of all classes of stock entitled to vote of the acquired corporation.

Paragraph (2) shall cease to apply when (at any time on or after October 9, 1969) the issuing corporation has acquired control (as defined in section 368(c)) of the acquired corporation.

(j) Effect on other provisions.

No inference shall be drawn from any provision in this section that any instrument designated as a bond, debenture, note, or certificate or other evidence of indebtedness by its issuer represents an obligation or indebtedness of such issuer in applying any other provision of this title. (Added Pub. L. 91-172, title IV, § 411(a), Dec. 30, 1969, 83 Stat. 604.)

EFFECTIVE DATE

Section 411(c) of Pub. L. 91-172 provided that: "The amendments made by this section [enacting this section] shall apply to the determination of the allowability of the deduction of interest paid or incurred with respect to indebtedness incurred after October 9, 1969."

PART X.—TERMINAL RAILROAD CORPORATIONS AND THEIR SHAREHOLDERS

Sec.
281. Terminal railroad corporations and their shareholders.

AMENDMENTS

1962—Pub. L. 87-870, § 1(a), Oct. 23, 1962, 76 Stat. 1158, added Part X and item 281.

§ 281. Terminal railroad corporations and their shareholders.

(a) Computation of taxable income of terminal railroad corporations.

(1) In general.

In computing the taxable income of a terminal railroad corporation—

(A) such corporation shall not be considered to have received or accrued—

(i) the portion of any liability of any railroad corporation, with respect to related terminal services provided by such corporation, which is discharged by crediting such liability with an amount of related terminal income, or

(ii) the portion of any charge which would be made by such corporation for related terminal services provided by it, but which is not made as a result of taking related terminal income into account in computing such charge; and

(B) no deduction otherwise allowable under this chapter shall be disallowed as a result of any discharge of liability described in subparagraph (A)(i) or as a result of any computation of charges in the manner described in subparagraph (A)(ii).

(2) Limitation.

In the case of any taxable year ending after the date of the enactment of this section, paragraph (1) shall not apply to the extent that it would (but for this paragraph) operate to create (or increase) a net operating loss for the terminal railroad corporation for the taxable year.

(b) Computation of taxable income of shareholders.

Subject to the limitation in subsection (a)(2), in computing the taxable income of any shareholder of a terminal railroad corporation, no amount shall be considered to have been received or accrued or paid or incurred by such shareholder as a result of any discharge of liability described in subsection (a)(1)(A)(i) or as a result of any computation of charges in the manner described in subsection (a)(1)(A)(ii).

(c) Agreement required.

In the case of any taxable year, subsections (a) and (b) shall apply with respect to any discharge of liability described in subsection (a)(1)(A)(i), and to any computation of charges in the manner described in subsection (a)(1)(A)(ii), only if such discharge or computatioin (as the case may be) was provided for in a written agreement, to which all of the shareholders of the terminal railroad corporation were parties, entered into before the beginning of such taxable year.

(d) Definitions.

For purposes of this section—

(1) Terminal railroad corporation.

The term "terminal railroad corporation" means a domestic railroad corporation which is not a member, other than as a common parent corporation, of an affiliated group (as defined in section 1504) and—

(A) all of the shareholders of which are domestic railroad corporations subject to part I of the Interstate Commerce Act;

(B) the primary business of which is the providing of railroad terminal and switching facilities and services to domestic railroad corporations subject to part I of the Interstate Commerce Act and to the shippers and passengers of such railroad corporations;

(C) a substantial part of the services of which for the taxable year is rendered to one or more of its shareholders; and

(D) each shareholder of which computes its taxable income on the basis of a taxable year beginning or ending on the same day that the taxable year of the terminal railroad corporation begins or ends.

(2) Related terminal income.

The term "related terminal income" means the income (determined in accordance with regulations prescribed by the Secretary or his delegate) of a terminal railroad corporation derived—

(A) from services or facilities of a character ordinarily and regularly provided by terminal railroad corporations for railroad corporations or for the employees, passengers, or shippers of railroad corporations;

(B) from the use by persons other than railroad corporations of portions of a facility, or a service which is used primarily for railroad purposes;

(C) from any railroad corporation for services or facilities provided by such terminal railroad corporation in connection with railroad operations; and

(D) from the United States in payment for facilities or services in connection with mail handling.

For purposes of subparagraph (B), a substantial addition, constructed after the date of the enactment of this section, to a facility shall be treated as a separate facility.

(3) Related terminal services.

The term "related terminal services" includes only services, and the use of facilities, taken into account in computing related terminal income.

(e) Application to taxable years ending before the date of enactment.

In the case of any taxable year ending before the date of the enactment of this section—

(1) this section shall apply only to the extent that the taxpayer computed on its return, filed at or prior to the time (including extensions thereof) that the return for such taxable year was required to be filed, its taxable income in the manner described in subsection (a) in the case of a terminal railroad corporation, or in the manner described in subsection (b) in the case of a shareholder of a terminal railroad corporation; and

(2) this section shall apply to a taxable year for which the assessment of any deficiency, or for which refund or credit of any overpayment, whichever is applicable, was prevented, on the date of the enactment of this section, by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of this title, relating to closing agreements, and section 3761 of the Internal Revenue Code of 1939 or section 7122 of this title, relating to compromises), only—

(A) to the extent any overpayment of income tax would result from the recomputation of the taxable income of a terminal railroad corporation in the manner described in subsection (a),

(B) if claim for credit or refund of such overpayment, based upon such recomputation, is filed prior to one year after the date of the enactment of this section,

(C) to the extent that paragraph (1) applies, and

(D) if each shareholder of such terminal railroad corporation consents in writing to the assessment, within such period as may be agreed upon with the Secretary or his delegate, of any deficiency for any year to the extent attributable to the recomputation of its taxable income in the manner described in subsection (b) correlative to its allocable share of the adjustment of taxable income made by the terminal railroad corporation in its recomputation under subparagraph (A).

(f) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section. (Added Pub. L. 87–870, § 1(a), Oct. 23, 1962, 76 Stat. 1158.)

REFERENCES IN TEXT

The date of the enactment of this section, referred to in subsecs. (a)(2), (d)(2) and (e), refers to the date of enactment of Pub. L. 87–870, which was approved Oct. 23, 1962.

Part I of the Interstate Commerce Act, referred to in subsec. (d)(1)(A), (B), is classified to chapter 1 of Title 49, Transportation.

EFFECTIVE DATE

Section 2(a) of Pub. L. 87–870 provided that: "The amendments made by the first section of this Act [enacting this section] shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954."

INTERNAL REVENUE CODE OF 1939; INCLUSION OF TERMINAL RAILROAD CORPORATIONS AND THEIR SHAREHOLDERS PROVISION

Section 2(b) of Pub. L. 87–870 provided that: "Provisions having the same effect as section 281 of the Internal Revenue Code of 1954 (as added by the first section of this Act) [this section] shall be deemed to be included in the Internal Revenue Code of 1939, effective with respect to all taxable years to which such Code applies."

Subchapter C.—Corporate Distributions and Adjustments

Part
I. Distributions by corporations.
II. Corporate liquidations.
III. Corporate organizations and reorganizations.
IV. Insolvency reorganizations.
V. Carryovers.
VI. Treatment of certain corporate interests as stock or indebtedness.
VII. Effective date of subchapter C.

AMENDMENTS

1969—Pub. L. 91–172, title IV, § 415(b), Dec. 30, 1969, 83 Stat. 614, redesignated former Part VI as Part VII and added Part VI.

SUBCHAPTER REFERRED TO IN OTHER SECTIONS

This subchapter is referred to in section 1081 of this title.

PART I.—DISTRIBUTIONS BY CORPORATIONS

Subpart
A. Effects on recipients.
B. Effects on corporation.
C. Definitions; constructive ownership of stock.

SUBPART A.—EFFECTS ON RECIPIENTS

Sec.
301. Distributions of property.
302. Distributions in redemption of stock.
303. Distributions in redemption of stock to pay death taxes.
304. Redemption through use of related corporations.
305. Distributions of stock and stock rights.
306. Dispositions of certain stock.
307. Basis of stock and stock rights acquired in distributions.

§ 301. Distributions of property.

(a) In general.

Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) Amount distributed.

(1) General rule.

For purposes of this section, the amount of any distribution shall be—

(A) Noncorporate distributees.

If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) Corporate distributees.

If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before

the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b), (c), or (d) of section 311, under section 341(f), or under section 617(d)(1), 1245(a), 1250(a), 1251(c), or 1252(a).

(C) Certain corporate distributees of foreign corporation.

Notwithstanding subparagraph (B), if the shareholder is a corporation and the distributing corporation is a foreign corporation, the amount taken into account with respect to property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income which is effectively connected with the conduct of a trade or business within the United States, and

(ii) the proportion of the fair market value of such property properly attributable to gross income which is not effectively connected with the conduct of a trade or business within the United States.

For purposes of clause (i), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States. For purposes of clause (ii), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is not effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources without the United States.

(2) Reduction for liabilities.

The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by—

(A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) the amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) Determination of fair market value.

For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) Amount taxable.

In the case of a distribution to which subsection (a) applies—

(1) Amount constituting dividend.

That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) Amount applied against basis.

That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) Amount in excess of basis.

(A) In general.

Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) Distributions out of increase in value accrued before March 1, 1913.

That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

(d) Basis.

The basis of property received in a distribution to which subsection (a) applies shall be—

(1) Noncorporate distributees.

If the shareholder is not a corporation, the fair market value of such property.

(2) Corporate distributees.

If the shareholder is a corporation, whichever of the following is the lesser:

(A) the fair market value of such property; or

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property, increased in the amount of gain to the distributing corporation which is recognized under subsection (b), (c), or (d) of section 311, under section 341(f), or under section 617(d)(1), 1245(a), 1250(a), 1251(c), or 1252(a).

(3) Certain corporate distributees of foreign corporation.

In the case of property described in subparagraph (C) of subsection (b)(1), the basis shall be determined by substituting the amount determined under such subparagraph (C) for the amount described in paragraph (2) of this subsection.

(e) Exception for certain distributions by personal service corporations.

Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 (40 Stat. 1070), or section 218 of the Revenue Act of 1921 (42 Stat. 245), shall be exempt from tax to the distributees.

(f) Special rules for distributions of antitrust stock to corporations.

(1) Definition of antitrust stock.

For purposes of this subsection, the term "antitrust stock" means stock received, by a corpora-

tion which is a party to a suit described in section 1111(d) (relating to definition of antitrust order), in a distribution made after September 6, 1961, either pursuant to the terms of, or in anticipation of, an antitrust order (as defined in subsection (d) of section 1111).

(2) Amount distributed.

Notwithstanding subsection (b)(1) (but subject to subsection (b)(2)), for purposes of this section the amount of a distribution of antitrust stock received by a corporation shall be the fair market value of such stock.

(3) Basis.

Notwithstanding subsection (d), the basis of antitrust stock received by a corporation in a distribution to which subsection (a) applies shall be the fair market value of such stock decreased by so much of the deduction for dividends received under the provisions of section 243, 244, or 245 as is, under regulations prescribed by the Secretary or his delegate, attributable to the excess, if any, of—

(A) the fair market value of the stock, over

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the stock, increased by the amount of gain which is recognized to the distributing corporation by reason of the distribution.

(g) Special rules.

(1) For distributions in redemption of stock, see section 302.

(2) For distributions in partial or complete liquidation, see part II (sec. 331 and following).

(3) For distributions in corporate organizations and reorganizations, see part III (sec. 351 and following).

(4) For partial exclusion from gross income of dividends received by individuals, see section 116.

(Aug. 16, 1954, ch. 736, 68A Stat. 84; Feb. 2, 1962, Pub. L. 87-403, § 2(a), 76 Stat. 5; Oct. 16, 1962, Pub. L. 87-834, §§ 5(a), (b), 13(f)(2), 76 Stat. 977, 1035; Feb. 26, 1964, Pub. L. 88-272, title II, § 231(b)(2), 78 Stat. 105; Aug. 22, 1964, Pub. L. 88-484, § 1(b)(1), 78 Stat. 597; Sept. 12, 1966, Pub. L. 89-570, § 1(b)(2), 80 Stat. 762; Nov. 13, 1966, Pub. L. 89-809, title I, § 104(f), 80 Stat. 1559; Dec. 30, 1969, Pub. L. 91-172, title II, § 211(b)(1), (2), title IX, § 905(b)(2), 83 Stat. 570, 714.)

AMENDMENTS

1969—Subsec. (b)(1)(B)(ii). Pub. L. 91-172, §§ 211(b)(1), 905(b)(2), substituted "1250(a), 1251(c), or 1252(a)" for "or 1250(a)" and inserted reference to section 311(a).

Subsec. (d)(2)(B). Pub. L. 91-172, §§ 211(b)(2), 905(b)(2), substituted "1250(a), 1251(c), or 1252(a)", for "or 1250(a)" and inserted reference to section 311(a).

1966—Subsec. (b)(1)(B)(ii). Pub. L. 89-570 included reference to section 617(d)(1).

Subsec. (b)(1)(C). Pub. L. 89-809 substituted "gross income which is effectively connected with the conduct of a trade or business within the United States" for "gross income from sources within the United States" in clause (i), "gross income which is not effectively connected with the conduct of a trade or business within the United States" for "gross income from sources without the United States" in clause (ii), and added material following clause (ii) setting out the treatment to be accorded gross income for any period before the first taxable year beginning after December 31, 1966.

Subsec. (d)(2)(B). Pub. L. 89-570 included reference to section 617(d)(1).

1964—Subsec. (b). Pub. L. 88-484 included the amount of the gain recognized under section 341(f).

Pub. L. 88-272 inserted reference to section 1250(a).

Subsec. (d). Pub. L. 88-484 included the amount of the gain recognized under section 341(f).

Pub. L. 88-272 inserted reference to section 1250(a).

1962—Subsec. (b)(1)(B). Pub. L. 87-834, § 13(f)(2), substituted "subsection (b) or (c) of section 311 or under section 1245(a)" for "subsection (b) or (c) of section 311."

Subsec. (b)(1)(C). Pub. L. 87-834, § 5(a), added subsec. (b)(1)(C).

Subsec. (d)(2). Pub. L. 87-834, § 13(f)(2), substituted "subsection (b) or (c) of section 311 or under section 1245(a)" for "subsection (b) or (c) of section 311."

Subsec. (d)(3). Pub. L. 87-834, § 5(b), added subsec. (d)(3).

Subsec. (f). Pub. L. 87-403 added subsec. (f). Former subsec. (f) redesignated (g).

Subsec. (g). Pub. L. 87-403 redesignated former subsec. (f) as (g).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsecs. (b) and (d) by section 211(b)(1), (2) of Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1969, see section 211(c) of Pub. L. 91-172, set out as a note under section 1251 of this title.

Amendment of subsecs. (b) and (d) by section 905(b)(2) of Pub. L. 91-172 effective with respect to distributions made after Nov. 30, 1969, see section 905(c) of Pub. L. 91-172, set out as a note under section 311 of this title.

EFFECTIVE DATE OF 1966 AMENDMENTS

Amendment of section by Pub. L. 89-809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

Amendment of section by Pub. L. 89-570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 89-570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Amendment of section by Pub. L. 88-484 applicable with respect to transactions after Aug. 22, 1964, in taxable years ending after such date, see section 2 of Pub. L. 88-484, set out as a note under section 341 of this title.

Amendment of section by Pub. L. 88-272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 231(c) of Pub. L. 88-272, set out as a note under section 1250 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of subsecs. (b)(1)(B), (d)(2) of this section by Pub. L. 87-834 applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87-834, set out as a note under section 1245 of this title.

Section 5(d) of Pub. L. 87-834 provided that: "The amendments made by this section [adding subsecs. (b)(1)(C) and (d)(3) of this section and amending section 245 of this title] shall apply to distributions made after December 31, 1962."

Section 2(b) of Pub. L. 87-403 provided that: "The amendments made by this section [to subsecs. (f) and (g) of this section] shall apply only with respect to distributions made after the date of the enactment of this Act [Feb. 2, 1962]."

CROSS REFERENCES

Collapsible corporations, treatment of gain to shareholders, see section 341 of this title.

Controlled corporations, additional consideration received in distribution of stock and securities, see section 356(b) of this title.

Disposition of "section 306 stock" as a redemption, see section 306(a)(2) of this title.

Dividend, definition of, see section 316.

Gain or loss on disposition of property, generally, see section 1001 et seq. of this title.

Non-application of section to distributions of property in corporate liquidation, see section 331 of this title.

Stock and stock rights, see section 305 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 245, 279, 305, 306, 312, 316, 331, 341, 356, 535, 545, 556, 561, 877, 1111, 2107, 2501 of this title.

§ 302. Distributions in redemption of stock.

(a) General rule.

If a corporation redeems its stock (within the meaning of section 317 (b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) Redemptions treated as exchanges.

(1) Redemptions not equivalent to dividends.

Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) Substantially disproportionate redemption of stock.

(A) In general.

Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

(B) Limitation.

This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) Definitions.

For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of—

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) Series of redemptions.

This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) Termination of shareholder's interest.

Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

(4) Stock issued by railroad corporations in certain reorganizations.

Subsection (a) shall apply if the redemption is of stock issued by a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act, as amended) pursuant to a plan of reorganization under section 77 of the Bankruptcy Act.

(5) Application of paragraphs.

In determining whether a redemption meets the requirements of paragraph (1), the fact that such redemption fails to meet the requirements of paragraph (2), (3), or (4) shall not be taken into account. If a redemption meets the requirements of paragraph (3) and also the requirements of paragraph (1), (2), or (4), then so much of subsection (c) (2) as would (but for this sentence) apply in respect of the acquisition of an interest in the corporation within the 10-year period beginning on the date of the distribution shall not apply.

(c) Constructive ownership of stock.

(1) In general.

Except as provided in paragraph (2) of this subsection, section 318 (a) shall apply in determining the ownership of stock for purposes of this section.

(2) For determining termination of interest.

(A) In the case of a distribution described in subsection (b) (3), section 318 (a) (1) shall not apply if—

(i) immediately after the distribution the distributee has no interest in the corporation (including an interest as officer, director, or employee), other than an interest as a creditor,

(ii) the distributee does not acquire any such interest (other than stock acquired by bequest or inheritance) within 10 years from the date of such distribution, and

(iii) the distributee, at such time and in such manner as the Secretary or his delegate by regulations prescribes, files an agreement to notify the Secretary or his delegate of any acquisition described in clause (ii) and to retain such records as may be necessary for the application of this paragraph.

If the distributee acquires such an interest in the corporation (other than by bequest or inheritance) within 10 years from the date of the distribution, then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment and the collection by levy or a proceeding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting from such acquisition, include one year immediately following the date on which the distributee (in accordance with regulations prescribed by the Secretary or his delegate) notifies the Secretary or his delegate of such acquisition; and such assessment and collection may be made notwithstanding any provision of law or rule of law which otherwise would prevent such assessment and collection.

(B) Subparagraph (A) of this paragraph shall not apply if—

(i) any portion of the stock redeemed was acquired, directly or indirectly, within the 10-year period ending on the date of the distribution by the distributee from a person the ownership of whose stock would (at the time of distribution) be attributable to the distributee under section 318 (a), or

(ii) any person owns (at the time of the distribution) stock the ownership of which is attributable to the distributee under section 318 (a) and such person acquired any stock in the corporation, directly or indirectly, from the distributee within the 10-year period ending on the date of the distribution, unless such stock so acquired from the distributee is redeemed in the same transaction.

The preceding sentence shall not apply if the acquisition (or, in the case of clause (ii), the disposition) by the distributee did not have as one of its principal purposes the avoidance of Federal income tax.

(d) Redemptions treated as distributions of property.

Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317 (b)), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

(e) Cross references.

For special rules relating to redemption—

(1) Death Taxes.—Of stock to pay death taxes, see section 303.

(2) Section 306 Stock.—Of section 306 stock, see section 306.

(3) Liquidations.—Of stock in partial or complete liquidation, see section 331.

(Aug. 16, 1954, ch. 736, 68A Stat. 85.)

REFERENCES IN TEXT

Section 77 of the Bankruptcy Act, referred to in subsec. (b)(4), is classified to section 205 of Title 11, Bankruptcy.

SAVINGS PROVISIONS

Applicability of subsec. (b)(1) to the determination of gross investment income under sections 4940 and 4948(a) of this title, see section 101(*l*)(8) of Pub. L. 91-172, set out as a note under section 4940 of this title.

CROSS REFERENCES

Disposition of stock to which this section applies, see section 306 (b) of this title.

Distribution of property, see section 301 of this title.

Earnings and profits, special rule for certain redemptions, see section 312 (e) of this title.

Partial liquidation defined, treatment of certain redemptions, see section 346 (c) of this title.

Redemption through use of related corporations, see section 304 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 304, 306, 311, 312, 346, 1246, 1248 of this title.

§ 303. Distributions in redemption of stock to pay death taxes.

(a) In general.

A distribution of property to a shareholder by a corporation in redemption of part or all of the stock of such corporation which (for Federal estate tax purposes) is included in determining the gross estate of a decedent, to the extent that the amount of such distribution does not exceed the sum of—

(1) the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of such decedent's death, and

(2) the amount of funeral and administration expenses allowable as deductions to the estate under section 2053 (or under section 2106 in the case of the estate of a decedent nonresident, not a citizen of the United States),

shall be treated as a distribution in full payment in exchange for the stock so redeemed.

(b) Limitations on application of subsection (a).

(1) Period for distribution.

Subsection (a) shall apply only to amounts distributed after the death of the decedent and—

(A) within the period of limitations provided in section 6501 (a) for the assessment of the Federal estate tax (determined without the application of any provision other than section 6501 (a)), or within 90 days after the expiration of such period, or

(B) if a petition for redetermination of a deficiency in such estate tax has been filed with the Tax Court within the time prescribed in section 6213, at any time before the expiration of 60 days after the decision of the Tax Court becomes final.

(2) Relationship of stock to decedent's estate.

(A) In general.

Subsection (a) shall apply to a distribution by a corporation only if the value (for Federal estate tax purposes) of all the stock of such corporation which is included in determining the value of the decedent's gross estate is either—

(i) more than 35 percent of the value of the gross estate of such decedent, or

(ii) more than 50 percent of the taxable estate of such decedent.

(B) Special rule for stock of two or more corporations.

For purposes of the 35 percent and 50 percent requirements of subparagraph (A), stock of two or more corporations, with respect to each of which there is included in determining the value of the decedent's gross estate more than 75 percent in value of the outstanding stock, shall be treated as the stock of a single corporation. For the purpose of the 75 percent requirement of the preceding sentence, stock which, at the decedent's death, represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property shall be treated as having been included in determining the value of the decedent's gross estate.

(c) Stock with substituted basis.

If—

(1) a shareholder owns stock of a corporation (referred to in this subsection as "new stock") the basis of which is determined by reference to the basis of stock of a corporation (referred to in this subsection as "old stock"),

(2) the old stock was included (for Federal estate tax purposes) in determining the gross estate of a decedent, and

(3) subsection (a) would apply to a distribution of property to such shareholder in redemption of the old stock,

then, subject to the limitation specified in subsection (b) (1), subsection (a) shall apply in respect of a distribution in redemption of the new stock. (Aug. 16, 1954, ch. 736, 68A Stat. 88.)

CROSS REFERENCES

Distributions in redemption of stock, see section 302 of this title.

Earnings and profits, special rule for certain redemptions, see section 312 (e) of this title.

Redemption through use of related corporations, see section 304 of this title.

Special limitations on net operating loss carryovers, exception for decrease resulting from redemption to pay death taxes, see section 382 (a) (1) (B) (ii) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 304, 311, 312, 382, 537, 1248, 6166 of this title.

§ 304. Redemption through use of related corporations.

(a) Treatment of certain stock purchases.

(1) Acquisition by related corporation (other than subsidiary).

For purposes of sections 302 and 303, if—

(A) one or more persons are in control of each of two corporations, and

(B) in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control,

then (unless paragraph (2) applies) such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock. In any such case, the stock so acquired shall be treated as having been transferred by the person from whom acquired, and as having been received by the corporation acquiring it, as a contribution to the capital of such corporation.

(2) Acquisition by subsidiary.

For purposes of sections 302 and 303, if—

(A) in return for property, one corporation acquires from a shareholder of another corporation stock in such other corporation, and

(B) the issuing corporation controls the acquiring corporation, then such property shall be treated as a distribution in redemption of the stock of the issuing corporation.

(b) Special rules for application of subsection (a).

(1) Rule for determinations under section 302 (b).

In the case of any acquisition of stock to which subsection (a) of this section applies, determinations as to whether the acquisition is, by reason of section 302 (b), to be treated as a distribution in part or full payment in exchange for the stock shall be made by reference to the stock of the issuing corporation. In applying section 318 (a) (relating to constructive ownership of stock) with respect to section 302(b) for purposes of this paragraph, sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

(2) Amount constituting dividend.

(A) Where subsection (a) (1) applies.

In the case of any acquisition of stock to which paragraph (1) (and not paragraph (2)) of subsection (a) of this section applies, the determination of the amount which is a dividend shall be made solely by reference to the earnings and profits of the acquiring corporation.

(B) Where subsection (a) (2) applies.

In the case of any acquisition of stock to which subsection (a) (2) of this section applies, the determination of the amount which is a dividend shall be made as if the property were distributed by the acquiring corporation to the issuing corporation and immediately thereafter distributed by the issuing corporation.

(c) Control.

(1) In general.

For purposes of this section, control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock. If a person (or persons) is in control (within the meaning of the preceding sentence) of a corporation which in turn owns at least 50 percent of the total combined voting power of all stock entitled to vote of another corporation, or owns at least 50 percent of the total value of the shares of all classes of stock of another corporation, then such person (or persons) shall be treated as in control of such other corporation.

(2) Constructive ownership.

Section 318(a) relating to the constructive ownership of stock) shall apply for purposes of determining control under paragraph (1). For purposes of the preceding sentence, sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

(Aug. 16, 1954, ch. 736, 68A Stat. 89; Aug. 31, 1964, Pub. L. 88–554, § 4(b)(1), 78 Stat. 763.)

AMENDMENTS

1964—Subsec. (b)(1). Pub. L. 88–554 inserted the reference to section 318(a)(3)(C) of this title.

Subsec. (c)(2). Pub. L. 88–554 inserted the reference to section 318(a)(3)(C) of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by section 4 of Pub. L. 88–554 effective Aug. 31, 1964, except that for purposes of this section and section 302 of this title, such amendments shall not apply to distributions in payment for stock acquisitions or redemptions, if such acquisition or redemption occurred before Aug. 31, 1964, see section 4(c) of Pub. L. 88–554 set out as a note under section 318 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 391, 6166 of this title.

§ 305. Distributions of stock and stock rights.

(a) General rule.

Except as otherwise provided in this section, gross income does not include the amount of any distribution of the stock of a corporation made by such corporation to its shareholders with respect to its stock.

(b) Exceptions.

Subsection (a) shall not apply to a distribution by a corporation of its stock, and the distribution shall

be treated as a distribution of property to which section 301 applies—

(1) Distributions in lieu of money.

If the distribution is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either—

(A) in its stock, or

(B) in property.

(2) Disproportionate distributions.

If the distribution (or a series of distributions of which such distribution is one) has the result of—

(A) the receipt of property by some shareholders, and

(B) an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the corporation.

(3) Distributions of common and preferred stock.

If the distribution (or a series of distributions of which such distribution is one) has the result of—

(A) the receipt of preferred stock by some common shareholders, and

(B) the receipt of common stock by other common shareholders.

(4) Distributions on preferred stock.

If the distribution is with respect to preferred stock, other than an increase in the conversion ratio of convertible preferred stock made solely to take account of a stock dividend or stock split with respect to the stock into which such convertible stock is convertible.

(5) Distributions of convertible preferred stock.

If the distribution is of convertible preferred stock, unless it is established to the satisfaction of the Secretary or his delegate that such distribution will not have the result deseribed in paragraph (2).

(c) Certain transactions treated as distributions.

For purposes of this section and section 301, the Secretary or his delegate shall prescribe regulations under which a change in conversion ratio, a change in redemption price, a difference between redemption price and issue price, a redemption which is treated as a distribution to which section 301 applies, or any transaction (including a recapitalization) having a similar effect on the interest of any shareholder shall be treated as a distribution with respect to any shareholder whose proportionate interest in the earnings and profits or assets of the corporation is increased by such change, difference, redemption, or similar transaction.

(d) Definitions.

(1) Rights to acquire stock.

For purposes of this section, the term "stock" includes rights to acquire such stock.

(2) Shareholders.

For purposes of subsections (b) and (c), the term "shareholder" includes a holder of rights or of convertible securities.

(e) Cross references.

For special rules—

(1) Relating to the receipt of stock and stock rights in corporate organizations and reorganizations, see part III (sec. 351 and following).

(2) In the case of a distribution which results in a gift, see section 2501 and following.

(3) In the case of a distribution which has the effect of the payment of compensation, see section 61 (a) (1).

(Aug. 16, 1954, ch. 736, 68A Stat. 90; Dec. 30, 1969, Pub. L. 91–172, title IV, § 421(a), 83 Stat. 614.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 substituted reference to this section, for reference to subsec. (b), and omitted reference to rights to acquire its stock.

Subsec. (b). Pub. L. 91–172 omitted reference to rights to acquire its stock, in the material preceding par. (1), redesignated former par. (2) as par. (I) and added pars. (2) to (5). Former par. (1) providing for the extent to which distribution of preference dividends were to be treated as distribution of property to which section 301 applied, was stricken.

Subsec. (c). Pub. L. 91–172 added subsec. (c). Former subsec. (c) was redesignated as subsec. (e).

Subsec. (d). Pub. L. 91–172 added subsec. (d).

Subsec. (e). Pub. L. 91–172 redesignated former subsec. (c) as (e).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 421(b) of Pub. L. 91–172 provided that:

"(1) Except as otherwise provided in this subsection, the amendment made by subsection (a) [amending this section] shall apply with respect to distributions (or deemed distributions) made after January 10, 1969, in taxable years ending after such date.

"(2)(A) Section 305(b)(2) of the Internal Revenue Code of 1954 (as added by subsection (a)) [subsec. (b)(2) of this section] shall not apply to a distribution (or deemed distribution) of stock made before January 1, 1991, with respect to stock (i) outstanding on January 10, 1969, (ii) issued pursuant to a contract binding on January 10, 1969, on the distributing corporation, (iii) which is additional stock of that class of stock which (as of January 10, 1969) had the largest fair market value of all classes of stock of the corporation (taking into account only stock outstanding on January 10, 1969, or issued pursuant to a contract binding on January 10, 1969), (iv) described in subparagraph (C) (iii), or (v) issued in a prior distribution described in clause (i), (ii), (iii), or (iv).

"(B) Subparagraph (A) shall apply only if—

"(i) the stock as to which there is a receipt of property was outstanding on January 10, 1969 (or was issued pursuant to a contract binding on January 10, 1969, on the distributing corporation), and

(ii) if such stock and any stock described in subparagraph (A)(i) were also outstanding on January 10, 1968, a distribution of property was made on or before January 10, 1969, with respect to such stock, and a distribution of stock was made on or before January 10, 1969, with respect to such stock described in subparagraph (A)(i).

"(C) Subparagraph (A) shall cease to apply when at any time after October 9, 1969, the distributing corporation issues any of its stock (other than in a distribution of stock with respect to stock of the same class) which is not—

"(i) nonconvertible preferred stock,

"(ii) additional stock of that class of stock which meets the requirements of subparagraph (A)(iii), or

"(iii) preferred stock which is convertible into stock which meets the requirements of subparagraph (A)(iii) at a fixed conversion ratio which takes account of all stock dividends and stock splits with respect to the stock into which such convertible stock is convertible.

"(D) For purposes of this paragraph, the term 'stock' includes rights to acquire such stock.

"(3) In cases to which Treasury Decision 6990 (promulgated January 10, 1969) would not have applied, in applying paragraphs (1) and (2) April 22, 1969, shall be substituted for January 10, 1969.

"(4) Section 305(b)(4) of the Internal Revenue Code of 1954 (as added by subsection (a)) [subsec. (b)(4) of this section] shall not apply to any distribution (or deemed distribution) with respect to preferred stock (including any increase in the conversion ratio of convertible stock) made before January 1, 1991, pursuant to the terms

relating to the issuance of such stock which were in effect on January 10, 1969.

"(5) With respect to distributions made or considered as made after January 10, 1969, in taxable years ending after such date, to the extent that the amendment made by subsection (a) [amending this section] does not apply by reason of paragraph (2), (3), or (4) of this subsection, section 305 of the Internal Revenue Code of 1954 [this section] (as in effect before the amendment made by subsection (a)) shall continue to apply."

CROSS REFERENCES

Basis of stock and stock rights acquired in a distribution to which this section applies, see section 307 of this title.

Definition of "section 306 stock" as including stock distributions not includible as gross income by reason of this section, see section 306 (c) of this title.

Earnings and profits, distributions not subject to tax by reason of this section, see section 312 (d) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 306, 307, 312, 425, 1101 of this title.

§ 306. Dispositions of certain stock.

(a) General rule.

If a shareholder sells or otherwise disposes of section 306 stock (as defined in subsection (c))—

(1) Dispositions other than redemptions.

If such disposition is not a redemption (within the meaning of section 317 (b))—

(A) The amount realized shall be treated as gain from the sale of property which is not a capital asset. This subparagraph shall not apply to the extent that—

(i) the amount realized, exceeds

(ii) such stock's ratable share of the amount which would have been a dividend at the time of distribution if (in lieu of section 306 stock) the corporation had distributed money in an amount equal to the fair market value of the stock at the time of distribution.

(B) Any excess of the amount realized over the sum of—

(i) the amount treated under subparagraph (A) as gain from the sale of property which is not a capital assets, plus

(ii) the adjusted basis of the stock, shall be treated as gain from the sale of such stock.

(C) No loss shall be recognized.

(2) Redemption.

If the disposition is a redemption, the amount realized shall be treated as a distribution of property to which section 301 applies.

(b) Exceptions.

Subsection (a) shall not apply—

(1) Termination of shareholder's interest.

(A) Not in redemption.

If the disposition—

(i) is not a redemption;

(ii) is not, directly or indirectly, to a person the ownership of whose stock would (under section 318 (a)) be attributable to the shareholder; and

(iii) terminates the entire stock interest of the shareholder in the corporation (and for purposes of this clause, section 318 (a) shall apply).

(B) In redemption.

If the disposition is a redemption and section 302 (b) (3) applies.

(2) Liquidations.

If the section 306 stock is redeemed in a distribution in partial or complete liquidation to which part II (sec. 331 and following) applies.

(3) Where gain or loss is not recognized.

To the extent that, under any provision of this subtitle, gain or loss to the shareholder is not recognized with respect to the disposition of the section 306 stock.

(4) Transactions not in avoidance.

If it is established to the satisfaction of the Secretary or his delegate—

(A) that the distribution, and the disposition or redemption, or

(B) in the case of a prior or simultaneous disposition (or redemption) of the stock with respect to which the section 306 stock disposed of (or redeemed) was issued, that the disposition (or redemption) of the section 306 stock,

was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

(c) Section 306 stock defined.

(1) In general.

For purposes of this subchapter, the term "section 306 stock" means stock which meets the requirements of subparagraph (A), (B), or (C) of this paragraph.

(A) Distributed to seller.

Stock (other than common stock issued with respect to common stock) which was distributed to the shareholder selling or otherwise disposing of such stock if, by reason of section 305 (a), any part of such distribution was not includible in the gross income of the shareholder.

(B) Received in a corporate reorganization or separation.

Stock which is not common stock and—

(i) which was received, by the shareholder selling or otherwise disposing of such stock, in pursuance of a plan of reorganization (within the meaning of seotion-368 (a)), or in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applied, and

(ii) with respect to the receipt of which gain or loss to the shareholder was to any extent not recognized by reason of part III, but only to the extent that either the effect of the transaction was substantially the same as the receipt of a stock dividend, or the stock was received in exchange for section 306 stock.

For purposes of this section, a receipt of stock to which the foregoing provisions of this subparagraph apply shall be treated as a distribution of stock.

(C) Stock having transferred or substituted basis.

Except as otherwise provided in subparagraph (B), stock the basis of which (in the hands of the shareholder selling or otherwise disposing

of such stock) is determined by reference to the basis (in the hands of such shareholder or any other person) of section 306 stock.

(2) Exception where no earnings and profits.

For purposes of this section, the term "section 306 stock" does not include any stock no part of the distribution of which would have been a dividend at the time of the distribution if money had been distributed in lieu of the stock.

(d) Stock rights.

For purposes of this section—

(1) stock rights shall be treated as stock, and

(2) stock acquired through the exercise of stock rights shall be treated as stock distributed at the time of the distribution of the stock rights, to the extent of the fair market value of such rights at the time of the distribution.

(e) Convertible stock.

For purposes of subsection (c)—

(1) if section 306 stock was issued with respect to common stock and later such section 306 stock is exchanged for common stock in the same corporation (whether or not such exchange is pursuant to a conversion privilege contained in the section 306 stock), then (except as provided in paragraph (2)) the common stock so received shall not be treated as section 306 stock; and

(2) common stock with respect to which there is a privilege of converting into stock other than common stock (or into property), whether or not the conversion privilege is contained in such stock, shall not be treated as common stock.

(f) Source of gain.

The amount treated under subsection (a) (1) (A) as gain from the sale of property which is not a capital asset shall, for purposes of part I of subchapter N (sec. 861 and following, relating to determination of sources of income), be treated as derived from the same source as would have been the source if money had been received from the corporation as a dividend at the time of the distribution of such stock. If under the preceding sentence such amount is determined to be derived from sources within the United States, such amount shall be considered to be fixed or determinable annual or periodical gains, profits, and income within the meaning of section 871 (a) or section 881 (a), as the case may be.

(g) Change in terms and conditions of stock.

If a substantial change is made in the terms and conditions of any stock, then, for purposes of this section—

(1) the fair market value of such stock shall be the fair market value at the time of the distribution or at the time of such change, whichever such value is higher;

(2) such stock's ratable share of the amount which would have been a dividend if money had been distributed in lieu of stock shall be determined as of the time of distribution or as of the time of such change, whichever such ratable share is higher; and

(3) subsection (c) (2) shall not apply unless the stock meets the requirements of such subsection both at the time of such distribution and at the time of such change.

(h) Stock received in distributions and reorganizations to which 1939 Code applied.

If stock—

(1) was received in a distribution or reorganization to which the Internal Revenue Code of 1939 (or the corresponding provisions of prior law) applied,

(2) such stock would have been section 306 stock if this Code applied to such distribution or reorganization, and

(3) such stock is disposed of or redeemed on or after June 22, 1954,

then the foregoing subsections of this section shall not apply in respect of such disposition or redemption. The extent to which such disposition or redemption shall be treated as a dividend shall be determined as if the Internal Revenue Code of 1939 (as modified by the provisions of this Code other than the foregoing subsections of this section) continued to apply in respect of such disposition or redemption. (Aug. 16, 1954, ch. 736, 68A Stat. 89.)

CROSS REFERENCES

Constructive ownership of stock, see section 318 of this title.

Distributions in redemption of stock, see section 302 of this title.

Effective date, section 306 shall apply only with respect to dispositions (or redemptions) occurring on or after June 22, 1954, see section 391 of this title.

Receipt of additional consideration, exchanges for section 306 stock, see section 356 (e) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 356, 391 of this title.

§ 307. Basis of stock and stock rights acquired in distributions.

(a) General rule.

If a shareholder in a corporation receives its stock or rights to acquire its stock (referred to in this subsection as "new stock") in a distribution to which section 305 (a) applies, then the basis of such new stock and of the stock with respect to which it is distributed (referred to in this section as "old stock"), respectively, shall, in the shareholder's hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock. Such allocation shall be made under regulations prescribed by the Secretary or his delegate.

(b) Exception for certain stock rights.

(1) In general.

If—

(A) a corporation distributes rights to acquire its stock to a shareholder in a distribution to which section 305 (a) applies, and

(B) the fair market value of such rights at the time of the distribution is less than 15 percent of the fair market value of the old stock at such time,

then subsection (a) shall not apply and the basis of such rights shall be zero, unless the taxpayer elects under paragraph (2) of this subsection to determine the basis of the old stock and of the stock rights under the method of allocation provided in subsection (a).

(2) Election.

The election referred to in paragraph (1) shall be made in the return filed within the time prescribed by law (including extensions thereof) for the taxable year in which such rights were received. Such election shall be made in such manner as the Secretary or his delegate may by regulations prescribe, and shall be irrevocable when made.

(c) Cross reference.

For basis of stock and stock rights distributed before June 22, 1954, see section 1052.

(Aug. 16, 1954, ch. 736, 68A Stat. 93.)

CROSS REFERENCES

Capital gains and losses, determination of period for which taxpayer has held stock or rights to acquire stock received on a distribution, if basis is determined under this section, see section 1223 (5) of this title.

Corporate—

Liquidations, basis of property received in corporate liquidations, see section 334 of this title.

Organizations, basis to distributees, see section 358 of this title.

Effect on earnings and profits of receipt of tax free distributions, see section 312 (f) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 312, 1223 of this title.

SUBPART B.—EFFECTS ON CORPORATION

Sec.
311. Taxability of corporation on distribution.
312. Effect on earnings and profits.

§ 311. Taxability of corporation on distribution.

(a) General rule.

Except as provided in subsections (b), (c), and (d) of this section and section 453(d), no gain or loss shall be recognized to a corporation on the distribution, with respect to its stock, of—

(1) its stock (or rights to acquire its stock), or

(2) property.

(b) LIFO inventory.

(1) Recognition of gain.

If a corporation inventorying goods under the method provided in section 472 (relating to last-in, first-out inventories) distributes inventory assets (as defined in paragraph (2) (A)), then the amount (if any) by which—

(A) the inventory amount (as defined in paragraph (2) (B)) of such assets under a method authorized by section 471 (relating to general rule for inventories), exceeds

(B) the inventory amount of such assets under the method provided in section 472,

shall be treated as gain to the corporation recognized from the sale of such inventory assets.

(2) Definitions.

For purposes of paragraph (1)—

(A) Inventory assets.

The term "inventory assets" means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(B) Inventory amount.

The term "inventory amount" means, in the case of inventory assets distributed during a taxable year, the amount of such inventory assets determined as if the taxable year closed at the time of such distribution.

(3) Method of determining inventory amount.

For purposes of this subsection, the inventory amount of assets under a method authorized by section 471 shall be determined—

(A) if the corporation uses the retail method of valuing inventories under section 472, by using such method, or

(B) if subparagraph (A) does not apply, by using cost or market, whichever is lower.

(c) Liability in excess of basis.

If—

(1) a corporation distributes property to a shareholder with respect to its stock,

(2) such property is subject to a liability, or the shareholder assumes a liability of the corporation in connection with the distribution, and

(3) the amount of such liability exceeds the adjusted basis (in the hands of the distributing corporation) of such property,

then gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. In the case of a distribution of property subject to a liability which is not assumed by the shareholder, the amount of gain to be recognized under the preceding sentence shall not exceed the excess, if any, of the fair market value of such property over its adjusted basis.

(d) Appreciated property used to redeem stock.

(1) In general.

If—

(A) a corporation distributes property (other than an obligation of such corporation) to a shareholder in a redemption (to which subpart A applies) of part or all of his stock in such corporation, and

(B) the fair market value of such property exceeds its adjusted basis (in the hands of the distributing corporation),

then again shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. Subsections (b) and (c) shall not apply to any distribution to which this subsection applies.

(2) Exceptions and limitations.

Paragraph (1) shall not apply to—

(A) a distribution in complete redemption of all of the stock of a shareholder who, at all times within the 12-month period ending on the date of such distribution, owns at least 10 percent in value of the outstanding stock of the distributing corporation, but only if the redemption qualifies under section 302(b)(3) (determined without the application of section 302(c)(2)(A)(ii));

(B) a distribution of stock or an obligation of a corporation—

(i) which is engaged in at least one trade or business,

(ii) which has not received property constituting a substantial part of its assets from the distributing corporation. in a transaction

to which section 351 applied or as a contribution to capital, within the 5-year period ending on the date of the distribution, and

(iii) at least 50 percent in value of the outstanding stock of which is owned by the distributing corporation at any time within the 9-year period ending one year before the date of the distribution;

(C) a distribution before December 1, 1974, of stock of a corporation substantially all of the assets of which the distributing corporation (or a corporation which is a member of the same affiliated group (as defined in section 1504(a)) as the distributing corporation) held on November 30, 1969, if such assets constitute a trade or business which has been actively conducted throughout the one-year period ending on the date of the distribution;

(D) a distribution of stock or securities pursuant to the terms of a final judgment rendered by a court with respect to the distributing corporation in a court proceeding under the Sherman Act (26 Stat. 209; 15 U.S.C. 1–7) or the Clayton Act (38 Stat. 730; 15 U.S.C. 12–27), or both, to which the United States is a party, but only if the distribution of such stock or securities in redemption of the distributing corporation's stock is in furtherance of the purposes of the judgment;

(E) a distribution to the extent that section 303(a) (relating te distribuions in redempion of stock to pay death taxes) applies to such distribution;

(F) a distribution to a private foundation in redemption of stock which is described in section 537(b)(2) (A) and (B); and

(G) a distribution by a corporation to which part I of subchapter M (relating to regulated investment companies) applies, if such distribution is in redemption of its stock upon the demand of the shareholder.

(Aug. 16, 1954, ch. 736, 68A Stat. 94; Dec. 30, 1969, Pub. L. 91–172, title IX, § 905(a), (b)(1), 83 Stat. 713, 714.)

REFERENCES IN TEXT

The Sherman Act (26 Stat. 209; 15 U.S.C. 1–7) and the Clayton Act (38 Stat. 730; 15 U.S.C. 12–27), referred to in subsec. (d)(2)(D), are classified, respectively, to sections 1 to 7 and 12 to 27 of Title 15, Commerce and Trade.

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 905(b)(1), inserted reference to subsec. (d).

Subsec. (d). Pub. L. 91–172, § 905(a), added subsec. (d).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 905(c) of Pub. L. 91–172, as amended by Pub. L. 91–675, Jan. 12, 1971, 84 Stat. 2059, provided that:

"(1) Except as provided in paragraphs (2), (3), (4), and (5), the amendments made by subsections (a) and (b) [adding subsec. (d) of this section and amending sections 301(b)(1)(B)(ii), (d)(2)(B) and 312(c)(3) of this title] shall apply with respect to distributions after November 30, 1969.

"(2) The amendments made by subsections (a) and (b) shall not apply to a distribution before April 1, 1970, pursuant to the terms of—

"(A) a written contract which was binding on the distributing corporation on November 30, 1969, and at all times thereafter before the distribution,

"(B) an offer made by the distributing corporation before December 1, 1969,

"(C) an offer made in accordance with a request for a ruling filed by the distributing corporation with the Internal Revenue Service before December 1, 1969, or

"(D) an offer made in accordance with a registration statement filed with the Securities and Exchange Commission before December 1, 1969.

For purposes of subparagraphs (B), (C), and (D), an offer shall be treated as an offer only if it was in writing and not revocable by its express terms.

"(3) The amendments made by subsections (a) and (b) [adding subsec. (d) of this section and amending sections 301(b)(1)(B)(ii), (d)(2)(B), and 312(c)(3) of this title] shall not apply to a distribution by a corporation of specific property in redemption of stock outstanding on November 30, 1969, if—

"(A) every holder of such stock on such date had the right to demand redemption of his stock in such specific property, and

"(B) the corporation had such specific property on hand on such date in a quantity sufficient to redeem all of such stock.

For purposes of the preceding sentence, stock shall be considered to have been outstanding on November 30, 1969, if it could have been acquired on such date through the exercise of an existing right of conversion contained in other stock held on such date.

"(4) The amendments made by subsections (a) and (b) [adding subsec. (d), of this section and amending sections 301(b)(1)(B)(ii), (d)(2)(B), and 312(c)(3) of this title] shall not apply to a distribution by a corporation of property (held on December 1, 1969, by the distributing corporation or a corporation which was a wholly owned subsidiary of the distributing corporation on such date) in redemption of stock outstanding on November 30, 1969, which is redeemed and canceled before July 31, 1971, if—

"(A) such redemption is pursuant to a resolution adopted before November 1, 1969, by the Board of Directors authorizing the redemption of a specific amount of stock constituting more than 10 percent of the outstanding stock of the corporation at the time of the adoption of such resolution; and

"(B) more than 40 percent of the stock authorized to be redeemed pursuant to such resolution was redeemed before December 30, 1969, and more than one-half of the stock so redeemed was redeemed with property other than money.

"(5) The amendments made by subsections (a) and (b) [adding subsec. (d) of this section and amending sections 301(b)(1)(B)(ii), (d)(2)(B) and 312(c)(3) of this title] shall not apply to a distribution of stock, by a corporation organized prior to December 1, 1969, for the principal purpose of providing an equity participation plan for employees of the corporation whose stock is being distributed (hereinafter referred to as the 'employer corporation') if—

"(A) the stock being distributed was owned by the distributing corporation on November 30, 1969,

"(B) the stock being redeemed was acquired before January 1, 1973, pursuant to such equity participation plan by the shareholder presenting such stock for redemption (or by a predecessor of such shareholder),

"(C) the employment of the shareholder presenting the stock for redemption (or the predecessor of such shareholder) by the employer corporation commenced before January 1, 1971,

"(D) at least 90 percent in value of the assets of the distributing corporation on November 30, 1969, consisted of common stock of the employer corporation, and

"(E) at least 50 percent of the outstanding voting stock of the employer corporation is owned by the distributing corporation at any time within the nine-year period ending one year before the date of such distribution."

CROSS REFERENCES

Corporate—

Liquidations, gain or loss on sales or exchanges with certain liquidations, see section 337 of this title.

Organizations, nonrecognition of gain or loss to corporations, see section 361 of this title.

Distributions of property, corporate distributees, see section 301 of this title.

Effect on earnings and profits, adjustment shall be made for any gain recognized under subsection (b) or (c) of this section, see section 312 (c) (3) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 301, 312 of this title.

§ 312. Effect on earnings and profits.

(a) General rule.

Except as otherwise provided in this section, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of—

(1) the amount of money,

(2) the principal amount of the obligations of such corporation, and

(3) the adjusted basis of the other property, so distributed.

(b) Certain inventory assets.

(1) In general.

On the distribution by a corporation, with respect to its stock, of inventory assets (as defined in paragraph (2) (A)) the fair market value of which exceeds the adjusted basis thereof, the earnings and profits of the corporation—

(A) shall be increased by the amount of such excess; and

(B) shall be decreased by whichever of the following is the lesser:

(i) the fair market value of the inventory assets distributed, or

(ii) the earnings and profits (as increased under subparagraph (A)).

(2) Definitions.

(A) Inventory assets.

For purposes of paragraph (1), the term "inventory assets" means—

(i) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year;

(ii) property held by the corporation primarily for sale to customers in the ordinary course of its trade or business; and

(iii) unrealized receivables or fees, except receivables from sales or exchanges of assets other than assets described in this subparagraph.

(B) Unrealized receivables or fees.

For purposes of subparagraph (A) (iii), the term "unrealized receivables or fees" means, to the extent not previously includible in income under the method of accounting used by the corporation, any rights (contractual or otherwise) to payment for—

(i) goods delivered, or to be delivered, to the extent that the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(ii) services rendered or to be rendered.

(c) Adjustments for liabilities, etc.

In making the adjustments to the earnings and profits of a corporation under subsection (a) or (b), proper adjustment shall be made for—

(1) the amount of any liability to which the property distributed is subject,

(2) the amount of any liability of the corporation assumed by a shareholder in connection with the distribution, and

(3) any gain to the corporation recognized under subsection (b), (c), or (d) of section 311, under section 341(f), or under section 617(d)(1), 1245(a), 1250(a), 1251(c), or 1252(a).

(d) Certain distributions of stock and securities.

(1) In general.

The distribution to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property, in a distribution to which this Code applies, shall not be considered a distribution of the earnings and profits of any corporation—

(A) if no gain to such distributee from the receipt of such stock or securities, or property, was recognized under this Code, or

(B) if the distribution was not subject to tax in the hands of such distributee by reason of section 305 (a).

(2) Prior distributions.

In the case of a distribution of stock or securities, or property, to which section 115 (h) of the Internal Revenue Code of 1939 (or the corresponding provision of prior law) applied, the effect on earnings and profits of such distribution shall be determined under such section 115 (h), or the corresponding provision of prior law, as the case may be.

(3) Stock or securities.

For purposes of this subsection, the term "stock or securities" includes rights to acquire stock or securities.

(e) Special rule for partial liquidations and certain redemptions.

In the case of amounts distributed in partial liquidation (whether before, on, or after June 22, 1954) or in a redemption to which section 302 (a) or 303 applies, the part of such distribution which is properly chargeable to capital account shall not be treated as a distribution of earnings and profits.

(f) Effect on earnings and profits of gain or loss and of receipt of tax-free distributions.

(1) Effect on earnings and profits of gain or loss.

The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(A) for the purpose of the computation of the earnings and profits of the corporation, shall (except as provided in subparagraph (B)) be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(B) for purposes of the computation of the earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing taxable income under the law applicable to the year in which such sale or disposition was made. Where, in determining the adjusted basis used in computing such realized gain or loss, the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. For purposes of this subsection, a loss with respect to which a deduction is disallowed under section 1091 (relating to wash sales of stock or securities), or the corresponding provision of prior law, shall not be deemed to be recognized.

(2) Effect on earnings and profits of receipt of tax-free distributions.

Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

(A) no such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made; and

(B) no such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received (or such basis would, but for section 307 (b), be so allocated).

(g) Earnings and profits—increase in value accrued before March 1, 1913.

(1) If any increase or decrease in the earnings and profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(2) If the application of subsection (f) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (f) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(h) Earnings and profits of personal service corporations.

In the case of a personal service corporation subject for any taxable year to supplement S of the Internal Revenue Code of 1939, an amount equal to the undistributed supplement S net income of the personal service corporation for its taxable year shall be considered as paid in as of the close of such taxable year as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of such taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend in the gross income of the shareholders.

(i) Allocation in certain corporate separations.

In the case of a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation (or corporations) shall be made under regulations prescribed by the Secretary or his delegate.

(j) Distribution of proceeds of loan insured by the United States.

(1) In general.

If a corporation distributes property with respect to its stock, and if, at the time of the distribution—

(A) there is outstanding a loan to such corporation which was made, guaranteed, or insured by the United States (or by any agency or instrumentality thereof), and

(B) the amount of such loan so outstanding exceeds the adjusted basis of the property constituting security for such loan,

then the earnings and profits of the corporation shall be increased by the amount of such excess, and (immediately after the distribution) shall be decreased by the amount of such excess. For purposes of subparagraph (B) of the preceding sentence, the adjusted basis of the property at the time of distribution shall be determined without regard to any adjustment under section 1016 (a) (2)) relating to adjustment for depreciation, etc.). For purposes of this paragraph, a commitment to make, guarantee, or insure a loan shall be treated as the making, guaranteeing, or insuring of a loan.

(2) Effective date.

Paragraph (1) shall apply only with respect to distributions made on or after June 22, 1954.

(k) Special adjustment on disposition of antitrust stock received as a dividend.

If a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded

the basis of the stock determined under section 301 (f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the earnings and profits of such corporation at the time such stock (or other property the basis of which is determined by reference to the basis of such stock) is disposed of by such corporation.

(*l*) Earnings and profits of foreign investment companies.

(1) Allocation within affiliated group.

In the case of a sale or exchange of stock in a foreign investment company (as defined in section 1246(b)) by a United States person (as defined in section 7701(a)(30)), if such company is a member of an affiliated group, then the accumulated earnings and profits of all members of such affiliated group shall be allocated, under regulations prescribed by the Secretary or his delegate, in such manner as is proper to carry out the purposes of section 1246.

(2) Affiliated group defined.

For purposes of paragraph (1) of this subsection, the term "affiliated group" has the meaning assigned to such term by section 1504(a); except that (A) "more than 50 percent" shall be substituted for "80 percent or more", and (B) all corporations shall be treated as includible corporations (without regard to the provisions of section 1504(b)).

(3) Partial liquidations and redemptions.

(A) In general.

If a foreign investment company (as defined in section 1246) distributes amounts in partial liquidation or in a redemption to which section 302(a) or 303 applies, the part of such distribution which is properly chargeable to earnings and profits shall be an amount which is not in excess of the ratable share of the earnings and profits of the company accumulated after February 28, 1913, attributable to the stock so redeemed.

(B) Effective date.

Subparagraph (A) shall apply only with respect to distributions made after December 31, 1962.

(m) Effect of depreciation on earnings and profits.

(1) General rule.

For purposes of computing the earnings and profits of a corporation for any taxable year beginning after June 30, 1972, the allowance for depreciation (and amortization, if any) shall be deemed to be the amount which would be allowable for such year if the straight line method of depreciation had been used for each taxable year beginning after June 30, 1972.

(2) Exceptions.

If for any taxable year beginning after June 30, 1972, a method of depreciation was used by the taxpayer which the Secretary or his delegate has determined results in a reasonable allowance under section 167(a), and which is not—

(A) a declining balance method,

(B) the sum of the years-digit method, or

(C) any other method allowable solely by reason of the application of subsection (b)(4) or (j)(1)(C) of section 167,

then the adjustment to earnings and profits for depreciation for such year shall be determined under the method so used (in lieu of under the straight line method).

(3) Certain foreign corporations.

The provisions of paragraph (1) shall not apply in computing the earnings and profits of a foreign corporation for any taxable year for which less than 20 percent of the gross income from all sources of such corporation is derived from sources within the United States.

(Aug. 16, 1954, ch. 736, 68A Stat. 95; Feb. 2, 1962, Pub. L. 87–403, § 3(a), 76 Stat. 6; Oct. 16, 1962, Pub. L. 87–834, §§ 13(f)(3), 14(b)(1), 76 Stat. 1035, 1040; Feb. 26, 1964, Pub. L. 88–272, title II, § 231 (b)(3), 78 Stat. 105; Aug. 22, 1964, Pub. L. 88–484, § 1(b)(1), 78 Stat. 597; Sept. 12, 1966, Pub. L. 89–570, § 1(b)(3), 80 Stat. 762; Dec. 30, 1969, Pub. L. 91–172, title II, § 211(b)(3), title IV, § 442(a), title IX, § 905(b)(2), 83 Stat. 570, 628, 714.)

AMENDMENTS

1969—Subsec. (c)(3). Pub. L. 91–172, §§ 211(b)(3), 905 (b)(2), substituted "1250(a), 1251(c), or 1252(a)", for "or 1250(a)" and inserted reference to section 311(d).

Subsec. (m). Pub. L. 91–172, § 442(a), added subsec. (m).

1966—Subsec. (c)(3). Pub. L. 89–570 included reference to section 617(d)(1).

1964—Subsec. (c)(3). Pub. L. 88–484 authorized adjustment for the amount of the gain recognized under section 341(f).

Pub. L. 88–272 inserted the reference to section 1250(a).

1962—Subsec. (c)(3). Pub. L. 87–834, § 13(f)(3), included any gain recognized under section 1245(a).

Subsec. (k). Pub. L. 87–403 added subsec. (k).

Subsec. (*l*). Pub. L. 87–834, § 14(b)(1), added subsec. (*l*).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (c)(3) by section 211(b)(3) of Pub. L. 91–172 applicable to taxable years beginning after December 31, 1969, see section 211(c) of Pub. L. 91–172, set out as a note under section 1251 of this title.

Amendment of subsec. (c)(3) by section 905(b)(2) Pub. L. 91–172 effective with respect to distributions made after Nov. 30, 1969, see section 905(c) of Pub. L. 91–172, set out as a note under section 311 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 89–570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Amendment of section by Pub. L. 88–484 applicable with respect to transactions after Aug. 22, 1964 in taxable years ending after such date, see section 2 of Pub. L. 88–484, set out as a note under section 341 of this title.

Amendment of section by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 231(c) of Pub. L. 88–272, set out as a note under section 1250 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of subsec. (c)(3) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

Section 3(g) of Pub. L. 87–403 provided that: "The amendments made by this section [to this section and sections 535, 543, 545, 556 and 561 of this title] shall

apply only with respect to distributions made after the date of the enactment of this Act [Feb. 2, 1962]."

Subsec. (*l*) of this section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 14(c) of Pub. L. 87–834, set out as a note under section 1246 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 964, 1111, 1248, 3122 of this title.

SUBPART C.—DEFINITIONS; CONSTRUCTIVE OWNERSHIP OF STOCK

Sec.
316. Dividend defined.
317. Other definitions.
318. Constructive ownership of stock.

§ 316. Dividend defined.

(a) General rule.

For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

(b) Special rules.

(1) Certain insurance company dividends.

The definition in subsection (a) shall not apply to the term "dividend" as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such.

(2) Distributions by personal holding companies.

(A) In the case of a corporation which—

(i) under the law applicable to the taxable year in which the distribution is made, is a personal holding company (as defined in section 542), or

(ii) for the taxable year in respect of which the distribution is made under section 563(b) (relating to dividends paid after the close of the taxable year), or section 547 (relating to deficiency dividends), or the corresponding provisions of prior law, is a personal holding company under the law applicable to such taxable year,

the term "dividend" also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by the corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 without regard to distributions under this paragraph) for such year.

(B) For purposes of subparagraph (A), the term "distribution of property" includes a distribution in complete liquidation occuring within 24 months after the adoption of a plan of liquidation, but—

(i) only to the extent of the amounts distributed to distributees other than corporate shareholders, and

(ii) only to the extent that the corporation designates such amounts as a dividend distribution and duly notifies such distributees of such designation, under regulations prescribed by the Secretary or his delegate, but

(iii) not in excess of the sum of such distributees' allocable share of the undistributed personal holding company income for such year, computed without regard to this subparagraph or section 562(b).

(Aug. 16, 1954, ch. 736, 68A Stat. 98; Mar. 13, 1956, ch. 83, § 5(1), 70 Stat. 49; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(f)(1), 78 Stat. 87.)

AMENDMENTS

1964—Subsec. (b)(2). Pub. L. 88–272 inserted the definition of "distribution of property."

1956—Subsec. (b)(1). Act Mar. 13, 1956, substituted "subchapter L" for "sections 803(e), 821(a)(2), and 832(c)(11)".

EFFECTIVE DATE OF 1964 AMENDMENT

Section 225(*l*) of Pub. L. 88–272 provided that:

"(1) The amendments made by this section [adding section 1022 and redesignating former section 1022 as 1023, amending this section, and sections 331, 333, 381, 541, 542, 543, 544, 545, 551, 553, 554, 562, 856, 1016, 1361, 6501 and the analysis preceding section 1011, and enacting provisions set out as a note under section 333 of this title] (other than by subsections (c)(1), (f), (g), and (j) [adding section 1022, redesignating former section 1022 as 1023, amending this section, and sections 331, 333, 542(c)(2), 551, 562, 1016, and the analysis preceding section 1011 of this title]) shall apply to taxable years beginning after December 31, 1963.

"(2) The amendment made by subsection (c)(1) [to section 542(c)(2) of this title] shall apply to taxable years beginning after October 16, 1962.

"(3) The amendments made by subsections (f) and (g) [to this section, and to sections 331, 333, 551 and 562 of this title] shall apply to distributions made in any taxable year of the distributing corporation beginning after December 31, 1963.

"(4) The amendments made by subsection (j) [adding section 1022, redesignating former section 1022 as 1023 amending section 1016 and the analysis preceding section 1011 of this title] shall apply in respect of decedents dying after December 31, 1963.

"(5) Subsection (h) [set out as a note under § 333 of this title] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956, applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

CROSS REFERENCES

Consent dividend as not including an amount specified in a consent which would not constitute a dividend as defined in this section, see section 565 (b) (2) of this title.

Dividends received from certain foreign corporations, deduction in amount equal to percent of dividends received out of earnings and profits specified in subsection (a)(1) of this section, see section 245(a)(2) of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

Rules applicable in determining dividends eligible for dividends paid credit deduction, see section 562 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 243, 245, 301, 331, 562, 565, 959, 1373, 1375, 6042 of this title.

§ 317. Other definitions.

(a) Property.

For purposes of this part, the term "property" means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock).

(b) Redemption of stock.

For purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired, or held as treasury stock. (Aug. 16, 1954, ch. 736, 68A Stat. 99.)

CROSS REFERENCES

Dispositions other than redemptions, see section 306 (a) (1) of this title.

Distributions of property, see section 301 of this title.

Redemptions treated as distributions of property, see section 302 (d) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 301, 302, 306, 593 of this title.

§ 318. Constructive ownership of stock.

(a) General rule.

For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable—

(1) Members of family.

(A) In general.

An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

(i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) his children, grandchildren, and parents.

(B) Effect of adoption.

For purposes of subparagraph (A) (ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

(2) Attribution from partnerships, estates, trusts, and corporations.

(A) From partnerships and estates.

Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

(B) From trusts.

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) From corporations.

If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

(3) Attribution to partnerships, estates, trusts, and corporations.

(A) To partnerships and estates.

Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate.

(B) To trusts.

(i) Stock owned, directly or indirectly, by or for a beneficiary of a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property.

(ii) Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by the trust.

(C) To corporations.

If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.

(4) Options.

If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(5) Operating rules.

(A) In general.

Except as provided in subparagraphs (B) and (C), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), or (4), shall, for purposes of applying paragraphs (1), (2), (3), and (4), be considered as actually owned by such person.

(B) Members of family.

Stock constructively owned by an individual by reason of the application of paragraph (1)

shall not be considered as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) Partnerships, estates, trusts, and corporations.

Stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of paragraph (3) shall not be considered as owned by it for purposes of applying paragraph (2) in order to make another the constructive owner of such stock.

(D) Option rule in lieu of family rule.

For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (4), it shall be considered as owned by him under paragraph (4).

(b) Cross references.

For provisions to which the rules contained in subsection (a) apply, see—
(1) section 302 (relating to redemption of stock);
(2) section 304 (relating to redemption by related corporations);
(3) section 306(b)(1)(A) (relating to disposition of section 306 stock);
(4) section 334(b)(3)(C) (relating to basis of property received in certain liquidations of subsidiaries);
(5) section 382(a)(3) (relating to special limitations on net operating loss carryovers);
(6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts);
(7) section 958(b) (relating to constructive ownership rules with respect to controlled foreign corporations); and
(8) section 6038(d)(1) (relating to information with respect to certain foreign corporations).

(Aug. 16, 1954, ch. 736, 68A Stat. 99; Sept. 14, 1960, Pub. L. 86–779, § 10(h), 74 Stat. 1009; Oct. 16, 1962, Pub. L. 87–834, § 20(d)(1), 76 Stat. 1063; Aug. 31, 1964, Pub. L. 88–554, § 4 (a), (b)(2), 78 Stat. 762, 763.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–554, § 4(a), eliminated sidewise attribution by providing that when stock is attributed to a partnership, estate, trust, or corporation from a partner, shareholder, or beneficiary, this stock is not to be attributed again to another partner, beneficiary, or shareholder.

Subsec. (b). Pub. L. 88–554, § 4(b)(2), added paragraph (7), and redesignated former paragraph (7) as (3).

1962—Subsec. (b). Pub. L. 87–884 added paragraph (7).

1960—Subsec. (b). Pub. L. 86–779 added paragraph (6).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 4(c) of Pub. L. 88–554 provided that: "The amendments made by this section [to this section and sections 304, 382, 856, 958, and 6038 of this title] shall take effect on the date of the enactment of this Act, [Aug. 31, 1964], except that, for purposes of sections 302 and 304 of the Internal Revenue Code of 1954 [sections 302 and 304 of this title], such amendments shall not apply with respect to distributions in payment for stock acquisitions or redemptions, if such acquisitions or redemptions occurred before the date of the enactment of this Act [Aug. 31, 1964,]."

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

CROSS REFERENCES

Basis of property received in liquidations, purchase defined, see section 334 (b) (3) of this title.

Distributions in redemption of stock, this section to apply in determining ownership, see section 302 (c) of this title.

Redemption through use of related corporations, this section to apply in determining control, see section 304 (c) (2) of this title.

Special limitations on net operating loss carryovers, this section to apply in determining ownership of stock, see section 382 (a) (3) of this title.

Termination of shareholder's interest, this section to apply, see section 306 (b) (1) (A) (iii) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 103, 302, 303, 304, 306, 334, 367, 382, 856, 958, 1379, 4914, 6038 of this title.

PART II.—CORPORATE LIQUIDATIONS

Subpart
A. Effects on recipients.
B. Effects on corporation.
C. Collapsible corporations; foreign personal holding companies.
D. Definition.

SUBPART A.—EFFECTS ON RECIPIENTS

Sec.
331. Gain or loss to shareholder in corporate liquidations.
332. Complete liquidations of subsidiaries.
333. Election as to recognition of gain in certain liquidations.
334. Basis of property received in liquidations.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 306 of this title.

§ 331. Gain or loss to shareholders in corporate liquidations.

(a) General rule.

(1) Complete liquidations.

Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) Partial liquidations.

Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

(b) Nonapplication of section 301.

Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property (other than a distribution referred to in paragraph (2)(B) of section 316(b)) in partial or complete liquidation.

(c) Cross references.

(1) For general rule for determination of the amount of gain or loss to the distributee, see section 1001.
(2) For general rule for determination of the amount of gain or loss recognized, see section 1002.

(Aug. 16, 1954, ch. 736, 68A Stat. 101; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(f)(2), 78 Stat. 88.)

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–272 inserted "(other than a distribution referred to in paragraph (2)(B) of section 316(b))."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section Pub. L. 88–272 applicable to distribution made in any taxable year of the distributing corporation beginning after Dec. 31, 1963, see section 225(1) of Pub. L. 88–272, set out as a note under section 316 of this title.

CROSS REFERENCES

Distributions in redemption of stock, see section 302 of this title.

Earnings and profits, special rule for partial liquidations, see section 312 (e) of this title.

Extension of time for payment of tax on gain attributable to liquidation of personal holding companies, see section 6162 of this title.

Gain or loss on sales or exchanges in connection with certain liquidations, see section 337 of this title.

Liquidation of certain foreign personal holding companies, see section 342 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1246, 1248, 1372, 6162 of this title.

§ 332. Complete liquidations of subsidiaries.

(a) General rule.

No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

(b) Liquidations to which section applies.

For purposes of subsection (a), a distribution shall be considered to be in complete liquidation only if—

(1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends); and either

(2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(3) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within 3 years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year, the Secretary or his delegate may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such 3-year period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, the assessment and collection of all income taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this subsection shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for purposes of this subsection a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, on an exchange described in section 361, and (B) the complete cancellation or redemption under the plan, as a result of exchanges described in section 354, of the shares not owned by the taxpayer.

(c) Special rule for indebtedness of subsidiary to parent.

If—

(1) a corporation is liquidated and subsection (a) applies to such liquidation, and

(2) on the date of the adoption of the plan of liquidation, such corporation was indebted to the corporation which meets the 80 percent stock ownership requirements specified in subsection (b),

then no gain or loss shall be recognized to the corporation so indebted because of the transfer of property in satisfaction of such indebtedness. (Aug. 16, 1954, ch. 736, 68A Stat. 102.)

CROSS REFERENCES

Basis of property received in liquidations, see section 334 of this title.

Carryovers in corporate acquisitions to which this section applies, see section 381 (a) of this title.

Foreign corporations, not considered as a corporation in determining the extent to which gain shall be recognized in the case of exchanges described in this section, see section 367 of this title.

Gain or loss on sales or exchanges in connection with certain liquidations, liquidations to which this section applies, see section 337 (c) (2) of this title.

Installment obligation, effect of distribution in liquidation on recognition of gain or loss, see section 453 (d) (4) (A) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 333, 334, 337, 341, 367, 381, 453, 1101, 1245, 1250, 1251 of this title.

§ 333. Election as to recognition of gain in certain liquidations.

(a) General rule.

In the case of property distributed in complete liquidation of a domestic corporation (other than a collapsible corporation to which section 341 (a) applies), if—

(1) the liquidation is made in pursuance of a plan of liquidation adopted on or after June 22, 1954, and

(2) the distribution is in complete cancellation or redemption of all the stock, and the transfer of all the property under the liquidation occurs within some one calendar month,

then in the case of each qualified electing shareholder (as defined in subsection (c)) gain on the

shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in subsections (e) and (f).

(b) Excluded corporation.

For purposes of this section, the term "excluded corporation" means a corporation which at any time between January 1, 1954, and the date of the adoption of the plan of liquidation, both dates inclusive, was the owner of stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote on the adoption of such plan.

(c) Qualified electing shareholders.

For purposes of this section, the term "qualified electing shareholder" means a shareholder (other than an excluded corporation) of any class of stock (whether or not entitled to vote on the adoption of the plan of liquidation) who is a shareholder at the time of the adoption of such plan, and whose written election to have the benefits of subsection (a) has been made and filed in accordance with subsection (d), but—

(1) in the case of a shareholder other than a corporation, only if written elections have been so filed by shareholders (other than corporations) who at the time of the adoption of the plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation; or

(2) in the case of a shareholder which is a corporation, only if written elections have been so filed by corporate shareholders (other than an excluded corporation) which at the time of the adoption of such plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by an excluded corporation and by shareholders who are not corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation.

(d) Making and filing of elections.

The written elections referred to in subsection (c) must be made and filed in such manner as to be not in contravention of regulations prescribed by the Secretary or his delegate. The filing must be within 30 days after the date of the adoption of the plan of liquidation.

(e) Noncorporate sbareholders.

In the case of a qualified electing shareholder other than a corporation—

(1) there shall be recognized, and treated as a dividend, so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, such earnings and profits to be determined as of the close of the month in which the transfer in liquidation occurred under subsection (a) (2), but without diminution by reason of distributions made during such month; but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed; and

(2) there shall be recognized, and treated as short-term or long-term capital gain, as the case may be, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consists of money, or of stock or securities acquired by the corporation after December 31, 1953, exceeds his ratable share of such earnings and profits.

(f) Corporate shareholders.

In the case of a qualified electing shareholder which is a corporation, the gain shall be recognized only to the extent of the greater of the two following—

(1) the portion of the assets received by it which consists of money, or of stock or securities acquired by the liquidating corporation after December 31, 1953; or

(2) its ratable share of the earnings and profits of the liquidating corporation accummulated after February 28, 1913, such earnings and profits to be determined as of the close of the month in which the transfer in liquidation occurred under subsection (a) (2), but without diminution by reason of distributions made during such month; but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed.

(g) Special rule.

(1) Liquidations before January 1, 1967.

In the case of a liquidation occurring before January 1, 1967, of a corporation referred to in paragraph (3)—

(A) the date "December 31, 1953" referred to in subsection (e) (2) and (f) (1) shall be treated as if such date were "December 31, 1962", and

(B) in the case of stock in such corporation held for more than 6 months, the term "a dividend" as used in subsection (e) (1) shall be treated as if such term were "long-term capital gain".

Subparagraph (B) shall not apply to any earnings and profits to which the corporation succeeds after December 31, 1963, pursuant to any corporate reorganization or pursuant to any liquidation to which section 332 applies, except earnings and profits which on December 31, 1963, constituted earnings and profits of a corporation referred to in paragraph (3), and except earnings and profits which were earned after such date by a corporation referred to in paragraph (3).

(2) Liquidations after December 31, 1966.

(A) In general.

In the case of a liquidation occurring after December 31, 1966, of a corporation to which this subparagraph applies—

(i) the date "December 31, 1953" referred to in subsections (e) (2) and (f) (1) shall be treated as if such date were "December 31, 1962", and

(ii) so much of the gain recognized under subsection (e) (1) as is attributable to the earnings and profits accumulated after February 28, 1913, and before January 1, 1967,

shall, in the case of stock in such corporation held for more than 6 months, be treated as long-term capital gain, and only the remainder of such gain shall be treated as a dividend.

Clause (ii) shall not apply to any earnings and profits to which the corporation succeeds after December 31, 1963, pursuant to any corporate reorganization or pursuant to any liquidation to which section 332 applies, except earnings and profits which on December 31, 1963, constituted earnings and profits of a corporation referred to in paragraph (3), and except earnings and profits which were earned after such date by a corporation referred to in paragraph (3).

(B) Corporations to which applicable.

Subparagraph (A) shall apply only with respect to a corporation which is referred to in paragraph (3) and which—

(i) on January 1, 1964, owes qualified indebtedness (as defined in section 545(c)),

(ii) before January 1, 1968, notifies the Secretary or his delegate that it may wish to have subparagraph (A) apply to it and submits such information as may be required by regulations prescribed by the Secretary or his delegate, and

(iii) liquidates before the close of the taxable year in which such corporation ceases to owe such qualified indebtedness or (if earlier) the taxable year referred to in subparagraph (C).

(C) Adjusted post-1963 earnings and profits exceed qualified indebtedness.

In the case of any corporation, the taxable year referred to in this subparagraph is the first taxable year at the close of which its adjusted post-1963 earnings and profits equal or exceed the amount of such corporation's qualified indebtedness on January 1, 1964. For purposes of the preceding sentence, the term "adjusted post-1963 earnings and profits" means the sum of—

(i) the earnings and profits of such corporation for taxable years beginning after December 31, 1963, without diminution by reason of any distributions made out of such earnings and profits, and

(ii) the deductions allowed for taxable years beginning after December 31, 1963, for exhaustion, wear and tear, obsolescence, amortization, or depletion.

(3) Corporations referred to.

For purposes of paragraphs (1) and (2), a corporation referred to in this paragraph is a corporation which for at least one of the two most recent taxable years ending before the date of the enactment of this subsection was not a personal holding company under section 542, but would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such taxable year.

(4) Mistake as to applicability of subsection.

An election made under this section by a qualified electing shareholder of a corporation in which such shareholder states that such election is made on the assumption that such corporation is a corporation referred to in paragraph (3) shall have no force or effect if it is determined that the corporation is not a corporation referred to in paragraph (3).

(Aug. 16, 1954, ch. 736, 68A Stat. 103; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(g), 78 Stat. 89.)

AMENDMENTS

1964—Subsec. (g). Pub. L. 88–272 added subsection (g).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section Pub. L. 88–272 applicable to distributions made in any taxable year of the distributing corporation beginning after Dec. 31, 1963, see section 225(1) of Pub. L. 88–272, set out as a note under section 316 of this title.

RECOGNITION OF GAIN IN CERTAIN LIQUIDATIONS

Pub. L. 91–172, title IX, § 917, Dec. 30, 1969, 83 Stat. 724, provided that:

"For purposes of applying section 333 (e) and (f) of the Internal Revenue Code of 1954 [subsecs. (e) and (f) of this section] to a distribution in liquidation of a corporation during 1970, stock (including stock received in respect of such stock by reason of a stock dividend or stock split) or securities received by a qualified electing shareholder in exchange for his stock in the liquidating corporation shall be considered as having been acquired by the liquidating corporation before January 1, 1954, if—

"(1) such stock or securities were acquired by the the liquidating corporation after December 31, 1953, from such qualified electing shareholder (or from a person from whom such qualified electing shareholder acquired such stock in the liquidating corporation by gift, bequest, or inheritance) solely in exchange for its stock in a transaction to which section 351 of such Code [section 351 of this title] (or the corresponding provisions of prior law) applied, and

"(2) the holding period of such stock or securities in the hands of the liquidating corporation, determined under section 1223(2) of such Code [section 1223(2) of this title], includes any period before January 1, 1954."

LIQUIDATION BEFORE JANUARY 1, 1966

Section 225(h) of Pub. L. 88–272 provided that:

"(1) General rule.—

"Except as provided in paragraph (2), in the case of a corporation referred to in section 333(g)(3) of the Internal Revenue Code of 1954 (as added by subsection (g) of this section), the amendments made by this section [adding section 1022 and redesignating former section 1022 as 1023, amending this section, and sections 316, 331, 381, 541, 542, 543, 544, 545, 551, 553, 554, 562, 856, 1016, 1361, 6501, and the analysis preceding section 1011, and enacting provisions set out as a note under section 316 of this title] (other than subsections (f) and (g) [amending this section and sections 316, 331, 551, and 562 of this title]) shall not apply if there is a complete liquidation of such corporation and if the distribution of all the property under such liquidation occurs before January 1, 1966.

"(2) Exception.—

"Paragraph (1) shall not apply to any liquidation to which section 332 of the Internal Revenue Code of 1954 applies unless—

"(A) the corporate distributee (referred to in subsection (b)(1) of such section 332) in such liquidation is liquidated in a complete liquidation to which such section 332 does not apply, and

"(B) the distribution of all the property under such liquidation occurs before the 91st day after the last distribution referred to in paragraph (1) and before January 1, 1966."

CROSS REFERENCES

Basis of property received in liquidation under this section, see section 334 (c) of this title.

For application of section 225(h) of Pub. L. 88-272 to taxable years beginning after Dec. 31, 1963, see section 225(i) of Pub. L. 88-272, set out as a note under section 316 of this title.

Gain or loss, section as not applicable to any sale or exchange following adoption of a plan of complete liquidation to which this section applies, see section 337 (c)(1) of this title.

Partial liquidation defined, see section 346 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 334, 337 of this title.

§ 334. Basis of property received in liquidations.

(a) General rule.

If property is received in a distribution in partial or complete liquidation (other than a distribution to which section 333 applies), and if gain or loss is recognized on receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution.

(b) Liquidation of subsidiary.

(1) In general.

If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332 (b)), then, except as provided in paragraph (2), the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the transferor. If property is received by a corporation in a transfer to which section 332 (c) applies, and if paragraph (2) of this subsection does not apply, then the basis of the property in the hands of the transferee shall be the same as it would be in the hands of the transferor.

(2) Exception.

If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332 (b)), and if—

(A) the distribution is pursuant to a plan of liquidation adopted—

(i) on or after June 22, 1954, and

(ii) not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and

(B) stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as defined in paragraph (3)) during a 12-month period beginning with the earlier of—

(i) the date of the first acquisition by purchase of such stock, or

(ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made,

then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made. For purposes of the preceding sentence, under regulations prescribed by the Secretary or his delegate, proper adjustment in the adjusted basis of any stock shall be made for any distribution made to the distributee with respect to such stock before the adoption of the plan of liquidation, for any money received, for any liabilities assumed or subject to which the property was received, and for other items.

(3) Purchase defined.

For purposes of paragraph (2) (B), the term "purchase" means any acquisition of stock, but only if—

(A) the basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (ii) under section 1014 (a) (relating to property acquired from a decedent),

(B) the stock is not acquired in an exchange to which section 351 applies, and

(C) the stock is not acquired from a person the ownership of whose stock would, under section 318 (a), be attributed to the person acquiring such stock.

Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2)(B), the term "purchase" also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence).

(4) Distributee defined.

For purposes of this subsection, the term "distributee" means only the corporation which meets the 80 percent stock ownership requirements specified in section 332 (b).

(c) Property received in liquidation under section 333.

If—

(1) property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock, and

(2) with respect to such acquisition—

(A) gain was realized, but

(B) as the result of an election made by the shareholder under section 333, the extent to which gain was recognized was determined under section 333,

then the basis shall be the same as the basis of such stock cancelled or redeemed in the liquidation, decreased in the amount of any money received by the shareholder, and increased in the amount of gain recognized to him. (Aug. 16, 1954, ch. 736, 68A Stat. 104; Nov. 13, 1966, Pub. L. 89-809, title II, § 202(a), (b), 80 Stat. 1576.)

AMENDMENTS

1966—Subsec. (b)(2)(B). Pub. L. 89-809, § 202(b), inserted provisions for the determination of the date on

which to commence the running of the 12-month period during which the distributee must have acquired the stock by purchase by adding clauses (i) and (ii).

Subsec. (b)(3). Pub. L. 89-809, § 202(a), added provision that, for purposes of par. (2)(B), the term "purchase" also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 202(d) of Pub. L. 89-809 provided that: "The amendment made by subsection (a) [amending subsec. (b)(3) of this section] shall apply only with respect to acquisitions of stock after December 31, 1965. The amendments made by subsections (b) and (c) [amending subsec. (b)(2)(B) of this section and section 453(d)(4)(A) of this title] shall apply only with respect to distributions made after the date of the enactment of this Act [November 13, 1966]."

CROSS REFERENCES

Carryovers in corporate acquisitions, exception where basis of assets distributed is determined under subsection (b)(2) of this section, see section 381(a)(1) of this section.

Corporate organizations, basis to distributees, see section 358 of this title.

Exploration expenditures, limitation, see section 615(c) of this title.

Gain or loss on sales or exchanges in connection with liquidations to which section 332 applies, see section 337(c)(2) of this title.

Partial liquidation defined, see section 346 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 337, 381, 453, 615, 617 of this title.

SUBPART B.—EFFECTS ON CORPORATION

Sec.
336. General rule.
337. Gain or loss on sales or exchanges in connection with certain liquidations.
338. Effect on earnings and profits.

§ 336. General rule.

Except as provided in section 453(d) (relating to disposition of installment obligations), no gain or loss shall be recognized to a corporation on the distribution of property in partial or complete liquidation. (Aug. 16, 1954, ch. 736, 68A Stat. 106.)

§ 337. Gain or loss on sales or exchanges in connection with certain liquidations.

(a) General rule.

If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property defined.

(1) In general.

For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition with respect to inventory in certain cases.

Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

(c) Limitations.

(1) Collapsible corporations and liquidations to which section 333 applies.

This section shall not apply to any sale or exchange—

(A) made by a collapsible corporation (as defined in section 341(b)), or

(B) following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) Liquidations to which section 332 applies.

In the case of a sale or exchange following the adoption of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(1), this section shall not apply; or

(B) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2), this section shall apply only to that portion (if any) of the gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334(b)(2)) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquidating corporation, of the property sold or exchanged.

(d) Special rule for certain minority shareholders.

If a corporation adopts a plan of complete liquidation on or after January 1, 1958, and if subsection (a) does not apply to sales or exchanges of property

by such corporation, solely by reason of the application of subsection (c) (2) (A), then for the first taxable year of any share holder (other than a corporation which meets the 80 percent stock ownership requirement specified in section 332 (b) (1)) in which he receives a distribution in complete liquidation—

(1) the amount realized by such shareholder on the distribution shall be increased by his proportionate share of the amount by which the tax imposed by this subtitle on such corporation would have been reduced if subsection (c) (2) (A) had not been applicable, and

(2) for purposes of this title, such shareholder shall be deemed to have paid, on the last day prescribed by law for the payment of the tax imposed by this subtitle on such shareholder for such taxable year, an amount of tax equal to the amount of the increase described in paragraph (1).

(Aug. 16, 1954, ch. 736, 68A Stat. 106; Sept. 2, 1958, Pub. L. 85–866, title I, § 19, 72 Stat. 1615.)

AMENDMENTS

1958—Subsec. (d). Pub. L. 85–866 added subsection (d).

EFFECTIVE DATE OF 1958 AMENDMENT

Subsection (d) of this section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

CROSS REFERENCES

Effective date of part II of subchapter C, certain provisions of this section made applicable, see section 392 (b) (2) of this title.

Gain or loss to shareholders in corporate liquidations, see section 331 of this title.

Installment obligation, effect of distribution in liquidation on recognition of gain or loss, see section 453 (d) (4) (B) of this title.

Partial liquidation defined, see section 346 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 341, 392, 453, 1248 of this title.

§ 338. Effect on earnings and profits.

For special rule relating to the effect on earnings and profits of certain distributions in partial liquidation, see section 312 (e).

(Aug. 16, 1954, ch. 736, 68A Stat. 107.)

SUBPART C.—COLLAPSIBLE CORPORATIONS; FOREIGN PERSONAL HOLDING COMPANIES

Sec.
341. Collapsible corporations.
342. Liquidation of certain foreign personal holding companies.

§ 341. Collapsible corporations.

(a) Treatment of gain to shareholders.

Gain from—

(1) the sale or exchange of stock of a collapsible corporation,

(2) a distribution in partial or complete liquidation of a collapsible corporation, which distribution is treated under this part as in part or full payment in exchange for stock, and

(3) a distribution made by a collapsible corporation which, under section 301 (c) (3) (A), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property,

to the extent that it would be considered (but for the provisions of this section) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except as otherwise provided in this section, be considered as gain from the sale or exchange of property which is not a capital asset.

(b) Definitions.

(1) Collapsible corporation.

For purposes of this section, the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in paragraph (3), or for the holding of stock in a corporation so formed or availed of, with a view to—

(A) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) the realization by such shareholders of gain attributable to such property.

(2) Production or purchase of property.

For purposes of paragraph (1), a corporation shall be deemed to have manufactured, conconstructed, produced, or purchased property, if—

(A) it engaged in the manufacture, construction, or production of such property to any extent,

(B) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or

(C) it holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, produced, or purchased by the corporation.

(3) Section 341 assets.

For purposes of this section, the term "section 341 assets" means property held for a period of less than 3 years which is—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year;

(B) property held by the corporation primarily for sale to customers in the ordinary course of its trade or business;

(C) unrealized receivables or fees, except receivables from sales of property other than property described in this paragraph; or

(D) property described in section 1231 (b) (without regard to any holding period therein provided), except such property which is or has been used in connection with the manufacture, construction, production, or sale of property described in subparagraph (A) or (B).

In determining whether the 3-year holding period specified in this paragraph has been satisfied, section 1223 shall apply, but no such period shall be deemed to begin before the completion of the

manufacture, construction, production, or purchase.

(4) Unrealized receivables.

For purposes of paragraph (3) (C), the term "unrealized receivables or fees" means, to the extent not previously includible in income under the method of accounting used by the corporation, any rights (contractual or otherwise) to payment for—

(A) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(B) services rendered or to be rendered.

(c) Presumption in certain cases.

(1) In general.

For purposes of this section, a corporation shall, unless shown to the contrary, be deemed to be a collapsible corporation if (at the time of the sale or exchange, or the distribution, described in subsection (a)) the fair market value of its section 341 assets (as defined in subsection (b) (3)) is—

(A) 50 percent or more of the fair market value of its total assets, and

(B) 120 percent or more of the adjusted basis of such section 341 assets.

Absence of the conditions described in subparagraphs (A) and (B) shall not give rise to a presumption that the corporation was not a collapsible corporation.

(2) Determination of total assets.

In determining the fair market value of the total assets of a corporation for purposes of paragraph (1) (A), there shall not be taken into account—

(A) cash,

(B) obligations which are capital assets in the hands of the corporation (and governmental obligations described in section 1221 (5)), and

(C) stock in any other corporation.

(d) Limitations on application of section.

In the case of gain realized by a shareholder with respect to his stock in a collapsible corporation, this section shall not apply—

(1) unless, at any time after the commencement of the manufacture, construction, or production of the property, or at the time of the purchase of the property described in subsection (b) (3) or at any time thereafter, such shareholder (A) owned (or was considered as owning) more than 5 percent in value of the outstanding stock of the corporation, or (B) owned stock which was considered as owned at such time by another shareholder who then owned (or was considered as owning) more than 5 percent in value of the outstanding stock of the corporation;

(2) to the gain recognized during a taxable year, unless more than 70 percent of such gain is attributable to the property so manufactured, constructed, produced, or purchased; and

(3) to gain realized after the expiration of 3 years following the completion of such manufacture, construction, production, or purchase.

For purposes of paragraph (1), the ownership of stock shall be determined in accordance with the rules prescribed in paragraphs (1), (2), (3), (5), and (6) of section 544 (a) (relating to personal holding companies); except that, in addition to the persons prescribed by paragraph (2) of that section, the family of an individual shall include the spouses of that individual's brothers and sisters (whether by the whole or half blood) and the spouses of that individual's lineal descendants.

(e) Exceptions to application of section.

(1) Sales or exchanges of stock.

For purposes of subsection (a) (1), a corporation shall not be considered to be a collapsible corporation with respect to any sale or exchange of stock of the corporation by a shareholder, if, at the time of such sale or exchange, the sum of—

(A) the net unrealized appreciation in subsection (e) assets of the corporation (as defined in paragraph (5) (A)), plus

(B) if the shareholder owns more than 5 percent in value of the outstanding stock of the corporation the net unrealized appreciation in assets of the corporation (other than assets described in subparagraph (A)) which would be subsection (e) assets under clauses (i) and (iii) of paragraph (5) (A) if the shareholder owned more than 20 percent in value of such stock, plus

(C) if the shareholder owns more than 20 percent in value of the outstanding stock of the corporation and owns, or at any time during the preceding 3-year period owned, more than 20 percent in value of the outstanding stock of any other corporation more than 70 percent in value of the assets of which are, or were at any time during which such shareholder owned during such 3-year period more than 20 percent in value of the outstanding stock, assets similar or related in service or use to assets comprising more than 70 percent in value of the assets of the corporation, the net unrealized appreciation in assets of the corporation (other than assets described in subparagraph (A)) which would be subsection (e) assets under clauses (i) and (iii) of paragraph (5) (A) if the determination whether the property, in the hands of such shareholder, would be property gain from the sale or exchange of which would under any provision of this chapter be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b), were made—

(i) by treating any sale or exchange by such shareholder of stock in such other corporation within the preceding 3-year period (but only if at the time of such sale or exchange the shareholder owned more than 20 percent in value of the outstanding stock in such other corporation) as a sale or exchange by such shareholder of his proportionate share of the assets of such other corporation, and

(ii) by treating any sale or exchange of property by such other corporation within such 3-year period (but only if at the time of such sale or exchange the shareholder owned more than 20 percent in value of the outstanding stock in such other corporation), gain or loss on which was not recognized to such other corporation under section 337 (a), as a sale or exchange by such shareholder of his proportionate share of the property sold or exchanged,

does not exceed an amount equal to 15 percent of the net worth of the corporation. This paragraph shall not apply to any sale or exchange of stock to the issuing corporation or, in the case of a shareholder who owns more than 20 percent in value of the outstanding stock of the corporation, to any sale or exchange of stock by such shareholder to any person related to him (within the meaning of paragraph (8)).

(2) Distributions in liquidation.

For purposes of subsection (a) (2), a corporation shall not be considered to be a collapsible corporation with respect to any distribution to a shareholder pursuant to a plan of complete liquidation if, by reason of the application of paragraph (4) of this subsection, section 337 (a) applies to sales or exchanges of property by the corporation within the 12-month period beginning on the date of the adoption of such plan, and if, at all times after the adoption of the plan of liquidation, the sum of—

(A) the net unrealized appreciation in subsection (e) assets of the corporation (as defined in paragraph (5) (A)), plus

(B) if the shareholder owns more than 5 percent in value of the outstanding stock of the corporation, the net unrealized appreciation in assets of the corporation described in paragraph (1) (B) (other than assets described in subparagraph (A) of this paragraph), plus

(C) if the shareholder owns more than 20 percent in value of the outstanding stock of the corporation and owns, or at any time during the preceding 3-year period owned, more than 20 percent in value of the outstanding stock of any other corporation more than 70 percent in value of the assets of which are, or were at any time during which such shareholder owned during such 3-year period more than 20 percent in value of the outstanding stock, assets similar or related in service or use to assets comprising more than 70 percent in value of the assets of the corporation, the net unrealized appreciation in assets of the corporation described in paragraph (1) (C) (other than assets described in subparagraph (A) of this paragraph),

does not exceed an amount equal to 15 percent of the net worth of the corporation.

(3) Recognition of gain in certain liquidations.

For purposes of section 333, a corporation shall not be considered to be a collapsible corporation if at all times after the adoption of the plan of liquidation, the net unrealized appreciation in subsection (e) assets of the corporation (as defined in paragraph (5) (B)) does not exceed an amount equal to 15 percent of the net worth of the corporation.

(4) Gain or loss on sales or exchanges in connection with certain liquidations.

For purposes of section 337, a corporation shall not be considered to be a collapsible corporation with respect to any sale or exchange by it of property within the 12-month period beginning on the date of the adoption of a plan of complete liquidation, if—

(A) at all times after the adoption of such plan, the net unrealized appreciation in subsection (e) assets of the corporation (as defined in paragraph (5) (A)) does not exceed an amount equal to 15 percent of the net worth of the corporation,

(B) within the 12-month period beginning on the date of the adoption of such plan, the corporation sells substantially all of the properties held by it on such date, and

(C) following the adoption of such plan, no distribution is made of any property which in the hands of the corporation or in the hands of the distributee is property in respect of which a deduction for exhaustion, wear and tear, obsolescence, amortization, or depletion is allowable.

This paragraph shall not apply with respect to any sale or exchange of property by the corporation to any shareholder who owns more than 20 percent in value of the outstanding stock of the corporation or to any person related to such shareholder (within the meaning of paragraph (8)), if such property in the hands of the corporation or in the hands of such shareholder or related person is property in respect of which a deduction for exhaustion, wear and tear, obsolescence, amortization, or depletion is allowable.

(5) Subsection (e) asset defined.

(A) For purposes of paragraphs (1), (2), and (4), the term "subsection (e) asset" means, with respect to property held by any corporation—

(i) property (except property used in the trade or business, as defined in paragraph (9)) which in the hands of the corporation is, or, in the hands of a shareholder who owns more than 20 percent in value of the outstanding stock of the corporation, would be, property gain from the sale or exchange of which would under any provision of this chapter be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (b);

(ii) property used in the trade or business (as defined in paragraph (9)), but only if the unrealized depreciation on all such property on which there is unrealized depreciation exceeds the unrealized appreciation on all such property on which there is unrealized appreciation;

(iii) if there is net unrealized appreciation on all property used in the trade or business (as defined in paragraph (9)), property used in the trade or business (as defined in paragraph (9)) which, in the hands of a shareholder who owns more than 20 percent in value of the outstanding stock of the corporation, would be property gain from the sale or exchange of which would under any provision of this chapter be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (b); and

(iv) property (unless included under clause (i), (ii), or (iii)) which consists of a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, or any interest in any such property, if the property was created in whole or in part by the personal efforts of, or (in the case of a letter, memorandum, or similar property) was prepared, or produced in whole or in part for, any individual who owns more than 5 percent in value of the stock of the corporation.

The determination as to whether property of the corporation in the hands of the corporation is, or in the hands of a shareholder would be, property gain from the sale or exchange of which would under any provision of this chapter be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (b) shall be made as if all property of the corporation had been sold or exchanged to one person in one transaction.

(B) For purposes of paragraph (3), the term "subsection (e) asset" means, with respect to property held by any corporation, property described in clauses (i), (ii), (iii), and (iv) of subparagraph (A), except that clauses (i) and (iii) shall apply in respect of any shareholder who owns more than 5 percent in value of the outstanding stock of the corporation (in lieu of any shareholder who owns more than 20 percent in value of such stock).

(6) Net unrealized appreciation defined.

(A) For purposes of this subsection, the term "net unrealized appreciation" means, with respect to the assets of a corporation, the amount by which—

(i) the unrealized appreciation in such assets on which there is unrealized appreciation, exceeds

(ii) the unrealized depreciation in such assets on which there is unrealized depreciation.

(B) For purposes of subparagraph (A) and paragraph (5) (A), the term "unrealized appreciation" means, with respect to any asset, the amount by which—

(i) the fair market value of such asset, exceeds

(ii) the adjusted basis for determining gain from the sale or other disposition of such asset.

(C) For purposes of subparagraph (A) and paragraph (5) (A), the term "unrealized depreciation" means, with respect to any asset, the amount by which—

(i) the adjusted basis for determining gain from the sale or other disposition of such asset, exceeds

(ii) the fair market value of such asset.

(D) For purposes of this paragraph (but not paragraph (5) (A)), in the case of any asset on the sale or exchange of which only a portion of the gain would under any provision of this chapter be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (b), there shall be taken into account only an amount of the unrealized appreciation in such asset which is equal to such portion of the gain.

(7) Net worth defined.

For purposes of this subsection, the net worth of a corporation, as of any day, is the amount by which—

(A) (i) the fair market value of all its assets at the close of such day, plus

(ii) the amount of any distribution in complete liquidation made by it on or before such day, exceeds

(B) all its liabilities at the close of such day.

For purposes of this paragraph, the net worth of a corporation as of any day shall not take into account any increase in net worth during the one-year period ending on such day to the extent attributable to any amount received by it for stock, or as a contribution to capital or as paid-in surplus, if it appears that there was not a bona fide business purpose for the transaction in respect of which such amount was received.

(8) Related person defined.

For purposes of paragraphs (1) and (4), the following persons shall be considered to be related to a shareholder:

(A) If the shareholder is an individual—

(i) his spouse, ancestors, and lineal descendants, and

(ii) a corporation which is controlled by such shareholder.

(B) If the shareholder is a corporation—

(i) a corporation which controls, or is controlled by, the shareholder, and

(ii) if more than 50 percent in value of the outstanding stock of the shareholder is owned by any person, a corporation more than 50 percent in value of the outstanding stock of which is owned by the same person.

For purposes of determining the ownership of stock in applying subparagraphs (A) and (B), the rules of section 267 (c) shall apply, except that the family of an individual shall include only his spouse, ancestors, and lineal descendants. For purposes of this paragraph, control means the ownership of stock possessing at least 50 percent of the total combined voting power of all

classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(9) Property used in the trade or business.

For purposes of this subsection, the term "property used in the trade or business" means property described in section 1231 (b), without regard to any holding period therein provided.

(10) Ownership of stock.

For purposes of this subsection (other than paragraph (8)), the ownership of stock shall be determined in the manner prescribed in subsection (d).

(11) Corporations and shareholders not meeting requirements.

In determining whether or not any corporation is a collapsible corporation within the meaning of subsection (b), the fact that such corporation, or such corporation with respect to any of its shareholders, does not meet the requirements of paragraph (1), (2), (3), or (4) of this subsection shall not be taken into account, and such determination, in the case of a corporation which does not meet such requirements, shall be made as if this subsection had not been enacted.

(12) Nonapplication of section 1245(a).[1]

For purposes of this subsection, the determination of whether gain from the sale or exchange of property would under any provision of this chapter be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b) shall be made without regard to the application of sections 617(d)(1), 1245(a), 1250(a), 1251(c), and 1252(a).

(f) Certain sales of stock of consenting corporations.

(1) In general.

Subsection (a)(1) shall not apply to a sale of stock of a corporation (other than a sale to the issuing corporation) if such corporation (hereinafter in this subsection referred to as "consenting corporation") consents (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have the provisions of paragraph (2) apply. Such consent shall apply with respect to each sale of stock of such corporation made within the 6-month period beginning with the date on which such consent is filed.

(2) Recognition of gain.

Except as provided in paragraph (3), if a subsection (f) asset (as defined in paragraph (4)) is disposed of at any time by a consenting corporation (or, if paragraph (3) applies, by a transferee corporation), then the amount by which—

(A) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(B) in the case of any other disposition, the fair market value of such asset,

exceeds the adjusted basis of such asset shall be treated as gain from the sale or exchange of such asset. Such gain shall be recognized notwithstanding any other provision of this subtitle, but only to the extent such gain is not recognized under any other provision of this subtitle.

(3) Exception for certain tax-free transactions.

If the basis of a subsection (f) asset in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), or 374(a), then the amount of gain taken into account by the transferor under paragraph (2) shall not exceed the amount of gain recognized to the transferor on the transfer of such asset (determined without regard to this subsection). This paragraph shall apply only if the transferee—

(A) is not an organization which is exempt from tax imposed by this chapter, and

(B) agrees (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have the provisions of paragraph (2) apply to any disposition by it of such subsection (f) asset.

(4) Subsection (f) asset defined.

For purposes of this subsection—

(A) In general.

The term "subsection (f) asset" means any property which, as of the date of any sale of stock referred to in paragraph (1), is not a capital asset and is property owned by, or subject to an option to acquire held by, the consenting corporation. For purposes of this subparagraph, land or any interest in real property (other than a security interest), and unrealized receivables or fees (as defined in subsection (b)(4)), shall be treated as property which is not a capital asset.

(B) Property under construction.

If manufacture, construction, or production with respect to any property described in subparagraph (A) has commenced before any date of sale described therein, the term "subsection (f) asset" includes the property resulting from such manufacture, construction, or production.

(C) Special rule for land.

In the case of land or any interest in real property (other than a security interest) described in subparagraph (A), the term "subsection (f) asset" includes any improvements resulting from construction with respect to such property if such construction is commenced (by the consenting corporation or by a transferee corporation which has agreed to the application of paragraph (2)) within 2 years after the date of any sale described in subparagraph (A).

(5) 5-year limitation as to shareholder.

Paragraph (1) shall not apply to the sale of stock of a corporation by a shareholder if, during the 5-year period ending on the date of such sale, such shareholder (or any related person within the meaning of subsection (e)(8)(A)) sold any stock of another consenting corporation within any 6-month period beginning on a date on which a consent was filed under paragraph (1) by such other corporation.

[1] Paragraph amended without amendment to paragraph catchline to reflect change.

(6) Special rule for stock ownership in other corporations.

If a corporation (hereinafter in this paragraph referred to as "owning corporation") owns 5 percent or more in value of the outstanding stock of another corporation on the date of any sale of stock of the owning corporation during a 6-month period with respect to which a consent under paragraph (1) was filed by the owning corporation, such consent shall not be valid with respect to such sale unless such other corporation has (within the 6-month period ending on the date of such sale) filed a valid consent under paragraph (1) with respect to sales of its stock. For purposes of applying paragraph (4) to such other corporation, a sale of stock of the owning corporation to which paragraph (1) applies shall be treated as a sale of stock of such other corporation. In the case of a chain of corporations connected by the 5-percent ownership requirements of this paragraph, rules similar to the rules of the two preceding sentences shall be applied.

(7) Adjustments to basis.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under paragraph (2).

(Aug. 16, 1954, ch. 736, 68A Stat. 107; Sept. 2, 1958, Pub. L. 85–866, title I, § 20 (a), 72 Stat. 1615; Oct. 16, 1962, Pub. L. 87–834, § 13 (f) (4), 76 Stat. 1035; Feb. 26, 1964, Pub. L. 88–272, title II, § 231 (b) (4), 78 Stat. 105; Aug. 22, 1964, Pub. L. 88–484, § 1 (a), 78 Stat. 596; Sept. 12, 1966, Pub. L. 89–570, § 1(b) (4), 80 Stat. 762; Dec. 30, 1969, Pub. L 91–172, title II, § 211(b) (4), title V, § 514(b) (1), 83 Stat. 570, 643.)

AMENDMENTS

1969—Subsec. (e) (5) (A) (iv). Pub. L. 91–172, § 514(b) (1), added reference to a letter or memorandum.

Subsec. (e) (12). Pub. L. 91–172, § 211(b) (4), substituted "1250(a), 1251(c), and 1252(a)" for "and 1250(a)".

1966—Subsec. (e) (12). Pub. L. 89–570 included reference to section 617(d) (1).

1964—Subsec. (a). Pub. L. 88–434 substituted "except as otherwise provided in this section" for "except as provided in subsection (d)."

Subsec. (e) (12). Pub. L. 88–272 inserted the reference to section 1250(a).

Subsec. (f). Pub. L. 88–484 added subsection (f).

1962—Subsec. (e) (12). Pub. L. 87–834 added subsec. (e) (12).

1958—Subsec. (e). Pub. L. 85–866 added subsec. (e).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (e) (5) (A) (iv) by section 514 (b) (1) of Pub. L. 91–172 applicable to sales and other dispositions occurring after July 25, 1969, see section 514(c) of Pub. L. 91–172, set out as a note under section 1221 of this title.

Amendment of subsec. (e) (12) by section 211(h) (4) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 211(c) of Pub. L. 91–172, set out as a note under section 1251 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–570 applicable to taxable years ending after Sept. 12. 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 89–570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Section 2 of Pub. L. 88–484 provided that: "The amendments made by the first section of this Act [to this section and sections 301, 312, and 453 of this title] shall apply with respect to transactions after the date of the enactment of this Act [Aug. 22, 1964] in taxable years ending after such date."

Amendment of section by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 231(c) of Pub. L. 88–272, set out as a note under section 1250 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Subsec. (e) (12) of this section applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 20 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [which added subsec. (e) of this section] shall apply with respect to taxable years beginning after December 31, 1957, but only with respect to sales, exchanges, and distributions after the date of the enactment of this Act [Sept. 2, 1958]."

CROSS REFERENCES

Effective date of part II of subchapter C, this section applicable only with respect to sales, exchanges, and distributions on or after June 22, 1954, see section 392 (a) of this title.

Election as to recognition of gain in liquidations other than distributions of property of a collapsible corporation to which subsection (a) of this section applies, see section 333 (a) of this title.

Gain or loss on sales or exchanges in connection with liquidations, section as not applicable to any sale or exchange made by a collapsible corporation, see section 337 (c) (1) (A) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 301, 312, 333, 337, 392, 453 of this title.

§ 342. Liquidation of certain foreign personal holding companies.

(a) In general.

If any distribution—

(1) is, within the meaning of the Internal Revenue Code of 1939, a distribution in partial liquidation or in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) and

(2) is made by a foreign corporation which, with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a United States group (as defined in section 552 (a) (2)) existed after August 26, 1937, and before January 1, 1938,

then the distribution shall be treated as a distribution in full or part payment in exchange for the stock, and the amount of the gain recognized (determined under section 1002 without regard to this part) resulting from such distribution shall be considered as a gain from the sale or exchange of a capital asset held for not more than 6 months.

(b) Special rule for certain liquidations before 1956.

Subsection (a) shall not apply in the case of a series of distributions in complete liquidation described in subsection (a) if—

(1) the first distribution is made on or after June 22, 1954, and

(2) the final distribution is made before January 1, 1956;

and the amount of the gain recognized (determined under section 1002 without regard to this part) resulting from such distributions shall be considered

as a gain from the sale or exchange of a capital asset, or of property which is not a capital asset, as the case may be. (Aug. 16, 1954, ch. 736, 68A Stat. 110.)

CROSS REFERENCES

Income tax, foreign personal holding companies—
Generally, see sections 551—558 of this title.
Deductions, amortizable bond premium, see section 171 of this title.
Gain or loss on property acquired from decedent, see section 1014 of this title.
Liquidations, extension of time for payment of tax on gain attributable to liquidation of personal holding companies, see section 6162 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1022, 6162 of this title.

SUBPART D.—DEFINITION

Sec.
346. Partial liquidation defined.

§ 346. Partial liquidation defined.

(a) In general.

For purposes of this subchapter, a distribution shall be treated as in partial liquidation of a corporation if—

(1) the distribution is one of a series of distributions in redemption of all of the stock of the corporation pursuant to a plan; or

(2) the distribution is not essentially equivalent to a dividend, is in redemption of a part of the stock of the corporation pursuant to a plan, and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year, including (but not limited to) a distribution which meets the requirements of subsection (b).

For purposes of section 562 (b) (relating to the dividends paid deduction) and section 6043 (relating to information returns), a partial liquidation includes a redemption of stock to which section 302 applies.

(b) Termination of a business.

A distribution shall be treated as a distribution described in subsection (a) (2) if the requirements of paragraphs (1) and (2) of this subsection are met.

(1) The distribution is attributable to the corporation's ceasing to conduct, or consists of the assets of, a trade or business which has been actively conducted throughout the 5-year period immediately before the distribution, which trade or business was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

(2) Immediately after the distribution the liquidating corporation is actively engaged in the conduct of a trade or business, which trade or business was actively conducted throughout the 5-year period ending on the date of the distribution and was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

Whether or not a distribution meets the requirements of paragraphs (1) and (2) of this subsection shall be determined without regard to whether or not the distribution is pro rata with respect to all of the shareholders of the corporation.

(c) Treatment of certain redemptions.

The fact that, with respect to a shareholder, a distribution qualifies under section 302 (a) (relating to redemptions treated as distributions in part or full payment in exchange for stock) by reason of section 302 (b) shall not be taken into account in determining whether the distribution, with respect to such shareholder, is also a distribution in partial liquidation of the corporation. (Aug. 16, 1954, ch. 736, 68A Stat. 110.)

CROSS REFERENCES

Corporations, gain or loss on sales or exchanges in connection with liquidations, see section 337 of this title.
Dividend defined, see section 316 of this title.
Effect on earnings and profits of certain distributions in partial liquidation, see section 312 (e) of this title.
Gain or loss to shareholders in corporate liquidations, partial liquidations, see section 831 (a) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 331 of this title.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart
A. Corporate organizations.
B. Effects on shareholders and security holders.
C. Effects on corporations.
D. Special rule; definitions.

SUBPART A.—CORPORATE ORGANIZATIONS

Sec.
351. Transfer to corporation controlled by transferor.

§ 351. Transfer to corporation controlled by transferor.

(a) General rule.

No gain or loss shall be recognized if property is transferred to a corporation (including, in the case of transfers made on or before June 30, 1967, an investment company) by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) Receipt of property.

If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then—

(1) gain (if any) to such recipient shall be recognized, but not in excess of—

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

(c) Special rule.

In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

(d) Application of June 30, 1967, date.

For purposes of this section, if, in connection with the transaction, a registration statement is required to be filed with the Securities and Exchange Com-

mission, a transfer of property to an investment company shall be treated as made on or before June 30, 1967, only if—

(1) such transfer is made on or before such date,

(2) the registration statement was filed with the Securities and Exchange Commission before January 1, 1967, and the aggregate issue price of the stock and securities of the investment company which are issued in the transaction does not exceed the aggregate amount therefor specified in the registration statement as of the close of December 31, 1966, and

(3) the transfer of property to the investment company in the transaction includes only property deposited before May 1, 1967.

(e) Cross references.

(1) For special rule where another party to the exchange assumes a liability, or acquires property subject to a liability, see section 357.

(2) For the basis of stock, securities, or property received in an exchange to which this section applies, see sections 358 and 362.

(3) For special rule in the case of an exchange described in this section but which results in a gift, see section 2501 and following.

(4) For special rule in the case of an exchange described in this section but which has the effect of the payment of compensation by the corporation or by a transferor, see section 61 (a) (1).

(Aug. 16, 1954, ch. 736, 68A Stat. 111; Nov. 13, 1966, Pub. L. 89–809, title II, § 203(a), (b), 80 Stat. 1577.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809, § 203(a), inserted "(including, in the case of transfers made on or before June 30, 1967, an investment company)" following "if property is transferred to a corporation".

Subsec. (d). Pub. L. 89–809, § 203(b), added subsec. (d) and redesignated former subsec. (d) as (e).

Subsec. (e). Pub. L. 89–809, § 203(b), redesignated former subsec. (d) as (e).

EFFECTIVE DATE OF 1966 AMENDMENT

Section 203(c) of Pub. L. 89–809 provided that: "The amendments made by subsections (a) and (b) [amending subsec. (a) of this section, adding subsec. (d), and redesignating former subsec. (d) as (e)] shall apply with respect to transfers of property to investment companies whether made before, on, or after the date of the enactment of this Act [November 13, 1966]."

CROSS REFERENCES

Assumption of liability, see section 357 of this title.

Basis of property received in liquidations, purchase defined, see section 334 (b) (3) of this title.

Basis to corporations, see section 362 of this title.

Basis to distributees, see section 358 of this title.

Effective dates of parts III and IV of subchapter C, special rules for plans of reorganization, see section 393 (b) of this title.

Foreign corporations, see section 367 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 311, 334, 341, 357, 358, 362, 367, 1245, 1250, 1251 of this title.

SUBPART B.—EFFECTS ON SHAREHOLDERS AND SECURITY HOLDERS

Sec.

354. Exchanges of stock and securities in certain reorganizations.
355. Distribution of stock and securities of a controlled corporation.
356. Receipt of additional consideration.
357. Assumption of liability.
358. Basis to distributees.

§ 354. Exchanges of stock and securities in certain reorganizations.

(a) General rule.

(1) In general.

No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(2) Limitation.

Paragraph (1) shall not apply if—

(A) the principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) any such securities are received and no such securities are surrendered.

(3) Cross reference.

For treatment of the exchange if any property is received which is not permitted to he received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) Exception.

(1) In general.

Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368 (a) (1) (D), unless—

(A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

(2) Cross reference.

For special rules for certain exchanges in pursuance of plans of reorganization within the meaning of section 368 (a) (1) (D), see section 355.

(c) Certain railroad reorganizations.

Notwithstanding any other provision of this subchapter, subsection (a) (1) (and so much of section 356 as relates to this section) shall apply with respect to a plan of reorganization (whether or not a reorganization within the meaning of section 368 (a)) for a railroad approved by the Interstate Commerce Commission under section 77 of the Bankruptcy Act, or under section 20b of the Interstate Commerce Act, as being in the public interest. (Aug. 16, 1954, ch. 736, 68A Stat. 112.)

REFERENCES IN TEXT

Section 77 of the Bankruptcy Act, referred to in subsec. (c), is classified to section 205 of Title 11, Bankruptcy.

Section 20b of the Interstate Commerce Act, referred to in subsec. (c), is classified to section 20b of Title 49, Transportation.

CROSS REFERENCES

Basis to distributees, see section 358 of this title.

Carryovers in corporate acquisitions, see section 381 of this title.

Complete liquidations of subsidiaries, liquidations to which section applies, see section 332 (b) of this title.

Foreign corporations, see section 367 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 81, 332, 356, 358, 367, 368, 381, 425, 1101, 4912 of this title.

§ 355. Distribution of stock and securities of a controlled corporation.

(a) Effect on distributees.

(1) General rule.

If—

(A) a corporation (referred to in this section as the "distributing corporation")—

(i) distributes to a shareholder, with respect to its stock, or

(ii) distributes to a security holder, in exchange for its securities,

solely stock or securities of a corporation (referred to in this section as "controlled corporation") which it controls immediately before the distribution,

(B) the transaction was not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (but the mere fact that subsequent to the distribution stock or securities in one or more of such corporations are sold or exchanged by all or some of the distributees (other than pursuant to an arrangement negotiated or agreed upon prior to such distribution) shall not be construed to mean that the transaction was used principally as such a device),

(C) the requirements of subsection (b) (relating to active businesses) are satisfied, and

(D) as part of the distribution, the distributing corporation distributes—

(i) all of the stock and securities in the controlled corporation held by it immediately before the distribution, or

(ii) an amount of stock in the controlled corporation constituting control within the meaning of section 368 (c), and it is established to the satisfaction of the Secretary or his delegate that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax,

then no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of such stock or securities.

(2) Non pro rata distributions, etc.

Paragraph (1) shall be applied without regard to the following:

(A) whether or not the distribution is pro rata with respect to all of the shareholders of the distributing corporation,

(B) whether or not the shareholder surrenders stock in the distributing corporation, and

(C) whether or not the distribution is in pursuance of a plan of reorganization (within the meaning of section 368 (a) (1) (D)).

(3) Limitation.

Paragraph (1) shall not apply if—

(A) the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities which are surrendered in connection with such distribution, or

(B) securities in the controlled corporation are received and no securities are surrendered in connection with such distribution.

For purposes of this section (other than paragraph (1) (D) of this subsection) and so much of section 356 as relates to this section, stock of a controlled corporation acquired by the distributing corporation by reason of any transaction which occurs within 5 years of the distribution of such stock and in which gain or loss was recognized in whole or in part, shall not be treated as stock of such controlled corporation, but as other property.

(4) Cross reference.

For treatment of the distribution if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) Requirements as to active business.

(1) In general.

Subsection (a) shall apply only if either—

(A) the distributing corporation, and the controlled corporation (or, if stock of more than one controlled corporation is distributed, each of such corporations), is engaged immediately after the distribution in the active conduct of a trade or business, or

(B) immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distribution in the active conduct of a trade or business.

(2) Definition.

For purposes of paragraph (1), a corporation shall be treated as engaged in the active conduct of a trade or business if and only if—

(A) it is engaged in the active conduct of a trade or business, or substantially all of its assets consist of stock and securities of a corporation controlled by it (immediately after the distribution) which is so engaged,

(B) such trade or business has been actively conducted throughout the 5-year period ending on the date of the distribution,

(C) such trade or business was not acquired within the period described in subparagraph (B) in a transaction in which gain or loss was recognized in whole or in part, and

(D) control of a corporation which (at the time of acquisition of control) was conducting such trade or business—

(i) was not acquired directly (or through one or more corporations) by another corporation within the period described in subparagraph (B), or

(ii) was so acquired by another corporation within such period, but such control was so acquired only by reason of transactions in which gain or loss was not recognized in whole or in part, or only by reason of such transactions combined with acquisitions before the beginning of such period.

(Aug. 16, 1954, ch. 736, 68A Stat. 113.)

CROSS REFERENCES

Allocation of earnings and profits in distributions or exchanges to which this section applies, see section 312 (i) of this title.

Basis to distributees, see section 358 of this title.

Capital gains and losses, distribution to which this section applies to be treated as an exchange, see section 1223 (1) (B) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 81, 306, 312, 356, 358, 367, 368, 393, 425, 815, 877, 1223, 2107, 2501, 4912, 6166 of this title.

§ 356. Receipt of additional consideration.

(a) Gain on exchanges.

(1) Recognition of gain.

If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) Treatment as dividend.

If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

(b) Additional consideration received in certain distributions.

If—

(1) section 355 would apply to a distribution but for the fact that

(2) the property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money,

then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

(c) Loss.

If—

(1) section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) the property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized.

(d) Securities as other property.

For purposes of this section—

(1) In general.

Except as provided in paragraph (2), the term "other property" includes securities.

(2) Exceptions.

(A) Securities with respect to which nonrecognition of gain would be permitted.

The term "other property" does not include securities to the extent that, under section 354 or 355, such securities would be permitted to be received without the recognition of gain.

(B) Greater principal amount in section 354 exchange.

If—

(i) in an exchange described in section 354 (other than subsection (c) thereof), securities of a corporation a party to the reorganization are surrendered and securities of any corporation a party to the reorganization are received, and

(ii) the principal amount of such securities received exceeds the principal amount of such securities surrendered,

then, with respect to such securities received, the term "other property" means only the fair market value of such excess. For purposes of this subparagraph and subparagraph (C), if no securities are surrendered, the excess shall be the entire principal amount of the securities received.

(C) Greater principal amount in section 355 transaction.

If, in an exchange or distribution described in section 355, the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities in the distributing corporation which are surrendered, then, with respect to such securities received, the term "other property" means only the fair market value of such excess.

(e) Exchanges for section 306 stock.

Notwithstanding any other provision of this section, to the extent that any of the other property (or money) is received in exchange for section 306 stock, an amount equal to the fair market value of such other property (or the amount of such money) shall be treated as a distribution of property to which section 301 applies.

(f) Transactions involving gift or compensation.

For special rules for a transaction described in section 354, 355, or this section, but which—

(1) results in a gift, see section 2501 and following, or

(2) has the effect of the payment of compensation, see section 61 (a) (1).

(Aug. 16, 1954, ch. 736, 68A Stat. 115.)

CROSS REFERENCES

Basis to distributees, see section 358 of this title.

Capital gains and losses, distributions under this section relating to section 355 to be treated as exchanges, see section 1223 (1) (B) of this title.

Definitions relating to corporate reorganizations, see section 368 of this title.

Effect on earnings and profits, allocation in corporate separations, see section 312 (i) of this title.

Effective dates of parts III and IV of subchapter C, special rules for plans of reorganization, see section 393 (b) of this title.

Foreign corporations, see section 367 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 81, 306, 312, 355, 358, 367, 368, 393, 425, 1223, 4912, 6166 of this title.

§ 357. Assumption of liability.

(a) General rule.

Except as provided in subsections (b) and (c), if—

(1) the taxpayer receives property which would be permitted to be received under section 351, 361, 371, or 374 without the recognition of gain if it were the sole consideration, and

(2) as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability,

then such assumption or acquisition shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351, 361, 371, or 374, as the case may be.

(b) Tax avoidance purpose.

(1) In general.

If, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer with respect to the assumption or acquisition described in subsection (a)—

(A) was a purpose to avoid Federal income tax on the exchange, or

(B) if not such purpose, was not a bona fide business purpose,

then such assumption or acquisition (in the total amount of the liability assumed or acquired pursuant to such exchange) shall, for purposes of section 351, 361, 371, or 374 (as the case may be), be considered as money received by the taxpayer on the exchange.

(2) Burden of proof.

In any suit or proceeding where the burden is on the taxpayer to prove such assumption or acquisition is not to be treated as money received by the taxpayer, such burden shall not be considered as sustained unless the taxpayer sustains such burden by the clear preponderance of the evidence.

(c) Liabilities in excess of basis.

(1) In general.

In the case of an exchange—

(A) to which section 351 applies, or

(B) to which section 361 applies by reason of a plan of reorganization within the meaning of section 368 (a) (1) (D),

if the sum of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

(2) Exceptions.

Paragraph (1) shall not apply to any exchange to which—

(A) subsection (b) (1) of this section applies, or

(B) section 371 or 374 applies.

(Aug. 16, 1954, ch. 736, 68A Stat. 116; June 29, 1956, ch. 463, § 2, 70 Stat. 403.)

AMENDMENTS

1956—Subsec. (a). Act June 29, 1956, § 2(1), substituted "371, or 374" for "or 371", in two instances.

Subsec. (b). Act June 29, 1956, § 2 (1), substituted "371, or 374" for "or 371".

Subsec. (c) (2) (B). Act June 29, 1956, § 2 (2), substituted "371 or 374" for "371".

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 371 of this title.

§ 358. Basis to distributees.

(a) General rule.

In the case of an exchange to which section 351, 354, 355, 356, 361, or 371 (b) applies—

(1) Nonrecognition property.

The basis of the property permitted to be received under such section without the recognition of gain or loss shall be the same as that of the property exchanged—

(A) decreased by—

(i) the fair market value of any other property (except money) received by the taxpayer,

(ii) the amount of any money received by the taxpayer, and

(iii) the amount of loss to the taxpayer which was recognized on such exchange, and

(B) increased by—

(i) the amount which was treated as a dividend, and

(ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

(2) Other property.

The basis of any other property (except money) received by the taxpayer shall be its fair market value.

(b) Allocation of basis.

(1) In general.

Under regulations prescribed by the Secretary or his delegate, the basis determined under subsection (a) (1) shall be allocated among the properties permitted to be received without the recognition of gain or loss.

(2) Special rule for section 355.

In the case of an exchange to which section 355 (or so much of section 356 as relates to section 355) applies, then in making the allocation under paragraph (1) of this subsection, there shall be taken into account not only the property so permitted to be received without the recognition of gain or loss, but also the stock or securities (if any) of the distributing corporation which are retained, and the allocation of basis shall be made among all such properties.

(c) Section 355 transactions which are not exchanges.

For purposes of this section, a distribution to which section 355 (or so much of section 356 as relates to section 355) applies shall be treated as an exchange, and for such purposes the stock and securities of the distributing corporation which are retained shall be treated as surrendered, and received back, in the exchange.

(d) Assumption of liability.

Where, as part of the consideration to the taxpayer, another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for purposes of this section, be treated as money received by the taxpayer on the exchange.

(e) Exception.

This section shall not apply to property acquired by a corporation by the exchange of its stock or securities (or the stock or securities of a corporation which is in control of the acquiring corporation) as consideration in whole or in part for the transfer of the property to it. (Aug. 16, 1954, ch. 736, 68A Stat. 117; Sept. 2, 1958, Pub. L. 85–866, title I, § 21(a), 72 Stat. 1620; Oct. 22, 1968, Pub. L. 90–621, § 2(a), 82 Stat. 1311.)

AMENDMENTS

1968—Subsec. (e). Pub. L. 90–621 substituted exchange of stock and securities for issuance of stock or securities as the transaction involved and added parenthetical provisions making reference to stock or securities of a corporation which is in control of the acquiring corporation.

1958—Subsec. (a) (1) (A) (iii). Pub. L. 85–866 added subsec. (a) (1) (A) (iii).

EFFECTIVE DATE OF 1968 AMENDMENT

Section 2(c) of Pub. L. 90–621 provided that: "The amendments made by subsections (a) and (b) [amending this section and section 362(b) of this title] shall apply only in respect of plans of reorganization adopted after the date of the enactment of this Act [Oct. 22, 1968]."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 21 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (a) (1) (A) of this section] shall apply as provided in section 393 of the Internal Revenue Code of 1954 as if the clause (iii) added by such amendment had been included in such Code at the time of its enactment [Aug. 16, 1954]."

SUBPART C.—EFFECTS ON CORPORATION

Sec.
361. Nonrecognition of gain or loss to corporations.
362. Basis to corporations.
363. Effect on earnings and profits.

§ 361. Nonrecognition of gain or loss to corporations.

(a) General rule.

No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(b) Exchanges not solely in kind.

(1) Gain.

If subsection (a) would apply to an exchange but for the fact that the property received in exchange consists not only of stock or securities permitted by subsection (a) to be received without the recognition of gain, but also of other property or money, then—

(A) if the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(B) if the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(2) Loss.

If subsection (a) would apply to an exchange but for the fact that the property received in exchange consists not only of property permitted by subsection (a) to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(Aug. 16, 1954, ch. 736, 68A Stat. 118.)

CROSS REFERENCES

Assumption of liability, see section 357 of this title.
Basis to distributees, see section 358 of this title.
Carryovers in corporate acquisitions, see section 381 of this title.
Complete liquidations of subsidiaries, exchange described in this section, see section 332 of this title.
Foreign corporations, see section 367 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 49, 332, 341, 357, 358, 367, 1245, 1250, 1251, 4914 of this title.

§ 362. Basis to corporations.

(a) Property acquired by issuance of stock or as paid-in surplus.

If property was acquired on or after June 22, 1954, by a corporation—

(1) in connection with a transaction to which section 351 (relating to transfer of property to corporation controlled by transferor) applies, or

(2) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer.

(b) Transfers to corporations.

If property was acquired by a corporation in connection with a reorganization to which this part applies, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. This subsection shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the exchange of stock or securities of the transferee (or of a corporation which is in control of the transferee) as the consideration in whole or in part for the transfer.

(c) Special rule for certain contributions to capital.

(1) Property other than money.

Notwithstanding subsection (a) (2), if property other than money—

(A) is acquired by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such,

then the basis of such property shall be zero.

(2) Money.

Notwithstanding subsection (a) (2), if money—

(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such,

then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution. The excess (if any) of the amount of such contribution over the amount of the reduction under the preceding sentence shall be applied to the reduction (as of the last day of the period specified in the preceding sentence) of the basis of any other property held by the taxpayer. The particular properties to which the reductions required by this paragraph shall be allocated shall be determined under regulations prescribed by the Secretary or his delegate.

(Aug. 16, 1954, ch. 736, 68A Stat. 118; Oct. 22, 1968, Pub. L. 90–621, § 2(b), 82 Stat. 1311.)

AMENDMENTS

1968—Subsec. (b). Pub. L. 90–621 substituted the exchange of stock or securities of the transferee (or of a corporation which is in control of the transferee) for the issuance of stock or securities of the transferee as the transaction rendering the subsection applicable.

EFFECTIVE DATE OF 1968 AMENDMENT

Amendment by Pub. L. 90–621 applicable only in respect of plans of reorganization adopted after Oct. 22, 1968, see section 2(c) of Pub. L. 90–621, set out as a note under section 358 of this title.

CROSS REFERENCES

Basis to distributees, see section 358 of this title.

Contributions to capital of corporation, see section 118 of this title.

Exchange of stock for property, nonrecognition of gain or loss, see section 1032 of this title.

Exploration expenditures, see section 615 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 615, 617 of this title.

§ 363. Effect on earnings and profits.

For rules relating to the effect on earnings and profits of transactions to which this part applies, see sections 312 and 381.

(Aug. 16, 1954, ch. 736, 68A Stat. 119.)

SUBPART D.—SPECIAL RULE; DEFINITIONS

Sec.
367. Foreign corporations.
368. Definitions relating to corporate reorganizations.

§ 367. Foreign corporations.

(a) General rule.

In determining the extent to which gain shall be recognized in the case of any of the exchanges described in section 332, 351, 354, 355, 356, or 361, a foreign corporation shall not be considered as a corperation unless—

(1) before such exchange, or

(2) in the case of an exchange described in subsection (b), either before or after such exchange, it has been established to the satisfaction of the Secretary or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

(b) Application of subsections (a)(2).

Subsection (a)(2) shall apply in the case of a mere change in form in which there is an exchange by a foreign corporation of—

(1) stock in one foreign corporation for,

(2) stock in another foreign corporation,

if the corporations referred to in paragraphs (1) and (2) differ only in their form of organization, and if the ownership of the corporation referred to in paragraph (1) immediately before such exchange is identical to the ownership of the corporation referred to in paragraph (2) immediately after such exchange.

(c) Section 355 distributions treated as exchanges.

For purposes of this section, any distribution described in section 355 (or so much of section 356 as relates to section 355) shall be treated as an exchange whether or not it is an exchange.

(d) Contributions of capital to controlled corporations.

For purposes of this chapter, any transfer of property to a foreign corporation as a contribution to the capital of such corporation by one or more persons who, immediately after the transfer, own (within the meaning of section 318) stock possessing at least 80 percent of the total combined voting power of all classes of stock of such corporation entitled to vote shall be treated as an exchange of such property for stock of the foreign corporation equal in value to the fair market value of the property transferred unless, before such transfer, it has been established to the satisfaction of the Secretary or his delegate that such transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. (Aug. 16, 1954, ch. 736, 68A Stat. 119; Jan. 12, 1971, Pub. L. 91–681, § 1(a), 84 Stat. 2065.)

AMENDMENTS

1971—Subsec. (a). Pub. L. 91–681 designated existing provisions as subsec. (a), and, as so designated, added provisions relating to instances of an exchange, described in subsection (b). Provisions relating to distributions described in section 355 (or so much of section 356 as relates to section 355) were stricken and were transferred to subsec. (c).

Subsec. (b). Pub. L. 91–681 added subsec. (b)

Subsec. (c). Pub. L. 91–681 designated as subsec. (c) provisions relating to distribution described in section 355 (or so much of section 356 as relates to section 355).

Subsec. (d). Pub. L. 91–681 added subsec. (d).

EFFECTIVE DATE OF 1971 AMENDMENT

Section 1(c) of Pub. L. 91–681 provided that: "The amendments made by this section [amending this section and section 1492 of this title] shall apply to transfers made after December 31, 1967; except that sections 367(d) and 1492 of the Internal Revenue Code of 1954 (as amended by this section) shall apply only with respect to transfers made after December 31, 1970.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1492, 4912, 4914 of this title.

§ 368. Definitions relating to corporate reorganizations.

(a) Reorganization.

(1) In general.

For purposes of parts I and II and this part, the term "reorganization" means—

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization; or

(F) a mere change in identity, form, or place of organization, however effected.

(2) Special rules relating to paragraph (1).

(A) Reorganizations described in both paragraph (1) (C) and paragraph (1) (D).

If a transaction is described in both paragraph (1) (C) and paragraph (1) (D), then, for purposes of this subchapter, such transaction shall be treated as described only in paragraph (1) (D).

(B) Additional consideration in certain paragraph (1) (C) cases.

If—

(i) one corporation acquires substantially all of the properties of another corporation,

(ii) the acquisition would qualify under paragraph (1) (C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and

(iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1) (C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation,

then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1) (C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property.

(C) Transfers of assets or stock to subsidiaries in certain paragraph (1)(A), (1)(B), and (1)(C) cases.

A transaction otherwise qualifying under paragraph (1)(A), (1)(B), or (1)(C) shall not be disqualified by reason of the fact that part or all of the assets or stock which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets or stock.

(D) Statutory merger using stock of controlling corporation.

The acquisition by one corporation, in exchange for stock of a corporation (referred to in this subparagraph as "controlling corporation") which is in control of the acquiring corporation, of substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation shall not disqualify a transaction under paragraph (1)(A) if (i) such transaction would have qualified under paragraph (1)(A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction.

(E) Statutory merger using voting stock of corporation controlling merged corporation.

A transaction otherwise qualifying under paragraph (1)(A) shall not be disqualified by reason of the fact that stock of a corporation (referred to in this subparagraph as the "controlling corporation") which before the merger was in control of the merged corporation is used in the transaction, if—

(i) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction); and

(ii) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation.

(b) Party to a reorganization.

For purposes of this part, the term "a party to a reorganization" includes—

(1) a corporation resulting from a reorganization, and

(2) both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another

In the case of a reorganization qualifying under paragraph (1)(B) or (1)(C) of subsection (a), if the stock exchanged for the stock or properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. In the case of a reorganization qualifying under paragraph (1)(A), (1)(B), or (1)(C) of subsection (a) by reason of paragraph (2)(C) of subsection (a), the term "a party to a reorganization" includes the corporation controlling the corporation to which the acquired assets or stock are transferred. In the case of a reorganization qualifying under paragraph (1)(A) of subsection (a) by reason of paragraph (2)(D) of that subsection, the term "a party to a reorganization" includes the controlling corporation referred to in such paragraph (2)(D). In the case of a reorganization qualifying under subsection (a)(1)(A) by reason of subsection (a)(2)(E), the term "party to a reorganization" includes the controlling corporation referred to in subsection (a)(2)(E).

(c) Control.

For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. (Aug. 16, 1954, ch. 736, 68A Stat. 120; Feb. 26, 1964, Pub. L. 88–272, title II, § 218(a), (b), 78 Stat. 57; Oct. 22, 1968, Pub. L. 90–621, § 1(a), (b), 82 Stat. 1310, 1311; Jan. 12, 1971, Pub. L. 91–693, § 1(a), (b), 84 Stat. 2077.)

AMENDMENTS

1971—Subsec. (a)(2). Pub. L. 91–693, § 1(a), added subpar. (E).

Subsec. (b). Pub. L. 91–693, § 1(b), defined the term "party to a reorganization" in the case of a reorganization qualifying under subsection (a)(1)(A) by reason of subsection (a)(2)(E).

1968—Subsec. (a)(2). Pub. L. 90–621, § 1(a), added subpar. (D).

Subsec. (b). Pub. L. 90–621, § 1(b), added reference to the inclusion of the controlling corporation in the term "a party to a reorganization" in reorganizations qualifying under paragraph (1)(A) of subsection (a) by reason of paragraph (2)(D) of subsection (a).

1964—Subsec. (a). Pub. L. 88–272, § 216(a), (b)(1), inserted "(or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation)" in par. (1)(B), and in par. (2)(C), inserted references to par. (1)(B), and substituted "assets or stock" for "assets" wherever appearing.

Subsec. (b). Pub. L. 88–272, § 218(b)(2), inserted references to par. (1)(B) wherever appearing.

EFFECTIVE DATE OF 1971 AMENDMENT

Section 1(c) of Pub. L. 91–693 provided that: "The amendments made by this section [to subsecs. (a)(2) and (b) of this section] shall apply to statutory mergers occurring after December 31, 1970."

EFFECTIVE DATE OF 1968 AMENDMENT

Section 1(c) of Pub. L. 90–621 provided that: "The amendments made by subsections (a) and (b) [amending this section] shall apply to statutory mergers occurring after the date of the enactment of this Act [Oct. 22, 1968]."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 218(c) of Pub. L. 88–272 provided that: "The amendments made by this section [to this section] shall apply with respect to transactions after December 31, 1963, in taxable years ending after such date."

CROSS REFERENCES

Assumption of liability, liabilities in excess of basis, see section 357 (c) of this title.

Carryovers in certain corporate acquisitions, operating rules, see section 381 (b) of this title.

Dividends paid on certain preferred stock of public utilities, stock issued in reorganization as defined in this section, see section 247 (b) (2) of this title.

Section 306 stock defined, stock received in reorganization within meaning of this section, see section 306 (c) (1) (B) of this title.

Taxability of beneficiary of employees' trust, certain plan terminations, see section 402 (e) of this title.

Transfer to corporation controlled by transferor, definition of control, see section 351 (a) of this title.

Transferred assets, other taxes, see section 6901 (a) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 247, 249, 279, 306, 351, 354, 355, 357, 381, 402, 512, 815, 1101, 1232, 1244, 4912, 4920, 6166, 6901 of this title; title 12 section 1717.

PART IV.—INSOLVENCY REORGANIZATIONS

Sec.

371. Reorganization in certain receivership and bankruptcy proceedings.
372. Basis in connection with certain receivership and bankruptcy proceedings.
373. Loss not recognized in certain railroad reorganizations.
374. Gain or loss not recognized in certain railroad reorganizations.

AMENDMENTS

1956—Act June 29, 1956, ch. 463, § 4, 70 Stat. 403, added item 374.

§ 371. Reorganization in certain receivership and bankruptcy proceedings.

(a) Exchanges by corporations.

(1) In general.

No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77 (m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205)) is transferred in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership, foreclosure, or similar proceeding, or

(B) in a proceeding under chapter X of the Bankruptcy Act (52 Stat. 883–905; 11 U. S. C., chapter 10) or the corresponding provisions of prior law,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

(2) Gain from exchanges not solely in kind.

If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by paragraph (1) to be received without the recognition of gain, but also of other property or money, then—

(A) if the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(B) if the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(b) Exchanges by security holders.

(1) In general.

No gain or loss shall be recognized on an exchange consisting of the relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (a), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

(2) Gain from exchanges not solely in kind.

If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of property permitted by paragraph (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(c) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (a) (1) or (b) (1) if it were not for the fact that the property received in exchange consists not only of property permitted by subsection (a) (1) or (b) (1) to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(d) Assumption of liabilities.

In the case of a transaction involving an assumption of a liability or the acquisition of property subject to a liability, the rules provided in section 357 shall apply. (Aug. 16, 1954, ch. 736, 68A Stat. 121.)

CROSS REFERENCES

Assumption of liability, see section 357 of this title.

Basis in connection with receivership and bankruptcy proceedings to which this section applies, see section 372 of this title.

Basis to distributees, see section 358 of this title.

Dividends paid on certain preferred stock of public utilities, transactions to which this section applies, see section 247 (b) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 247, 341, 357, 372, 1232, 1245, 1250, 1251 of this title.

§ 372. Basis in connection with certain receivership and bankruptcy proceedings.

(a) Corporation.

If property was acquired by a corporation in a transfer to which—

(1) section 371 (a) applies,

(2) so much of section 371 (c) as relates to section 371 (a) (1) applies, or

(3) the corresponding provisions of prior law apply,

then notwithstanding the provisions of section 270 of the Bankruptcy Act (54 Stat. 709; 11 U. S. C. 670), the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and such basis shall not be adjusted under section 1017 by reason of a discharge of indebtedness in pursuance of the plan of reorganization under which such transfer was made.

(h) Adjustment for depreciation sustained before March 1, 1913, in certain cases of property acquired from retirement method corporations.

(1) In general.

If the taxpayer has acquired property in a transaction described in section 373 (b) or 374 (b), and if any such property constitutes retirement-straight line property, then, in determining the adjusted basis of all retirement-straight line property held by the taxpayer on his adjustment date, adjustment shall be made (in lieu of the adjustment provided in section 1016 (a) (3) (A)) for depreciation sustained before March 1, 1913, on retirement-straight line property which was held on such date for which cost was or is claimed as basis, and which either—

(A) Retired before acquisition by taxpayer.

Was retired before the acquisition of the retirement-straight line property by the taxpayer, but only if a deduction was allowed in computing net income by reason of such retirement, and such deduction was computed on the basis of cost without adjustment for depreciation sustained before March 1, 1913. In the case of any such property retired during any taxable year beginning after December 31, 1929, the adjustment under this subparagraph shall not exceed that portion of the amount attributable to depreciation sustained before March 1, 1913, which resulted (by reason of the deduction so allowed) in a reduction in taxes under this subtitle or prior income, war-profits, or excess-profits tax laws.

(B) Acquired by taxpayer.

Was acquired by the taxpayer.

The adjustment determined under this paragraph shall be allocated (in the manner prescribed by the Secretary or his delegate) among all retirement-straight line property held by the taxpayer on his adjustment date. Such adjustment shall apply to all periods on and after the adjustment date.

(2) Retirement-straight line property defined.

For purposes of this subsection, the term "retirement-straight line property" means any property of a kind or class with respect to which (A) the corporation transferring such property to the taxpayer was using (at the time of transfer) the retirement method of computing the allowance of deductions for depreciation, and (B) the acquiring corporation has adopted any other method of computing such allowance.

(3) Other definitions.

For purposes of this subsection:

(A) Depreciation.

The term "depreciation" means exhaustion, wear and tear, and obsolescence.

(B) Adjustment date.

In the case of any kind or class of property, the term "adjustment date" means whichever of the following is the later:

(i) the first day of the taxpayer's first taxable year beginning after December 31, 1955, or

(ii) the first day of the first taxable year in which the taxpayer uses a method of computing the allowance of deductions for depreciation other than the retirement method.

(c) Stock or security holder.

For basis of stock or securities acquired under section 371 (b), see section 358.

(Aug. 16, 1954, ch. 736, 68A Stat. 122; Sept. 2, 1958, Pub. L. 85–866, title I, § 95(a), 72 Stat. 1671.)

AMENDMENTS

1958—Subsec. (b). Pub. L. 85–866 added subsec. (b) and redesignated former subsec. (b) as (c).

Subsec. (c). Pub. L. 85–866 redesignated former subsec. (b) as (c).

EFFECTIVE DATE OF 1958 AMENDMENT

Section 95 (b) of Pub. L. 85–866 provided that:

"(1) In general.—The amendments made by subsection (a) [to subsecs. (b) and (c) of this section] shall apply only to taxable years beginning after December 31, 1955.

"(2) Exception.—The amendments made by subsection (a) shall not apply with respect to any taxpayer if, before the date of the enactment of this Act [Sept. 2, 1958], there has been a determination, for any taxable year, of the adjusted basis of retirement-straight line property of the taxpayer of the type described in section 372 (b) of the Internal Revenue Code of 1954 (as added by subsection (a)) by the Tax Court of the United States, or by any other court of competent jurisdiction, in any proceeding in which the decision of the court became final after December 31, 1955, and which established the right of the taxpayer to use the straight line depreciation method of computing the annual depreciation allowance with respect to such property for Federal tax purposes for any year."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 615, 617 of this title.

§ 373. Loss not recognized in certain railroad reorganizations.

(a) Nonrecognition of loss.

No loss shall be recognized if property of a railroad corporation, as defined in section 77 (m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205), is transferred before August 1, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

(1) in a receivership proceeding, or

(2) in a proceeding under section 77 of the Bankruptcy Act,

to a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding.

(b) Basis.

(1) Railroad corporations.

If the property of a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) was acquired after December 31, 1938, and before August 1, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77 of the Bankruptcy Act,

and the acquiring corporation is a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, the basis shall be the same as it would be in the hands of the railroad corporation whose property was so acquired.

(2) Property acquired by street, suburban, or interurban electric railway corporation.

If the property of any street, suburban, or interurban electric railway corporation engaged as a common carrier in the transportation of persons or property in interstate commerce was acquired after December 31, 1934, in pursuance of an order of the court having jurisdiction of such corporation in a proceeding under section 77B of the Bankruptcy Act (48 Stat. 912), and the acquiring corporation is a street, suburban, or interurban electric railway engaged as a common carrier in the transportation of persons or property in interstate commerce, organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, then, notwithstanding the provisions of section 270 of the Bankruptcy Act (52 Stat. 904; 11 U. S. C. 670), the basis shall be the same as it would be in the hands of the corporation whose property was so acquired.

(Aug. 16, 1954, ch. 736, 68A Stat. 123; June 29, 1956, ch. 463, § 3, 70 Stat. 403.)

AMENDMENTS

1956—Subsec. (a). Act June 29, 1956, § 3(1), substituted "transferred before August 1, 1955, in pursuance" for "transferred in pursuance".

Subsec. (b)(1). Act June 29, 1956, § 3(2), substituted "December 31, 1938, and before August 1, 1955" for "December 31, 1938"

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 372, 615, 617, 1232 of this title.

§ 374. Gain or loss not recognized in certain railroad reorganizations.

(a) Exchanges by corporations.

(1) Nonrecognition of gain or loss.

No gain or loss shall be recognized if property of a railroad corporation, as defined in section 77 (m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205), is transferred after July 31, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77 of the Bankruptcy Act,

to another railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in ex-

change solely for stock or securities in such other railroad corporation.

(2) Gain from exchanges not solely in kind.

If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by paragraph (1) to be received without the recognition of gain, but also of other property or money, then—

(A) if the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(B) if the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(3) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(b) Basis.

If the property of a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) was acquired after July 31, 1955, in pursuance of an order of the court having jurisdiction of such corporation—

(1) in a receivership proceeding, or

(2) in a proceeding under section 77 of the Bankruptcy Act, and the acquiring corporation is a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding,

the basis shall be the same as it would be in the hands of the railroad corporation whose property was so acquired, increased in the amount of gain recognized under subsection (a) (2) to the transferor on such transfer.

(c) Assumption of liabilities.

In the case of a transaction involving an assumption of a liability or the acquisition of property subject to a liability, the rules provided in section 357 shall apply. (Added June 29, 1956, ch. 463, § 1, 70 Stat. 402.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 250, 341, 357, 372, 1232, 1245, 1250, 1251 of this title.

PART V.—CARRYOVERS

Sec.
381. Carryovers in certain corporate acquisitions.
382. Special limitations on net operating loss carryovers.

§ 381. Carryovers in certain corporate acquisitions.

(a) General rule.

In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b) (2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354 (b) (1) are met), or (F) of section 368 (a) (1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

(b) Operating rules.

Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368 (a) (1)—

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss or a net capital loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

(c) Items of the distributor or transferor corporation.

The items referred to in subsection (a) are:

(1) Net operating loss carryovers.

The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) In determining the net operating loss deduction, the portion of such deduction attributable to the net operating loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable year as the number of days in the tax-

able year after the date of distribution or transfer bears to the total number of days in the taxable year.

(C) For the purpose of determining the amount of the net operating loss carryovers under section 172 (b) (2), a net operating loss for a taxable year (hereinafter in this subparagraph referred to as the "loss year") of a distributor or transferor corporation which ends on or before the end of a loss year of the acquiring corporation shall be considered to be a net operating loss for a year prior to such loss year of the acquiring corporation. For the same purpose, the taxable income for a "prior taxable year" (as the term is used in section 172 (b) (2)) shall be computed as provided in such section; except that, if the date of distribution or transfer is on a day other than the last day of a taxable year of the acquiring corporation—

(i) such taxable year shall (for the purpose of this subparagraph only) be considered to be 2 taxable years (hereinafter in this subparagraph referred to as the "pre-acqulsition part year" and the "post-acquisition part year");

(ii) the pre-acquisition part year shall begin on the same day as such taxable year begins and shall end on the date of distribution or transfer;

(iii) the post-acquisition part year shall begin on the day following the date of distribution or transfer and shall end on the same day as the end of such taxable year;

(iv) the taxable income for such taxable year (computed with the modifications specified in section 172 (b) (2) (A) but without a net operating loss deduction) shall be dlvided between the pre-acquisition part year and the post-acquisition part year in proportion to the number of days in each;

(v) the net operating loss deduction for the pre-acquisition part year shall be determined as provided in section 172 (b) (2) (B), but without regard to a net operating loss year of the distributor or transferor corporation; and

(vi) the net operating loss deduction for the post-acquisition part year shall be determined as provided in section 172 (b) (2) (B).

(2) Earnings and profits.

In the case of a distribution or transfer described in subsection (a)—

(A) the earnings and profits or deficit in earnings and profits, as the case may be, of the distributor or transferor corporation shall, subject to subparagraph (B), be deemed to have been received or incurred by the acquiring corporation as of the close of the date of the distribution or transfer; and

(B) a deficit in earnings and profits of the distributor, transferor, or acquiring corporation shall be used only to offset earnings and profits accumulated after the date of transfer. For this purpose, the earnings and profits for the taxable year of the acquiring corporation in which the distribution or transfer occurs shall be deemed to have been accumulated after such distribution or transfer in an amount which bears the same ratio to the undistributed earnings and profits of the acquiring corporation for such taxable year (computed without regard to any earnings and profits received from the distributor or transferor corporation, as described in subparagraph (A) of this paragraph) as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(3) Capital loss carryover.

The capital loss carryover determined under section 1212, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the capital loss carryover of the distributor or transferor corporation is first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) The capital loss carryover shall be a short-term capital loss in the taxable year determined under subparagraph (A) but shall be limited to an amount which bears the same ratio to the net capital gain (determined without regard to a short-term capital loss attributable to capital loss carryover), if any, of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(C) For purposes of determining the amount of such capital loss carryover to taxable years following the taxable year determined under subparagraph (A), the net capital gain in tlie taxable year determined under subparagraph (A) shall be considered to be an amount equal to the amount determined under subparagraph (B).

(4) Method of accounting.

The acquiring corporation shall use the method of accounting used by the distributor or transferor corporation on the date of distribution or transfer unless different methods were used by several distributor or transferor corporations or by a distributor or transferor corporation and the acquiring corporation. If different methods were used, the acquiring corporation shall use tlie method or combination of methods of computing taxable income adopted pursuant to regulations prescribed by the Secretary or his delegate.

(5) Inventories.

In any case in which inventories are received by the acquiring corporation, such inventories shall be taken by such corporation (in determining its income) on the same basis on which such inventories were taken by the distributor or transferor corporation, unless different methods were used by several distributor or transferor corporations or by a distributor or transferor corporation and the acquiring corporation. If different methods were used, the acquiring corporation shall use the

method or combination of methods of taking inventory adopted pursuant to regulations prescribed by the Secretary or his delegate.

(6) Method of computing depreciation allowance.

The acquiring corporation shall be treated as the distributor or transferor corporation for purposes of computing the depreciation allowance under subsections (b), (j), and (k) of section 167 on property acquired in a distribution or transfer with respect to so much of the basis in the hands of the acquiring corporation as does not exceed the adjusted basis in the hands of the distributor or transferor corporation.

(7) Repealed. June 15, 1955, ch. 143, § 2 (1), 69 Stat. 134.

(8) Installment method.

If the acquiring corporation acquires installment obligations (the income from which the distributor or transferor corporation has elected, under section 453, to report on the installment basis) the acquiring corporation shall, for purposes of section 453, be treated as if it were the distributor or transferor corporation.

(9) Amortization of bond discount or premium.

If the acquiring corporation assumes liability for bonds of the distributor or transferor corporation issued at a discount or premium, the acquiring corporation shall be treated as the distributor or transferor corporation after the date of distribution or transfer for purposes of determining the amount of amortization allowable or includible with respect to such discount or premium.

(10) Treatment of certain mining exploration and development expenses of distrihutor of transferor corporation.

The acquiring corporation shall be entitled to deduct, as if it were the distributor or transferor corporation, expenses deferred under sections 615 and 616 (relating to pre-1970 exploration expenditures and development expenditures, respectively) if the distributor or transferor corporation has so elected. For the purpose of applying the limitation provided in section 615, if, for any taxable year, the distributor or transferor corporation was allowed the deduction in section 615(a) or made the election in section 615(b), the acquiring corperation shall be deemed to have been allowed such deduction or to have made such election, as the case may be. For the purpose of applying the limitation provided in section 617, if, for any taxable year, the distributor or transferor corporation was allowed the deduction in section 615(a) or section 617(a) or made the election provided in section 615(b), the acquiring corporation shall be deemed to have been allowed such deduction or deductions or to have made such election, as the case may be.

(11) Contributions to pension plans, employees' annuity plans, and stock bonus and profit-sharing plans.

The acquiring corporation shall be considered to be the distributor or transferor corporation after the date of distribution or transfer for the purpose of determining the amounts deductible under section 404 with respect to pension plans, employees' annuity plans, and stock bonus and profit-sharing plans.

(12) Recovery of bad debts, prior taxes, or delinquency amounts.

If the acquiring corporation is entitled to the recovery of bad debts, prior taxes, or delinquency amounts previously deducted or credited by the distributor or transferor corporation, the acquiring corporation shall include in its income such amounts as would have been includible by the distributor or transferor corporation in accordance with section 111 (relating to the recovery of bad debts, prior taxes, and delinquency amounts).

(13) Involuntary conversions under section 1033.

The acquiring corporation shall be treated as the distributor or transferor corporation after the date of distribution or transfer for purposes of applying section 1033.

(14) Dividend carryover to personal holding company.

The dividend carryover (described in section 564) to taxable years ending after the date of distribution or transfer.

(15) Indebtedness of certain personal bolding companies.

The acquiring corporation shall be considered to be the distributor or transferor corporation for the purpose of determining the applicability of subsections (b)(7) and (c) of section 545, relating to deduction with respect to payment of certain indebtedness.

(16) Certain obligations of distributor or transferor corporation.

If the acquiring corporation—

(A) assumes an obligation of the distributor or transferor corporation which, after the date of the distribution or transfer, gives rise to a liability, and

(B) such liability, if paid or accrued by the distributor or transferor corporation, would have been deductible in computing its taxable income,

the acquiring corporation shall be entitled to deduct such items when paid or accrued, as the case may be, as if such corporation were the distributor or transferor corporation. A corporation which would have been an acquiring corporation under this section if the date of distribution or transfer had occurred on or after the effective date of the provisions of this subchapter applicable to a liquidation or reorganization, as the case may be, shall be entitled, even though the date of distribution or transfer occurred before such effective date, to apply this paragraph with respect to amounts paid or accrued in taxable years beginning after December 31, 1953, on account of such obligations of the distributor or transferor corporation. This paragraph shall not apply if such obligations are reflected in the amount of stock, securities, or property transferred by the acquiring corporation to the transferor corporation for the property of the transferor corporation.

(17) Deficiency dividend of personal holding company.

If the acquiring corporation pays a deficiency dividend (as defined in section 547 (d)) with respect to the distributor or transferor corporation, such distributor or transferor corporation shall, with respect to such payments, be entitled to the deficiency dividend deduction provided in section 547.

(18) Percentage depletion on extraction of ores or minerals from the waste or residue of prior mining.

The acquiring corporation shall be considered to be the distributor or transferor corporation for the purpose of determining the applicability of section 613 (c) (3) (relating to extraction of ores or minerals from the ground).

(19) Charitable contributions in excess of prior years' limitation.

Contributions made in the taxable year ending on the date of distribution or transfer and the 4 prior taxable years by the distributor or transferor corporation in excess of the amount deductible under section 170(b)(2) for such taxable years shall be deductible by the acquiring corporation for its taxable years which begin after the date of distribution or transfer, subject to the limitations imposed in section 170(b)(2). In applying the preceding sentence, each taxable year of the distributor or transferor corporation beginning on or before the date of distribution or transfer shall be treated as a prior taxable year with reference to the acquiring corporation's taxable years beginning after such date.

(20) Carry-over of unused pension trust deductions in certain cases.

Notwithstanding the other provisions of this section, or section 394 (a), a corporation which has acquired the properties and assumed the liabilities of a wholly owned subsidiary shall be considered to have succeeded to and to be entitled to take into account contributions of the subsidiary to a pension plan, and shall be considered to be the distributor or transferor corporation after the date of distribution or transfer (but not for taxable years with respect to which this paragraph does not apply) for the purpose of determining the amounts deductible under section 404 with respect to contributions to a pension plan if—

(A) the corporate laws of the State of incorporation of the subsidiary required the surviving corporation in the case of merger to be incorporated under the laws of the State of incorporation of the subsidiary; and

(B) the properties were acquired in a liquidation of the subsidiary in a transaction subject to section 112 (b) (6) of the Internal Revenue Code of 1939.

(21) Pre-1954 adjustments resulting from change in method of accounting.

The acquiring corporation shall take into account any net amount of any adjustment described in section 481 (b) (4) of the distributor or transferor corporation—

(A) to the extent such net amount of such adjustment has not been taken into account by the distributor or transferor corporation, and

(B) in the same manner and at the same time as such net amount would have been taken into account by the distributor or transferor corporation.

(22) Successor insurance company.

If the acquiring corporation is an insurance company taxable under subchapter L, there shall be taken into account (to the extent proper to carry out the purposes of this section and of subchapter L, and under such regulations as may be prescribed by the Secretary or his delegate) the items required to be taken into account for purposes of subchapter L in respect of the distributor or transferor corporation.

(23) Credit under section 38 for investment in certain depreciable property.

The acquiring corporation shall take into account (to the extent proper to carry out the purposes of this section and section 38, and under such regulations as may be prescribed by the Secretary or his delegate) the items required to be taken into account for purposes of section 38 in respect of the distributor or transferor corporation.

(d) Operations loss carrybacks and carryovers of life insurance companies.

For application of this part to operations loss carrybacks and carryovers of life insurance companies, see section 812(f).

(Aug. 16, 1954, ch. 736, 68A Stat. 124; June 15, 1955, ch. 143, § 2(1), 69 Stat. 134; Jan. 28, 1956, ch. 15, § 1, 70 Stat. 7; Sept. 2, 1958, Pub. L. 85–866, title I, § 29 (c), 72 Stat. 1628; June 25, 1959, Pub. L. 86–69, § 3(c), 73 Stat. 139; Oct. 16, 1962, Pub. L. 87–834, § 2(d), 76 Stat. 971; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 209(d)(2), 225(i)(3), 78 Stat. 46, 92; Jan. 2, 1968, Pub. L. 90–240, § 5(d), 81 Stat. 778; Dec. 30, 1969, Pub. L. 91–172, title V, §§ 504(c)(2), 512(c), 521(f), 83 Stat. 633, 639, 654.)

AMENDMENTS

1969—Subsec. (b)(3). Pub. L. 91–172, § 512(c), substituted "a net operating loss or a net capital loss" for "a net operating loss."

Subsec. (c)(6). Pub. L. 91–172, § 521(f), substituted "subsections (b), (j) and (k) of section 167" for "paragraphs (2), (3) and (4) of section 167(b)" and added reference to adjusted basis in the hands of the distributor or transferor corporation.

Subsec. (c)(10). Pub. L. 91–172, § 504(c)(2), substituted "Treatment of certain mining exploration and development expenses of distributor or transferor corporation" for "Treatment of certain expenses deferred by the election of distributor or transferor corporation" in the par. catchline, limited deduction of expenses deferred under sections 615 and 616 of this title by the acquiring corporation as if it were the distributor or transferor corporation to pre-1970 exploration and development expenditures, and added provision that if distributor or transferor corporation, for any taxable year, was allowed the deduction in sections 615(a) or 617(a) of this title or made the election provided in section 615(b) of this title, acquiring corporation shall be deemed to have been allowed such deduction or deductions or to have made such election, as the case may be, for the purpose of applying the limitation provided in section 617 of this title.

1968—Subsec. (c)(22). Pub. L. 90–240 substituted successor insurance companies for successor life insurance companies as the business enterprise covered, substituted reference to insurance companies taxable under subchapter L for reference to life insurance companies as defined in section 801(a), and substituted reference to the purposes of this section and of subchapter L for reference to the purposes of this section and part I of subchapter L.

1964—Subsec. (c)(15). Pub. L. 88–272, § 225(1)(3), substituted "subsections (b)(7) and (c) of section 545, relating to deduction with respect to payment of certain indebtedness" for "section 545(b)(7), relating to a deduction for payment of certain indebtedness incurred before Jan. 1, 1934."

Subsec. (c)(19). Pub. L. 88–272, § 209(d)(2), permitted deductions for contributions made in the taxable year and in 4 prior taxable years, instead of one prior taxable year, and provided that each taxable year beginning on or before the distribution or transfer date shall be treated as a prior taxable year with reference to the acquiring corporation's taxable years beginning after such date.

1962—Subsec. (c)(23). Pub. L. 87–834 added subsec. (c)(23).

1959—Subsec. (c)(22). Pub. L. 86–69, § 3(c)(1), added subsec. (c)(22).

Subsec. (d). Pub. L. 86–69, § 3(c)(2), added subsec. (d).

1958—Subsec. (c)(21). Pub. L. 85–866 added subsec. (c)(21).

1956—Subsec. (c), (20). Act Jan. 28, 1956 added subsec. (c)(20).

1955—Subsec. (c), (7). Act June 15, 1955, repealed subsec. (c)(7), which related to carryover of prepaid income.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (b)(3) by section 512(c) of Pub. L. 91–172 applicable with respect to net capital losses sustained in taxable years beginning after Dec. 31, 1969, see section 512(g) of Pub. L. 91–172, set out as a note under section 1212 of this title.

Amendment of subsec. (c)(6) by section 521(f) of Pub. L. 91–172 applicable with respect to taxable years ending after July 24, 1969, see section 521(g) of Pub. L. 91–172, set out as a note under section 167 of this title.

Amendment of subsec. (c)(10) by section 504(c)(2) of Pub. L. 91–172 applicable with respect to exploration expenditures paid or incurred after Dec. 31, 1969, see section 504(d)(1) of Pub. L. 91–172, set out as a note under section 615 of this title.

EFFECTIVE DATE OF 1968 AMENDMENT

Amendment of subsec. (c)(22) of this section by Pub. L. 90–240 applicable to taxable years beginning after Dec. 31, 1966, see section 5(e) of Pub. L. 90–240, set out as a note under section 832 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (c)(15) by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272 set out as a note under section 316 of this title.

Amendment of subsec. (c)(19) by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, with respect to contributions paid or treated as paid under section 170(a)(2) of this title, in taxable years beginning after Dec. 31, 1961, see section 209(f)(2) of Pub. L. 88–272, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Subsec. (c)(23) of this section applicable with respect to taxable years ending after Dec. 31, 1961, see section 2(h) of Pub. L. 87–834, set out as a note under section 38 of this title.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86–69 applicable only with respect to taxable years beginning after December 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

For effective date of amendment by Pub. L. 85–866, which added subsec. (c)(21), see section 29(d) of Pub. L. 85–866, set out as a note under section 481 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Section 2 of act Jan. 28, 1956, provided that: "The amendments made by the first section of this Act [adding subsec. (c), par. (20) of this section] shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954."

EFFECTIVE DATE OF 1955 AMENDMENT

Section 3 of act June 15, 1955, provided that the repeal of sections 452 and 462 of this title and par. (7), subsec. (c) of this section, should apply with respect to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954.

SAVINGS PROVISIONS

Section 4 of act June 15, 1955, provided:

"(a) FILING OF STATEMENT.—If—

"(1) the amount of any tax required to be paid for any taxable year ending on or before the date of the enactment of this Act [June 15, 1955] is increased by reason of the enactment of this Act [repealing sections 452 and 462, and par. (7) of subsec. (c) of this section], and

"(2) the last date prescribed for payment of such tax (or any installment thereof) is before December 15, 1955, then the taxpayer shall, on or before December 15, 1955, file a statement which shows the increase in the amount of such tax required to be paid by reason of the enactment of this Act.

"(b) FORM AND EFFECT OF STATEMENT.—

"(1) FORM OF STATEMENT, ETC.—The statement required by subsection (a) shall be filed at the place fixed for filing the return. Such statement shall be in such form, and shall include such information necessary or appropriate to show the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act, as the Secretary of the Treasury or his delegate shall by regulations prescribe.

"(2) TREATMENT AS AMOUNT SHOWN ON RETURN.—The amount shown on a statement filed under subsection (a) as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act shall, for all purposes of the internal revenue laws, be treated as tax shown on the return. Notwithstanding the preceding sentence, that portion of the amount of increase in tax for any taxable year which is attributable to a decrease (by reason of the enactment of this Act) in the net operating loss for a succeeding taxable year shall not be treated as tax shown on the return.

"(3) WAIVER OF INTEREST IN CASE OF PAYMENT ON OR BEFORE DECEMBER 15, 1955.—If the taxpayer, on or before December 15, 1955, files the statement referred to in subsection (a) and pays in full that portion of the amount shown thereon for which the last date prescribed for payment is before December 15, 1955, then for purposes of computing interest (other than interest on overpayments) such portion shall be treated as having been paid on the last date prescribed for payment. This paragraph shall not apply if the amount shown on the statement as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act is greater than the actual increase unless the taxpayer establishes, to the satisfaction of the Secretary of the Treasury or his delegate, that his computation of the greater amount was based upon a reasonable interpretation and application of sections 452 and 462 of the Internal Revenue Code of 1954, as those sections existed before the enactment of this Act.

"(c) SPECIAL RULES.—

"(1) INTEREST FOR PERIOD BEFORE ENACTMENT.—Interest shall not be imposed on the amount of any increase in tax resulting from the enactment of this Act for any period before the day after the date of the enactment of this Act [June 15, 1955].

"(2) ESTIMATED TAX.—Any addition to the tax under section 294(d) of the Internal Revenue Code of 1939 shall be computed as if this Act had not been enacted. In the case of any installment for which the last date prescribed for payment is before December 15, 1955, any addition to the tax under section 6654 of the Internal Revenue Code of 1954 shall be computed as if this Act had not been enacted.

"(3) TREATMENT OF CERTAIN PAYMENTS WHICH TAXPAYER IS REQUIRED TO MAKE.—If—

"(A) the taxpayer is required to make a payment (or an additional payment) to another person by reason of the enactment of this Act, and

"(B) the Internal Revenue Code of 1954 prescribes a period, which expires after the close of the taxable year, within which the taxpayer must make such payment (or additional payment) if the amount thereof is to be taken into account (as a deduction or otherwise) in computing taxable income for such taxable year,

then, subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, if such payment (or additional payment) is made on or before December 15, 1955, it shall be treated as having been made within the period prescribed by such Code.

"(4) TREATMENT OF CERTAIN DIVIDENDS.—Subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, for purposes of section 561 (a) (1) of the Internal Revenue Code of 1954, dividends paid after the 15th day of the third month following the close of the taxable year and on or before December 15, 1955, may be treated as having been paid on the last day of the taxable year, but only to the extent (A) that such dividends are attributable to an increase in taxable income for the taxable year resulting from the enactment of this Act, and (B) elected by the taxpayer.

"(5) DETERMINATION OF DATE PRESCRIBED.—For purposes of this section, the determination of the last date prescribed for payment or for filing a return shall be made without regard to any extension of time therefor and without regard to any provision of this section.

"(6) REGULATIONS.—For requirement that the Secretary of the Treasury or his delegate shall prescribe all rules and regulations as may be necessary by reason of the enactment of this Act, see section 7805 (a) of the Internal Revenue Code of 1954."

CROSS REFERENCES

Effect on earnings and profits, see section 312 of this title.

Effective date of part V of subchapter C, this section as applicable to liquidations and reorganizations, see section 394 (a) of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88-272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 47, 48, 166, 250, 382, 394, 481, 545, 593, 615, 617, 805, 810, 812, 815, 818, 832, 1251 of this title.

§ 382. Special limitations on net operating loss carryovers.

(a) Purchase of a corporation and change in its trade or business.

(1) In general.

If, at the end of a taxable year of a corporation—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

(2) Description of person or persons.

The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of such outstanding stock.

(3) Attribution of ownership.

Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

(4) Definition of purchase.

For purposes of this subsection, the term "purchase" means the acquisition of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

(b) Change of ownership as the result of a reorganization.

(1) In general.

If, in the case of a reorganization specified in paragraph (2) of section 381 (a), the transferor corporation or the acquiring corporation—

(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corporation ending

after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) Reduction of net operating loss carryover.

The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

(3) Exception to limitation in this subsection.

The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion.

(4) Net operating loss carryovers to subsequent years.

In computing the net operating loss carryovers to taxable years subsequent to a taxable year in which there was a limitation applicable to a net operating loss carryover by operation of this subsection, the income in such taxable year, as computed under section 172 (b) (2), shall be increased by the amount of the reduction of the total net operating loss carryover determined under paragraph (2).

(5) Attribution of ownership.

If the transferor corporation or the acquiring corporation owns (immediately before the reorganization) any of the outstanding stock of the loss corporation, such transferor corporation or acquiring corporation shall, for purposes of this subsection, be treated as owning (immediately after the reorganization) a percentage of the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to the percentage of the fair market value of the outstanding stock of the loss corporation (immediately before the reorganization) owned by such transferor corporation or acquiring corporation as the fair market value of the total outstanding stock of the loss corporation (immediately before the reorganization) bears to the fair market value of the total outstanding stock of the acquiring corporation (immediately after the reorganization).

(6) Stock of corporation controlling acquiring corporation.

If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

(c) Definition of stock.

For purposes of this section, "stock" means all shares except nonvoting stock which is limited and preferred as to dividends. (Aug. 16, 1954, ch. 736, 68A Stat. 129; Aug. 31, 1964, Pub. L. 88-554, § 4(b)(3), 78 Stat. 763.)

AMENDMENTS

1964—Subsec. (a)(3). Pub. L. 88-554 inserted the reference to section 318(a)(3)(C) of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by section 4 of Pub. L. 88-554 effective Aug. 31, 1964, except that for purposes of sections 302 and 304 of this title, such amendments shall not apply to distributions in payment for stock acquisitions or redemptions, if such acquisitions or redemptions occurred before Aug. 31, 1964, see section 4(c) of Pub. L. 88-554, set out as a note under section 318 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 394 of this title.

PART VI.—TREATMENT OF CERTAIN CORPORATE INTERESTS AS STOCK OR INDEBTEDNESS

Sec.

385. Treatment of certain interests in corporations as stock or indebtedness.

AMENDMENTS

1969—Pub. L. 91-172, title IV, § 415(a), Dec. 30, 1969, 83 Stat. 613, added Part heading and analysis of sections.

§ 385. Treatment of certain interests in corporations as stock or indebtedness.

(a) Authority to prescribe regulations.

The Secretary or his delegate is authorized to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated for purposes of this title as stock or indebtedness.

(b) Factors.

The regulations prescribed under this section shall set forth factors which are to be taken into account in determining with respect to a particular factual situation whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists. The factors so set forth in the regulations may include among other factors:

(1) whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest,

(2) whether there is subordination to or preference over any indebtedness of the corporation,

(3) the ratio of debt to equity of the corporation,

(4) whether there is convertibility into the stock of the corporation, and

(5) the relationship between holdings of stock in the corporation and holdings of the interest in question.

(Added Pub. L. 91-172, title IV, § 415(a), Dec. 30, 1969, 83 Stat. 613.)

PART VII.—EFFECTIVE DATE OF SUBCHAPTER C

Sec.

391. Effective date of part I.
392. Effective date of part II.
393. Effective dates of parts III and IV.
394. Effective date of part V.
395. Special rules for application of this subchapter.

AMENDMENTS

1969—Pub. L. 91-172, title IV, § 415(a), Dec. 30, 1969, 83 Stat. 613, substituted "Part VII" for "Part VI" as the Part designation.

§ 391. Effective date of part I.

Except as otherwise provided in this subchapter, part I shall take effect on June 22, 1954. Section 306 shall apply only with respect to dispositions (or redemptions) occurring on or after June 22, 1954. In the case of—

(1) any acquisition of stock described in section 304 which occurred before June 22, 1954, and

(2) any acquisition of stock described in such section which occurred on or after June 22, 1954, and on or before December 31, 1958, pursuant to a contract entered into before June 22, 1954,

the extent to which the property received in return for such acquisition shall be treated as a dividend shall be determined as if the Internal Revenue Code of 1939 continued to apply in respect of such acquisition and as if this Code had not been enacted.

(Aug. 16, 1954, ch. 736, 68A Stat. 131; Sept. 2, 1958, Pub. L. 85–866, title I, § 22(a), 72 Stat. 1620.)

AMENDMENTS

1958—Pub. L. 85–866 added sentence relating to acquisition of stock before June 22, 1954, and acquisition of stock on or after June 22, 1954, and on or before Dec. 31, 1958.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 22 (b) of Pub. L. 85–866 provided that: "The third sentence of section 391 of the Internal Revenue Code of 1954, as added by subsection (a) of this section, shall apply as if included in such section on the date of the enactment of such Code [Aug. 16, 1954]."

§ 392. Effective date of part II.

(a) General rule.

Except as otherwise provided in this subchapter, part II shall apply with respect to a plan of liquidation only if the first distribution in pursuance of such plan occurs on or after June 22, 1954. Section 341 shall apply only with respect to sales, exchanges, and distributions on or after June 22, 1954.

(b) Special rule for certain sales during 1954.

(1) Nonrecognition of gain or loss.

If—

(A) all of the assets of a corporation (less assets retained to meet claims) are distributed before January 1, 1955, in complete liquidation of such corporation; and

(B) the corporation elects (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have this subsection apply,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property during the calendar year 1954.

(2) Certain provisions of section 337 made applicable.

For purposes of paragraph (1)—

(A) the term "property" has the meaning given to such term by section 337 (b); except that any determination required by section 337 (b) to be made by reference to the date of the adoption of the plan of liquidation shall be made by reference to January 1, 1954; and

(B) the limitations of section 337 (c) shall apply.

For purposes of section 453 (d) (4) (B) (relating to disposition of installment obligations), nonrecognition of gain or loss under paragraph (1) of this subsection shall be treated as nonrecognition of gain or loss under section 337.

(3) Plans of liquidation adopted after December 31, 1953, and before June 22, 1954.

If the plan of complete liquidation was adopted after December 31, 1953, and before June 22, 1954, then, at the election of the corporation (made at such time and in such manner as the Secretary or his delegate may by regulations prescribe)—

(A) the 12-month period beginning on the date of the adoption of such plan shall be (i) the period for distribution (in lieu of the requirement in paragraph (1) (A) of this subsection that the assets be distributed before January 1, 1955), and (ii) the period during which, by reason of paragraph (1) of this subsection, gain or loss to the corporation is not recognized (in lieu of nonrecognition of gain or loss during the calendar year 1954); and

(B) notwithstanding paragraph (2) (A) of this subsection, any determination required by section 337 (b) to be made by reference to the date of the adoption of the plan of liquidation shall be made by reference to such date (and not by reference to January 1, 1954).

(Aug. 16, 1954, ch. 736, 68A Stat. 131.)

§ 393. Effective dates of parts III and IV.

(a) General rule.

Except as otherwise provided in this subchapter, parts III and IV shall take effect on June 22, 1954.

(b) Special rules for plans of reorganization.

(1) In general.

Except as provided in paragraphs (2) and (3), parts III and IV shall apply only in respect of plans of reorganization adopted on or after June 22, 1954. For purposes of this paragraph and paragraphs (2) and (3), a plan to make a transfer to a controlled corporation described in section 351, or a plan to make an exchange or distribution which is described in section 355 (or so much of section 356 as relates to section 355) shall be treated as a plan of reorganization.

(2) Election to have 1939 Code apply.

If—

(A) a plan of reorganization was submitted to the Secretary or his delegate before June 22, 1954, but such plan was not adopted before such date,

(B) the Secretary or his delegate issues (whether before, on, or after such date) a ruling with respect to such plan, and

(C) the corporations which are parties to the reorganization elect (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have this paragraph apply,

then, if such reorganization is completed in accordance with the plan so submitted, the tax treatment of such reorganization (as to the corporations which are parties to the reorganization and as to their shareholders and security holders) shall be determined under the Internal Revenue Code of 1939 (in accordance with the contents of such ruling) and not under this Code.

(3) Election to have 1954 Code apply.

If—

(A) a plan of reorganization—

(i) was adopted after March 1, 1954, and before June 22, 1954, or

(ii) was adopted before June 22, 1954, in pursuance of a court order and all distributions under the plan occur after March 1, 1954, and before July 1, 1954, and

(B) the corporations which are parties to the reorganization elect (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have this paragraph apply,

then the tax treatment of such reorganization (as to the corporations which are parties to the reorganization and as to their shareholders and security holders) shall be determined under this Code and not under the Internal Revenue Code of 1939.

(Aug. 16, 1954, ch. 736, 68A Stat. 132.)

§ 394. Effective date of part V.

(a) Section 381.

Except as otherwise provided in this subchapter, section 381 shall apply to liquidations and reorganizations, the tax treatment of which is determined under this Code.

(b) Section 382 (a).

For purposes of applying the special limitation on net operating loss carryovers in section 382 (a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382 (a) (1) (A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later.

(c) Section 382 (b).

Section 382 (b) shall apply to reorganizations, the tax treatment of which is determined under this Code. (Aug. 16, 1954, ch. 736, 68A Stat. 133.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 381 of this title.

§ 395. Special rules for application of this subchapter.

(a) Taxable years affected.

Any provision of this subchapter the applicability of which is stated in terms of a specific date shall apply with respect to taxable years ending after such date. Each provision shall, in the case of a taxable year subject to the Internal Revenue Code of 1939, be deemed to be included in the Internal Revenue Code of 1939, but shall apply only to taxable years ending after such specific date.

(b) Repeal and continuance of Internal Revenue Code of 1939.

To the extent that the provisions of this subchapter supersede the provisions of the Internal Revenue Code of 1939, such provisions of the Internal Revenue Code of 1939 are hereby repealed. The provisions of the Internal Revenue Code of 1939 shall continue to apply with respect to transactions for which rules are provided in this subchapter until such rules take effect. (Aug. 16, 1954, ch. 736, 68A Stat. 133.)

Subchapter D.—Deferred Compensation, Etc.

Part
I. Pension, profit-sharing, stock bonus plans, etc.
II. Certain stock options.

AMENDMENTS

1964—Pub. L. 88-272, title II, § 221(d)(1), Feb. 26, 1964, 78 Stat. 75, substituted "Certain stock options" for "Miscellaneous provisions" in the heading to Part II.

PART I.—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

Sec.
401. Qualified pension, profit-sharing, and stock bonus plans.
402. Taxability of beneficiary of employees' trust.
403. Taxation of employee annuities.
404. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan.
405. Qualified bond purchase plans.
406. Certain employees of foreign subsidiaries.
407. Certain employees of domestic subsidiaries engaged in business outside the United States.

AMENDMENTS

1964—Pub. L. 88-272, title II, § 220(c)(1), Feb. 26, 1964, 78 Stat. 62, added items 406 and 407.

1962—Pub. L. 87-792, § 5(b), Oct. 10, 1962, 76 Stat. 827, added item 405.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 72 of this title.

§ 401. Qualified pension, profit-sharing, and stock bonus plans.

(a) Requirements for qualification.

A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404 (a) (3) (B) (relating to deduction for contributions to profit-sharing and stock bonus plans), for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries;

(3) if the trust, or two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under this subsection which benefits either—

(A) 70 percent or more of all the employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding 5 years, employees whose customary employment is for not more than 20

hours in any one week, and employees whose customary employment is for not more than 5 months in any calendar year, or

(B) such employees as qualify under a classification set up by the employer and found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees;

and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

(5) A classification shall not be considered discriminatory within the meaning of paragraph (3)(B) or (4) merely because it excludes employees the whole of whose remuneration constitutes "wages" under section 3121(a)(1) (relating to the Federal Insurance Contributions Act) or merely because it is limited to salaried or clerical employees. Neither shall a plan be considered discriminatory within the meaning of such provisions merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, or merely because the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" by section 3121(a)(1) differ from the contributions or benefits based on employee's remuneration not so excluded, or differ because of any retirement benefits created under State or Federal law. For purposes of this paragraph and paragraph (10), the total compensation of an individual who is an employee within the meaning of subsection (c)(1) means such individual's earned income (as defined in subsection (c)(2)), and the basic or regular rate of compensation of such an individual shall be determined, under regulations prescribed by the Secretary or his delegate, with respect to that portion of his earned income which bears the same ratio to his earned income as the basic or regular compensation of the employees under the plan bears to the total compensation of such employees.

(6) A plan shall be considered as meeting the requirements of paragraph (3) during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, upon its termination or upon complete discontinuance of contributions under the plan, the rights of all employees to benefits accrued to the date of such termination or discontinuance, to the extent then funded, or the amounts credited to the employees' accounts are nonforfeitable. This paragraph shall not apply to benefits or contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by paragraph (4), may not be used for designated employees in the event of early termination of the plan.

(8) A trust forming part of a pension plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

(9) In the case of a plan which provides contributions or benefits for employees some or all of whom are employees within the meaning of subsection (c)(1), a trust forming part of such plan shall not constitute a qualified trust under this section unless, under the plan, the entire interest of each employee—

(A) either will be distributed to him not later than his taxable year in which he attains the age of 70½ years, or, in the case of an employee other than an owner-employee (as defined in subsection (c)(3)), in which he retires, whichever is the later, or

(B) will be distributed, commencing not later than such taxable year, (i) in accordance with regulations prescribed by the Secretary or his delegate, over the life of such employee or over the lives of such employee and his spouse, or (ii) in accordance with such regulations, over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and his spouse.

A trust shall not be disqualified under this paragraph by reason of distributions under a designation, prior to the date of the enactment of this paragraph, by any employee under the plan of which such trust is a part, of a method of distribution which does not meet the terms of the preceding sentence.

(10) In the case of a plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3))—

(A) paragraph (3) and the first and second sentences of paragraph (5) shall not apply, but—

(i) such plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of or on behalf of employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, and

(ii) such plan shall not be considered discriminatory within the meaning of paragraph (4) solely because under the plan contributions described in subsection (e)(3)(A) which are in excess of the amounts which may be deducted under section 404 for the taxable year may be made on behalf of any owner-employee; and

(B) a trust forming a part of such plan shall constitute a qualified trust under this section only if the requirements in subsection (d) are also met.

(b) Certain retroactive changes in plan.

A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the re-

quirements of paragraphs (3), (4), (5), and (6) of subsection (a) for the period beginning with the date on which it was put into effect and ending with the 15th day of the third month following the close of the taxable year of the employer in which the plan was put in effect, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period.

(c) Definitions and rules relating to self-employed individuals and owner-employees.

For purposes of this section—

(1) Employee.

The term "employee" includes, for any taxable year, an individual who has earned income (as defined in paragraph (2)) for the taxable year. To the extent provided in regulations prescribed by the Secretary or his delegate, such term also includes, for any taxable year—

(A) an individual who would be an employee within the meaning of the preceding sentence but for the fact that the trade or business carried on by such individual did not have net profits for the taxable year, and

(B) an individual who has been an employee within the meaning of the preceding sentence for any prior taxable year.

(2) Earned income.

(A) In general.

The term "earned income" means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined—

(i) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor,

(ii) without regard to paragraphs (4) and (5) of section 1402(c),

(iii) in the case of any individual who is treated as an employee under sections 3121 (d)(3) (A), (C); or (D), without regard to paragraph (2) of section 1402(c), and

(iv) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

For purposes of this subparagraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date.

(B) Omitted. Pub. L. 89-809, title II, § 204(c), Nov. 13, 1966, 80 Stat. 1577.

(C) Income from disposition of certain property.

For purposes of this section, the term "earned income" includes gains (other than any gain which is treated under any provision of this chapter as gain from the sale or exchange of a capital asset) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created such property.

(3) Owner-employee.

The term "owner-employee" means an employee who—

(A) owns the entire interest in an unincorporated trade or business, or

(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

To the extent provided in regulations prescribed by the Secretary or his delegate, such term also means an individual who has been an owner-employee within the meaning of the preceding sentence.

(4) Employer.

An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

(5) Contributions on behalf of owner-employees.

The term "contribution on behalf of an owner-employee" includes, except as the context otherwise requires, a contribution under a plan—

(A) by the employer for an owner-employee, and

(B) by an owner-employee as an employee.

(d) Additional requirements for qualification of trusts and plans benefiting owner-employees.

A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the following requirements of this subsection are met by the trust and by the plan of which such trust is a part:

(1) In the case of a trust which is created on or after the date of the enactment of this subsection, or which was created before such date but is not exempt from tax under section 501(a) as an organization described in subsection (a) on the day before such date, the trustee is a bank, but a person (including the employer) other than a bank may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments (including reinvestments, disposals, and exchanges) or by disapproving proposed investments (including reinvestments, disposals, and exchanges). This paragraph shall not apply to a trust created or organized outside the United States before the date of the enactment of this subsection if, under section 402(c), it is treated as exempt from tax under section 501(a) on the day before such date; or, to the extent provided under regulations prescribed by the Secretary or his delegate, to a trust which uses annuity, endowment, or life insurance contracts of a life insurance company exclusively to fund the benefits prescribed by the trust, if the life insurance company supplies annually such information about trust transactions affecting owner-employees as the Secretary or his delegate shall by forms or regulations prescribe. For purposes of this paragraph, the term "bank"

means a bank as defined in section 581, a corporation which under the laws of the State of its incorporation is subject to supervision and examination by the commissioner of banking or other officer of such State in charge of the administration of the banking laws of such State, and, in the case of a trust created or organized outside the United States, a bank or trust company, wherever incorporated, exercising fiduciary powers and subject to supervision and examination by governmental authority.

(2) Under the plan—

(A) the employees' rights to or derived from the contributions under the plan are nonforfeitable at the time the contributions are paid to or under the plan; and

(B) in the case of a profit-sharing plan, there is a definite formula for determining the contributions to be made by the employer on behalf of employees (other than owner-employees).

Subparagraph (A) shall not apply to contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to reclude the discrimination prohibited by subsection (a)(4), may not be used to provide benefits for designated employees in the event of early termination of the plan.

(3) The plan benefits each employee having a period of employment of 3 years or more. For purposes of the preceding sentence, the term "employee" does not include any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year.

(4) Under the plan—

(A) contributions or benefits are not provided for any owner-employee unless such owner-employee has consented to being included under the plan; and

(B) no benefits may be paid to any owner-employee, except in the case of his becoming disabled (within the meaning of section 72(m)(7)), prior to his attaining the age of 59½ years.

(5) The plan does not permit—

(A) contributions to be made by the employer on behalf of any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year;

(B) in the case of a plan which provides contributions or benefits only for owner-employees, contributions to be made on behalf of any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year; and

(C) if a distribution under the plan is made to any employee and if any portion of such distribution is an amount described in section 72(m)(5)(A)(i), contributions to be made on behalf of such employee for the 5 taxable years succeeding the taxable year in which such distribution is made.

Subparagraphs (A) and (B) shall not apply to any contribution which is not considered to be an excess contribution (as defined in subsection (e)(1)) by reason of the application of subsection (e)(3).

(6) Except as provided in this paragraph, the plan meets the requirements of subsection (a)(4) without taking into account for any purpose contributions or benefits under chapter 2 (relating to tax on self-employment income), chapter 21 (relating to Federal Insurance Contributions Act), title II of the Social Security Act, as amended, or any other Federal or State law. If—

(A) of the contributions deductible under section 404, not more than one-third is deductible by reason of contributions by the employer on behalf of owner-employees, and

(B) taxes paid by the owner-employees under chapter 2 (relating to tax on self-employment income), and the taxes which would be payable under such chapter 2 by the owner-employees but for paragraphs (4) and (5) of section 1402(c), are taken into account as contributions by the employer on behalf of such owner-employees,

then taxes paid under section 3111 (relating to tax on employers) with respect to an employee may, for purposes of subsection (a)(4), be taken into account as contributions by the employer for such employee under the plan.

(7) Under the plan, if an owner-employee dies before his entire interest has been distributed to him, or if distribution has been commenced in accordance with subsection (a)(9)(B) to his surviving spouse and such surviving spouse dies before his entire interest has been distributed to such surviving spouse, his entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of his surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which will be immediately distributed to such beneficiary or beneficiaries. The preceding sentence shall not apply if distribution of the interest of an owner-employee has commenced and such distribution is for a term certain over a period permitted under subsection (a)(9)(B)(ii).

(8) Under the plan—

(A) any contribution which is an excess contribution, together with the income attributable to such excess contribution, is (unless subsection (e)(2)(E) applies) to be repaid to the owner-employee on whose behalf such excess contribution is made;

(B) if for any taxable year the plan does not, by reason of subsection (e)(2)(A), meet (for purposes of section 404) the requirements of this subsection with respect to an owner-employee, the income for the taxable year attributable to the interest of such owner-employee under the plan is to be paid to such owner-employee; and

(C) the entire interest of an owner-employee is to be repaid to him when required by the provisions of subsection (e)(2)(E).

(9)(A) If the plan provides contributions or benefits for an owner-employee who controls, or for two or more owner-employees who together control, the trade or business with respect to which the plan is established, and who also control as an owner-employee or as owner-employees one or more other trades or businesses, such plan and the plans established with respect to such other trades or businesses, when coalesced, constitute a single plan which meets the requirements of subsection (a) (including paragraph (10) thereof) and of this subsection with respect to the employees of all such trades or businesses (including the trade or business with respect to which the plan intended to qualify under this section is established).

(B) For purposes of subparagraph (A), an owner-employee, or two or more owner-employees, shall be considered to control a trade or business if such owner-employee, or such two or more owner-employees together—

(i) own the entire interest in an unincorporated trade or business, or

(ii) in the case of a partnership, own more than 50 percent of either the capital interest or the profits interest in such partnership.

For purposes of the preceding sentence, an owner-employee, or two or more owner-employees, shall be treated as owning any interest in a partnership which is owned, directly or indirectly, by a partnership which such owner-employee, or such two or more owner-employees, are considered to control within the meaning of the preceding sentence.

(10) The plan does not provide contributions or benefits for any owner-employee who controls (within the meaning of paragraph (9)(B)), or for two or more owner-employees who together control, as an owner-employee or as owner-employees, any other trade or business, unless the employees of each trade or business which such owner-employee or such owner-employees control are included under a plan which meets the requirements of subsection (a) (including paragraph (10) thereof) and of this subsection, and provides contributions and benefits for employees which are not less favorable than contributions and benefits provided for owner-employees under the plan.

(11) Under the plan, contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established.

(e) Excess contributions on behalf of owner-employees.

(1) Excess contribution defined.

For purposes of this section, the term "excess contribution" means, except as provided in paragraph (3)—

(A) if, in the taxable year, contributions are made under the plan only on behalf of owner-employees, the amount of any contribution made on behalf of any owner-employee which (without regard to this subsection) is not deductible under section 404 for the taxable year; or

(B) if, in the taxable year, contributions are made under the plan on behalf of employees other than owner-employees—

(i) the amount of any contribution made by the employer on behalf of any owner-employee which (without regard to this subsection) is not deductible under section 404 for the taxable year;

(ii) the amount of any contribution made by any owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees;

(iii) the amount of any contribution made by any owner-employee (as an employee) which exceeds the lesser of $2,500 or 10 percent of the earned income for such taxable year derived by such owner-employee from the trade or business with respect to which the plan is established; and

(iv) in the case of any individual on whose behalf contributions are made under more than one plan as an owner-employee, the amount of any contribution made by such owner-employee (as an employee) under all such plans which exceeds $2,500; and

(C) the amount of any contribution made on behalf of an owner-employee in any taxable year for which, under paragraph (2) (A) or (E), the plan does not (for purposes of section 404) meet the requirements of subsection (d) with respect to such owner-employee.

For purposes of this subsection, the amount of any contribution which is allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

(2) Effect of excess contribution.

(A) In general.

If an excess contribution (other than an excess contribution to which subparagraph (E) applies) is made on behalf of an owner-employee in any taxable year, the plan with respect to which such excess contribution is made shall, except as provided in subparagraphs (C) and (D), be considered, for purposes of section 404, as not meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year and for all succeeding taxable years.

(B) Inclusion of amounts in gross income of owner-employees.

For any taxable year for which any plan does not meet the requirements of subsection (d) with respect to an owner-employee by reason of subparagraph (A), the gross income of such owner-employee shall, for purposes of this chapter, include the amount of net income for such taxable year attributable to the interest of such owner-employee under such plan.

(C) Repayment within prescribed period.

Subparagraph (A) shall not apply to an excess contribution with respect to any taxable year, if, on or before the close of the 6-month period beginning on the day on which the Secretary or his delegate sends notice (by certified or registered mail) to the person to whom such excess contribution was paid of the amount of such excess contribution, the amount of such excess contribution, and the net income attributable thereto, is repaid to the owner-employee on whose behalf such excess contribution was made. If the excess contribution is an excess contribution as defined in paragraph (1)(A) or (B)(i), or is an excess contribution as defined in paragraph (1)(C) with respect to which a deduction has been claimed under section 404, the notice required by the preceding sentence shall not be mailed prior to the time that the amount of the tax under this chapter of such owner-employee for the taxable year in which such excess contribution was made has been finally determined.

(D) Repayment after prescribed period.

If an excess contribution, together with the net income attributable thereto, is not repaid within the 6-month period referred to in subparagraph (C), subparagraph (A) shall not apply to an excess contribution with respect to any taxable year beginning with the taxable year in which the person to whom such excess contribution was paid repays the amount of such excess contribution to the owner-employee on whose behalf such excess contribution was made, and pays to such owner-employee the amount of net income attributable to the interest of such owner-employee which, under subparagraph (B), has been included in the gross income of such owner-employee for any prior taxable year.

(E) Special rule if excess contribution was willfully made.

If an excess contribution made on behalf of an owner-employee is determined to have been willfully made, then—

(i) subparagraphs (A), (B), (C), and (D) shall not apply with respect to such excess contribution;

(ii) there shall be distributed to the owner-employee on whose behalf such excess contribution was willfully made his entire interest in all plans with respect to which he is an owner-employee; and

(iii) no plan shall, for purposes of section 404, be considered as meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year in which it is determined that such excess contribution was willfully made and for the 5 taxable years following such taxable year.

(F) Statute of limitations.

In any case in which subparagraph (A) applies, the period for assessing any deficiency arising by reason of—

(i) the disallowance of any deduction under section 404 on account of a plan not meeting the requirements of subsection (d) with respect to the owner-employee on whose behalf an excess contribution was made, or

(ii) the inclusion, under subparagraph (B), in gross income of such owner-employee of income attributable to the interest of such owner-employee under a plan,

for the taxable year in which such excess contribution was made or for any succeeding taxable year shall not expire prior to one year after the close of the 6-month period referred to in subparagraph (C).

(3) Contributions for premiums on annuity, etc., contracts.

A contribution by the employer on behalf of an owner-employee shall not be considered to be an excess contribution within the meaning of paragraph (1), if—

(A) under the plan such contribution is required to be applied (directly or through a trustee) to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of such owner-employee issued under the plan,

(B) the amount of such contribution exceeds the amount deductible under section 404 with respect to contributions made by the employer on behalf of such owner-employee under the plan, and

(C) the amount of such contribution does not exceed the average of the amounts which were deductible under section 404 with respect to contributions made by the employer on behalf of such owner-employee under the plan (or which would have been deductible under such section if such section had been in effect) for the first 3 taxable years (i) preceding the year in which the last such annuity, endowment, or life insurance contract was issued under the plan and (ii) in which such owner-employee derived earned income from the trade or business with respect to which the plan is established, or for so many of such taxable years as such owner-employee was engaged in such trade or business and derived earned income therefrom.

In the case of any individual on whose behalf contributions described in subparagraph (A) are made under more than one plan as an owner-employee during any taxable year, the preceding sentence shall not apply if the amount of such contributions under all such plans for such taxable year exceeds $2,500. Any contribution which is not considered to be an excess contribution by reason of the application of this paragraph shall, for purposes of subparagraphs (B)(ii), (iii), and (iv) of paragraph (1), be taken into account as a contribution made by such owner-employee as an employee to the extent that the amount of such contribution is not deductible under section 404 for the taxable year, but only for the purpose of applying such subparagraphs to other contribu-

tions made by such owner-employee as an employee.

(f) Certain custodial accounts.

(1) Treatment as qualified trust.

For purposes of this title, a custodial account shall be treated as a qualified trust under this section, if—

(A) such custodial account would, except for the fact that it is not a trust, constitute a qualified trust under this section;

(B) the custodian is a bank (as defined in subsection (d)(1));

(C) the investment of the funds in such account (including all earnings) is to be made—

(i) solely in regulated investment company stock with respect to which an employee is the beneficial owner, or

(ii) solely in annuity, endowment, or life insurance contracts issued by an insurance company;

(D) the shareholder of record of any such stock described in subparagraph (C)(i) is the custodian or its nominee; and

(E) the contracts described in subparagraph (C)(ii) are held by the custodian until distributed under the plan.

For purposes of this title, in the case of a custodial account treated as a qualified trust under this section by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

(2) Definition.

For purposes of paragraph (1), the term "regulated investment company" means a domestic corporation which—

(A) is a regulated investment company within the meaning of section 851(a), and

(B) issues only redeemable stock.

(g) Annuity defined.

For purposes of this section and sections 402, 403, and 404, the term "annuity" includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a–2); but does not include any contract or certificate issued after December 31, 1962, which is transferable, if any person other than the trustee of a trust described in section 401 (a) which is exempt from tax under section 501(a) is the owner of such contract or certificate.

(h) Medical, etc., benefits for retired employees and their spouses and dependents.

Under regulations prescribed by the Secretary or his delegate, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents, but only if—

(1) such benefits are subordinate to the retirement benefits provided by the plan,

(2) a separate account is established and maintained for such benefits,

(3) the employer's contributions to such separate account are reasonable and ascertainable,

(4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits, and

(5) notwithstanding the provisions of subsection (a)(2), upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer.

(i) Certain uuion-negotiated pension plans.

In the case of a trust forming part of a pension plan which has been determined by the Secretary or his delegate to constitute a qualified trust under subsection (a) and to be exempt from taxation under section 501(a) for a period beginning after contributions were first made to or for such trust, if it is shown to the satisfaction of the Secretary or his delegate that—

(1) such trust was created pursuant to a collective bargaining agreement between employee representatives and one or more employers,

(2) any disbursements of contributions, made to or for such trust before the time as of which the Secretary or his delegate determined that the trust constituted a qualified trust, substantially complied with the terms of the trust, and the plan of which the trust is a part, as subsequently qualified, and

(3) before the time as of which the Secretary or his delegate determined that the trust constitutes a qualified trust, the contributions to or for such trust were not used in a manner which would jeopardize the interests of its beneficiaries,

then such trust shall be considered as having constituted a qualified trust under subsection (a) and as having been exempt from taxation under section 501(a) for the period beginning on the date on which contributions were first made to or for such trust and ending on the date such trust first constituted (without regard to this subsection) a qualified trust under subsection (a).

(j) Cross reference.

For exemption from tax of a trust qualified under this section, see section 501 (a).

(Aug. 16, 1954, ch. 736, 68A Stat. 134; Oct. 10, 1962, Pub. L. 87–792, § 2, 76 Stat. 809; Oct. 23, 1962, Pub. L. 87–863, § 2(a), 76 Stat. 1141; Feb. 26, 1964, Pub. L. 88–272, title II, § 219(a), 78 Stat. 57; July 30, 1965, Pub. L. 89–97, title I, § 106(d)(4), 79 Stat. 337; Nov. 13, 1966, Pub. L. 89–809, title II, §§ 204(b)(1), (c), 205(a), 80 Stat. 1577, 1578; Jan. 12, 1971, Pub. L. 91–691, § 1(a), 84 Stat. 2074.)

REFERENCES IN TEXT

The date of the enactment of this paragraph, and the date of enactment of this subsection, referred to in subsecs. (a)(9) and (d)(1), respectively, mean the date of enactment of Pub. L. 87–792, which was approved on Oct. 10, 1962.

Title II of the Social Security Act, as amended, referred to in subsec. (d)(6), is classified to section 401 et seq. of Title 42, The Public Health and Welfare.

AMENDMENTS

1971—Subsec. (i). Pub. L. 91–691 eliminated "multi-employer" which preceded "pension plans" in subsection catchline, and substituted "one or more employers" for

"two or more employers who are not related (determined under regulations prescribed by the Secretary or his delegate)" in par. (1).

1966—Subsec. (a)(10)(A)(ii). Pub. L. 89–809, § 204(b)(1)(A), struck out "(determined without regard to section 404(a)(10))" following "deducted under section 404".

Subsec. (c)(2)(A). Pub. L. 89–809, § 204(c), struck out "to the extent that such net earnings constitute earned income (as defined in section 911(b) but determined with the application of subparagraph (B))" following "The term 'earned income' means the net earnings from self-employment (as defined in section 1402(a))", added clause (i) and redesignated former clauses (i)—(ii) as (ii)—(iv) respectively, and struck out references to section 911(b) and subparagraph (B), as in effect for a taxable year beginning on January 1, 1963, in the material following clause (iv).

Subsec. (c)(2)(B). Pub. L. 89–809, § 204(c), struck out subpar. (B) relating to earned income when both personal services and capital are material income-producing factors. See subsec. (c)(2)(A)(i).

Subsec. (c)(2)(C). Pub. L. 89–809, § 205(a), added subpar. (C).

Subsecs. (d)(5)(A), (B), (d)(6)(A), (e)(1)(A), (B)(1), (3). Pub. L. 89–809, § 204(b)(1)(B)—(E), struck out "(determined without regard to section 404(a)(10))" wherever appearing.

1965—Subsec. (d)(4)(B). Pub. L. 89–97 substituted "section 72(m)(7)" for "section 213(g)(3)".

1964—Subsec. (i). Pub. L. 88–272 added subsec (i). Former subsec. (i) redesignated (j).

Subsec. (j). Pub. L. 88–272 redesignated former subsec. (i) as (j).

1962—Subsec. (a)(5). Pub. L. 87–792, § 2(1), inserted provisions defining total compensation for purposes of par. (5) and par. (10) of this subsection.

Subsec. (a)(7)—(10). Pub. L. 87–792, § 2(2), added pars. (7)—(10).

Subsec. (c). Pub. L. 87–792, § 2(3), added subsec. (c) and redesignated former subsec. (c) as (h).

Subsecs. (d)—(g). Pub. L. 87–792, § 2(3), added subsecs. (d)—(g).

Subsec. (h). Pub. L. 87–863 added subsec. (h), and redesignated former subsec. (h) as (i).

Pub. L. 87–792, § 2(3), redesignated former subsec. (c) as (h).

Subsec. (i). Pub. L. 87–863 redesignated former subsec. (h) as (i).

EFFECTIVE DATE OF 1971 AMENDMENT

Section 1(b) of Pub. L. 91–691 provided that: "The amendments made by subsection (a) [amending subsec. (i) of this section] shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954, but only with respect to contributions made after December 31, 1954."

EFFECTIVE DATE OF 1966 AMENDMENT

Section 204(d) of Pub. L. 89–809, as amended by Pub. L. 90–607, Oct. 21, 1968, 82 Stat. 1189, provided that: "The amendments made by subsections (a) and (b) [repealing section 404(a)(10) and amending this section and section 404(e) of this title] shall apply with respect to taxable years beginning after December 31, 1967. The amendment made by subsection (c) [to subsec. (c)(2)(A), (B) of this section] shall apply with respect to taxable years beginning after December 31, 1967, and in the case of a taxpayer who applies the averaging provisions of section 401(e)(3) of the Internal Revenue Code of 1954 [subsec. (e)(3) of this section] for a taxable year beginning after December 31, 1967, the computation of the amount deductible under section 404 of such Code [section 404 of this title] for any prior taxable year which began before January 1, 1968, shall be made, for purposes of such averaging provisions, as if the amendment made by subsection (c) were applicable to such prior taxable year."

Section 205(b) of Pub. L. 89–809 provided that: "The amendment made by subsection (a) [adding subsec. (c)(2)(C) of this section] shall apply to taxable years ending after the date of the enactment of this Act [Nov. 13, 1966]."

EFFECTIVE DATE OF 1965 AMENDMENT

Amendment of this section by Pub. L. 89–97 applicable to taxable years beginning after Dec. 31, 1966, see section 106(e) of Pub. L. 89–97, set out as a note under section 213 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 219(b) of Pub. L. 88–272 provided that: "The amendments made by subsection (a) [to this section] shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954, but only with respect to contributions made after December 31, 1954."

EFFECTIVE DATE OF 1962 AMENDMENTS

Section 2(c) of Pub. L. 87–863 provided that: "The amendments made by subsections (a) and (b) [to this section and section 404 of this title] shall apply to taxable years beginning after the date of the enactment of this Act [Oct. 23, 1962]."

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

SHORT TITLE

Section 1 of Pub. L. 87–792 provided: "That this Act [enacting sections 405 and 6047 of this title, and amending this section and sections 37, 62, 72, 101, 104, 105, 172, 402—404, 503, 805, 1361, 2039, 2517, 3306, 3401 and 7207 of this title] may be cited as the 'Self-Employed Individuals Tax Retirement Act of 1962'."

CROSS REFERENCES

Constructive ownership of stock not applicable to employees' trust, see section 318(a)(2)(B) of this title.

Denial of exemption to trusts engaged in prohibited transactions, see section 503(a)(1)(C) of this title.

Partner or proprietor of unincorporated business enterprise not considered employee under this section, see section 1361(d) of this title.

Payments under section not wages for purposes of—
- Collection of income tax at source on wages, see section 3401(a)(12)(A) of this title.
- Federal Insurance Contributions Act, see section 3121(a)(5)(A) of this title.
- Federal Unemployment Tax Act, see section 3306(b)(5) of this title.
- Returns by exempt organizations, see section 6033(a) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 62, 72, 81, 101, 104, 105, 172, 318, 402, 403, 404, 405, 406, 407, 501, 503, 511, 513, 514, 542, 805, 871, 1348, 1379, 1491, 1563, 2039, 2517, 3121, 3306, 3401, 4912, 4941, 6033, 6043, 6047, 6324 of this title; title 15 sections 77c, 78*l*, 80a–3; title 42 section 409.

§ 402. Taxability of beneficiary of employees' trust.

(a) Taxability of beneficiary of exempt trust.

(1) General rule.

Except as provided in paragraphs (2) and (4), the amount actually distributed or made available to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities). The amount actually distributed or made available to any distributee shall not include net unrealized appreciation in securities of the employer corporation attributable to the amount contributed by the employee. Such net unrealized appreciation and the resulting adjustments to basis of such securities shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(2) Capital gains treatment for certain distributions.

In the case of an employees' trust described in section 401 (a), which is exempt from tax under section 501 (a), if the total distributions payable with respect to any employee are paid to the distributee within 1 taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the death of the employee after his separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee (determined by applying section 72 (f)), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not includible in gross income, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months. Where such total distributions include securities of the employer corporation, there shall be excluded from such excess the net unrealized appreciation attributable to that part of the total distributions which consists of the securities of the employer corporation so distributed. The amount of such net unrealized appreciation and the resulting adjustments to basis of the securities of the employer corporation so distributed shall be determined in accordance with regulations prescribed by the Secretary or his delegate. This paragraph shall not apply to distributions paid to any distributee to the extent such distributions are attributable to contributions made on behalf of the employee while he was an employee within the meaning of section 401(c)(1).

(3) Definitions.

For purposes of this subsection—

(A) The term "securities" means only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form.

(B) The term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 425) of the employer corporation.

(C) The term "total distributions payable" means the balance to the credit of an employee which becomes payable to a distributee on account of the employee's death or other separation from the service, or on account of his death after separation from the service.

(4) Distributions by United States to nonresident aliens.

The amount includible under paragraph (1) or (2) of this subsection in the gross income of a nonresident alien individual with respect to a distribution made by the United States in respect of services performed by an employee of the United States shall not exceed an amount which bears the same ratio to the amount includible in gross income without regard to this paragraph as—

(A) the aggregate basic salary paid by the United States to such employee for such services, reduced by the amount of such basic salary which was not includible in gross income by reason of being from sources without the United States, bears to

(B) the aggregate basic salary paid by the United States to such employee for such services.

In the case of distributions under the Civil Service Retirement Act (5 U.S.C. 2251), the term "basic salary" shall have the meaning provided in section 1(d) of such Act.

(5) Limitation on capital gains treatment.

The first sentence of paragraph (2) shall apply to a distribution paid after December 31, 1969, only to the extent that it does not exceed the sum of—

(A) the benefits accrued by the employee on behalf of whom it is paid during plan years beginning before January 1, 1970, and

(B) the portion of the benefits accrued by such employee during plan years beginning after December 31, 1969, which the distributee establishes does not consist of the employee's allocable share of employer contributions to the trust by which such distribution is paid.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph.

(b) Taxability of beneficiary of nonexempt trust.

Contributions to an employees' trust made by an employer during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt from tax under section 501 (a) shall be included in the gross income of the employee in accordance with section 83 (relating to property transferred in connection with performance of services), except that the value of the employee's interest in the trust shall be substituted for the fair market value of the property for purposes of applying such section. The amount actually distributed or made available to any distributee by any such trust shall be taxable to him in the year in which so distributed or made available, under section 72 (relating to annuities), except that distributions of income of such trust before the annuity starting date (as defined in section 72(c)(4)) shall be included in the gross income of the employee without regard to section 72(e)(1) (relating to amount not received as annuities). A beneficiary of any such trust shall not be considered the owner of any portion of such trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners).

(c) Taxability of beneficiary of certain foreign situs trusts.

For purposes of subsections (a) and (b), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501 (a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501 (a).

(d) Certain employees' annuities.

Notwithstanding subsection (b) or any other provision of this subtitle, a contribution to a trust by an employer shall not be included in the gross income of the employee in the year in which the contribution is made if—

(1) such contribution is to be applied by the trustee for the purchase of annuity contracts for the benefit of such employee;

(2) such contribution is made to the trustee pursuant to a written agreement entered into prior to October 21, 1942, between the employer and the trustee, or between the employer and the employee; and

(3) under the terms of the trust agreement the employee is not entitled during his lifetime, except with the consent of the trustee, to any payments under annuity contracts purchased by the trustee other than annuity payments.

The employee shall include in his gross income the amounts received under such contracts for the year received as provided in section 72 (relating to annuities). This subsection shall have no application with respect to amounts contributed to a trust after June 1, 1949, if the trust on such date was exempt under section 165 (a) of the Internal Revenue Code of 1939. For purposes of this subsection, amounts paid by an employer for the purchase of annuity contracts which are transferred to the trustee shall be deemed to be contributions made to a trust or trustee and contributions applied by the trustee for the purchase of annuity contracts; the term "annuity contracts purchased by the trustee" shall include annuity contracts so purchased by the employer and transferred to the trustee; and the term "employee" shall include only a person who was in the employ of the employer, and was covered by the agreement referred to in paragraph (2), prior to October 21, 1942.

(e) Certain plan terminations.

For purposes of subsection (a) (2), distributions made after December 31, 1953, and before January 1, 1955, as a result of the complete termination of a stock bonus, pension, or profit-sharing plan of an employer which is a corporation, if the termination of the plan is incident to the complete liquidation occurring before the date of enactment of this title, of the corporation, whether or not such liquidation is incident to a reorganization as defined in section 368 (a), shall be considered to be distributions on account of separation from service. (Aug. 16, 1954, ch. 736, 68A Stat. 135; Apr. 22, 1960, Pub. L. 86–437, §§ 1, 2(a), 74 Stat. 79; Oct. 10, 1962, Pub. L. 87–792, § 4(c), 76 Stat. 825; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 221(c)(1), 232(e) (1)—(3), 78 Stat. 75, 111; Dec. 30, 1969, Pub. L. 91–172, title III, § 321(b)(1), title V, § 515(a)(1), 83 Stat. 590, 643.)

REFERENCES IN TEXT

The Civil Service Retirement Act, referred to in subsec. (a)(4), was classified to chapter 30 of Title 5, Executive Departments and Government Officers and Employees, and is now covered by section 8301 et seq. of Title 5, Government Organization and Employees.

AMENDMENTS

1969—Subsec. (a)(5). Pub. L. 91–172, § 515(a)(1), added subsec. (a)(5).

Subsec. (b). Pub. L. 91–172, § 321(b)(1), substituted provision for inclusion of contributions made by an employer to a nonexempt trust in the "gross income of the employee in accordance with section 83 (relating to property transferred in connection with performance of services), except that the value of the employee's interest in the trust shall be substituted for the fair market value of the property for purposes of applying such section" for prior provision for inclusion in the "gross income of an employee for the taxable year in which the contribution is made to the trust in the case of an employee whose beneficial interest in such contribution is nonforfeitable at the time the contribution is made", and provided that distributions of income of such trust before the annuity starting date (as defined in section 72(c)(4)) shall be included in the gross income of the employee without regard to section 72(e)(1) (relating to amount not received as annuities) and that a beneficiary of any such trust shall not be considered the owner of any portion of such trust under subpart E of part I of subch. J (relating to grantors and others treated as substantial owners).

1964—Subsec. (a)(1). Pub. L. 88–272, § 232(e)(1), deleted "except that section 72(e)(3) shall not apply" following "(relating to annuities)."

Subsec. (a)(3)(B). Pub. L. 88–272, § 221(c)(1), substituted "subsections (e) and (f) of section 425" for "section 421(d) (2) and (3)."

Subsec. (b). Pub. L. 88–272, § 232(e)(2), deleted "except that section 72(e)(3) shall not apply" following "(relating to annuities)."

Subsec. (d). Pub. L. 88–272, § 232(e)(3), deleted "except that section 72(e)(3) shall not apply" following "(relating to annuities)."

1962—Subsec. (a)(2). Pub. L. 87–792 inserted sentence providing that this paragraph shall not apply to distributions paid to any distributee to the extent such distributions are attributable to contributions made on behalf of the employee while he was an employee within the meaning of section 401(c)(1).

1960—Subsec. (a)(1). Pub. L. 86–437, § 2(a), substituted "paragraphs (2) and (4)" for "paragraph (2)."

Subsec. (a)(4). Pub L. 86–437, § 1, added subsec. (a)(4).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 515(d) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and sections 72, 403, 405, 406, 407 and 1304 of this title] shall apply to taxable years ending after December 31, 1969."

Amendment of subsec. (b) of this section by section 321(b)(1) of Pub. L. 91–172 applicable with respect to contributions made and premiums paid after Aug. 1, 1969, see section 321(d) of Pub. L. 91–172, set out as a note under section 83 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (a)(3)(B) of section by Pub. L. 88–272 applicable to taxable years ending after Dec. 31, 1963, see section 221(e) of Pub. L. 88–272, set out as a note under section 421 of this title.

Amendment of subsecs. (a)(1), (b) and (d) of this section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Section 3 of Pub. L. 86–437 provided that: "The amendments made by this Act [to subsec. (a) of this section and section 871(d) of this title] shall apply only with respect to taxable years beginning after December 31, 1959."

CROSS REFERENCES

Limitation on retirement income inapplicable to any amount excluded under this section, see section 37 (e) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 72, 101, 401, 405, 406, 407, 871, 911, 1348, 1379, 1441, 2039 of this title.

§ 403. Taxation of employee annuities.

(a) Taxability of beneficiary under a qualified annuity plan.

(1) General rule.

Except as provided in paragraph (2), if an annuity contract is purchased by an employer for

an employee under a plan which meets the requirements of section 404 (a) (2) (whether or not the employer deducts the amounts paid for the contract under such section), the employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities).

(2) Capital gains treatment for certain distributions.

(A) General rule.

If—

(i) an annuity contract is purchased by an employer for an employee under a plan described in paragraph (1);

(ii) such plan requires that refunds of contributions with respect to annuity contracts purchased under such plan be used to reduce subsequent premiums on the contracts under the plan; and

(iii) the total amounts payable by reason of an employee's death or other separation from the service, or by reason of the death of an employee after the employee's separation from the service, are paid to the payee within one taxable year of the payee,

then the amount of such payments, to the extent exceeding the amount contributed by the employee (determined by applying section 72 (f)), which employee contributions shall be reduced by any amounts theretofore paid to him which were not includible in gross income, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months. This subparagraph shall not apply to amounts paid to any payee to the extent such amounts are attributable to contributions made on behalf of the employee while he was an employee within the meaning of section 401(c)(1).

(B) Definition.

For purposes of subparagraph (A), the term "total amounts" means the balance to the credit of an employee which becomes payable to the payee by reason of the employee's death or other separation from the service, or by reason of his death after separation from the service.

(C) Limitation on capital gains treatment.

Subparagraph (A) shall apply to a payment paid after December 31, 1969, only to the extent it does not exceed the sum of—

(i) the benefits accrued by the employee on behalf of whom it is paid during plan years beginning before January 1, 1970, and

(ii) the portion of the benefits accrued by such employee during plan years beginning after December 31, 1969, which the payee establishes does not consist of the employee's allocable share of employer contributions under the plan under which the annuity contract is purchased.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph.

(3) Self-employed individuals.

For purposes of this subsection, the term "employee" includes an individual who is an employee within the meaning of section 401(c)(1), and the employer of such individual is the person treated as his employer under section 401(c)(4).

(b) Taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school.

(1) General rule.

If—

(A) an annuity contract is purchased—

(i) for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a), or

(ii) for an employee (other than an employee described in clause (i)), who performs services for an educational institution (as defined in section 151(e)(4)), by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing,

(B) such annuity contract is not subject to subsection (a), and

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums,

then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such amounts does not exceed the exclusion allowance for such taxable year. The employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities).

(2) Exclusion allowance.

For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of—

(A) the amount determined by multiplying (i) 20 percent of his includible compensation, by (ii) the number of years of service, over

(B) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.

(3) Includible compensation.

For purposes of this subsection, the term "includible compensation" means, in the case of any employee, the amount of compensation which is received from the employer described in paragraph (1)(A), and which is includible in gross income (computed without regard to sections 105(d) and 911) for the most recent period (ending not later than the close of the taxable year) which under paragraph (4) may be counted as one year of service. Such term does not include any amount contributed by the employer for any annuity contract to which this subsection applies.

(4) Years of service.

In determining the number of years of service for purposes of this subsection, there shall be included—

(A) one year for each full year during which the individual was a full-time employee of the organization purchasing the annuity for him, and

(B) a fraction of a year (determined in accordance with regulations prescribed by the Secretary or his delegate) for each full year during which such individual was a part-time employee of such organization and for each part of a year during which such individual was a full-time or part-time employee of such organization.

In no case shall the number of years of service be less than one.

(5) Application to more than one annuity contract. If for any taxable year of the employee this subsection applies to 2 or more annuity contracts purchased by the employer, such contracts shall be treated as one contract.

(6) Forfeitable rights which become nonforfeitable. For purposes of this subsection and section 72 (f) (relating to special rules for computing employees' contributions to annuity contracts), if rights of the employee under an annuity contract described in subparagraphs (A) and (B) of paragraph (1) change from forfeitable to nonforfeitable rights, then the amount (determined without regard to this subsection) includible in gross income by reason of such change shall be treated as an amount contributed by the employer for such annuity contract as of the time such rights become nonforfeitable.

(c) Taxability of beneficiary under uonqualified annuities or under annuities purchased hy exempt organizations.

Premiums paid by an employer for an annuity contract which is not subject to subsection (a) shall be included in the gross income of the employee in accordance with section 83 (relatmg to property transferred in connection with performance of services), except that the value of such contract shall be substituted for the fair market value of the property for purposes of applying such section. The preceding sentence shall not apply to that portion of the premiums paid which is excluded from gross income under subsection (b). The amount actually paid or made available to any beneficiary under such contract shall be taxable to him in the year in which so paid or made available under section 72 (relating to annuities). (Aug. 16, 1954, ch. 736, 68A Stat. 137; Sept. 2, 1958, Pub. L. 85–866, title I, § 23(a)–(c), 72 Stat. 1620—1622; Oct. 4, 1961, Pub. L. 87–370, § 3(a), 75 Stat. 801; Oct. 10, 1962, Pub. L. 87–792, § 4(d), 76 Stat. 825; Feb. 26, 1964, Pub. L. 88–272, title II, § 232(e)(4)—(6), 78 Stat. 111; Dec. 30, 1969, Pub. L. 91–172, title III, § 321(b)(2), title V, § 515(a)(2), 83 Stat. 591, 644.)

AMENDMENTS

1969—Subsec. (a)(2). Pub. L. 91–172, § 515(a)(2), added subpar. (C).

Subsec. (c). Pub. L. 91–172, § 321(b)(2), consolidated former provisions of subsec. (c) providing for taxability of beneficiary under a nonqualified annuity, the employees gross income to include amount contributed by employer for annuity contract in the year in which amount is contributed, the amount to be included as provided in section 72 of this title and former subsec. (d) of this section providing for taxability of beneficiary under certain forfeitable contracts purchased by exempt organizations, including farmers' cooperatives, the gross income to include amount contributed by employer after Dec. 31, 1957, in the year of change from forfeitable to nonforfeitable rights, the new provisions including premiums paid by an employer in accordance with section 83, except that value of the contract shall be substituted for fair market value of the property for purposes of applying such section 83, such provision not to be applicable to that portion of premiums paid which is excluded from gross income under subsec. (b) of this section.

Subsec. (d). Pub. L. 91–172, § 321(b)(2), struck out former subsec. (d) providing for taxability of beneficiary under certain forfeitable contracts purchased by exempt organizations, including farmers' cooperatives, gross income of the employee to include (amount contributed by employer after Dec. 31, 1957), in year of change from forfeitable to nonforfeitable rights, which are now covered by subsec. (c) of this section.

1964—Subsec. (a)(1). Pub. L. 88–272, § 232(e)(4), deleted "except that section 72(e)(3) shall not apply" following "(relating to annuities)."

Subsec. (b)(1). Pub. L. 88–272, § 232(e)(5), deleted "except that section 72(e)(3) shall not apply" following "(relating to annuities)."

Subsec. (c). Pub. L. 88–272, § 232(e)(6), deleted "except that section 72(e)(3) shall not apply" following "(relating to annuities)."

1962—Subsec. (a)(2)(A). Pub. L. 87–792, § 4(d)(1), (2), substituted "described in paragraph (1)" for "which meets the requirements of section 401(a)(3), (4), (5), and (6)" in cl. (i), and inserted sentence at the end thereof providing that this subparagraph shall not apply to amounts paid to any payee to the extent such amounts are attributable to contributions made on behalf of the employee while he was an employee within the meaning of section 401(c)(1).

Subsec. (a)(3). Pub. L. 87–792, § 4(d)(3), added subsec. (a)(3).

1961—Subsec. (b). Pub. L. 87–370, § 3(a)(3), inserted "or public school" at the end of the catchline.

Subsec. (b)(1)(A). Pub. L. 87–370, § 3(a)(1), included annuity contracts purchased for an employee, other than one described in clause (i) of this subpar., who performs services for an educational institution, as defined in section 151(e)(4) of this title, by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of either.

Subsec. (b)(3). Pub. L. 87–370, § (3)(a)(2), substituted "the employer described in paragraph (1)(A)" for "the employer described in section 501(c)(3) and exempt from tax under section 501(a)."

1958—Subsec. (a)(1). Pub. L. 85–866, § 23(b), substituted "which meets the requirements of section 404(a)(2) (whether or not the employer deducts the amounts paid for the contract under such section)," for "with respect to which the employer's contribution is deductible under section 404(a)(2), or if an annuity contract is purchased for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),".

Subsec. (b). Pub. L. 85–866, § 23(a), added subsec. (b) and redesignated former subsec. (b) as (c).

Subsec. (c). Pub. L. 85–866, § 23(a), redesignated former subsec. (b) as (c).

Subsec. (d). Pub. L. 85–866, § 23(c), added subsec. (d).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a)(2) by section 515(a)(2) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 515(d) of Pub. L. 91–172, set out as a note under section 402 of this title.

Amendment of subsecs. (c) and (d) of this section by section 321(b)(2) of Pub. L. 91–172 applicable with respect to contributions made and premiums paid after Aug. 1, 1969, see section 321(d) of Pub. L. 91–172, set out as a note under section 83 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8

of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE OF 1961 AMENDMENT

Section 3(b) of Pub. L. 87–370 provided that: "The amendments made by subsection (a) [to subsec. (b) of this section] shall apply with respect to taxable years beginning after December 31, 1957."

EFFECTIVE DATES OF 1958 AMENDMENT

Section 23 (g) of Pub. L. 85–866 provided that: "The amendments made by subsections (a), (b), (c), and (d) [to subsecs. (a) (1), (b), (c) and (d) of this section, and to section 101 (b) (2) (B) of this title] shall apply with respect to taxable years beginning after December 31, 1957. The amendments made by subsection (e) [to section 2039 (c) of this title] shall apply with respect to estates of decedents dying after December 31, 1957. The amendments made by subsection (f) [to section 2517 (a), (b) of this title] shall apply with respect to calendar years after 1957."

CROSS REFERENCES

Limitation on retirement income inapplicable to any amount excluded under this section, see section 37 (c) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 62, 72, 101, 104, 404, 406, 407, 805, 871, 911, 1348, 1379, 1441, 2039, 2517, 3121, 3306, 3401, 6047 of this title; title 15 section 77c; title 42 section 409.

§ 404. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan.

(a) General rule.

If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income); but, if they satisfy the conditions of either of such sections, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

(1) Pension trusts.

In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 501 (a), in an amount determined as follows:

(A) an amount not in excess of 5 percent of the compensation otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount may be reduced for future years if found by the Secretary or his delegate upon periodical examinations at not less than 5-year intervals to be more than the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

(B) any excess over the amount allowable under subparagraph (A) necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Secretary or his delegate, but if such remaining unfunded cost with respect to any 3 individuals is more than 50 percent of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years, or

(C) in lieu of the amounts allowable under subparagraphs (A) and (B) above, an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Secretary or his delegate, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 percent of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the Secretary or his delegate, except that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased.

(D) Any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year in accordance with the foregoing limitations.

(2) Employees' annuities.

In the taxable year when paid, in an amount determined in accordance with paragraph (1), if the contributions are paid toward the purchase of retirement annuities, or retirement annuities and medical benefits as described in section 401(h), and such purchase is part of a plan which meets the requirements of section 401(a) (3), (4), (5), (6), (7), and (8), and, if applicable, the requirements of section 401(a) (9) and (10) and of section 401(d) (other than paragraph (1)), and if refunds of premiums, if any, are applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities, or such retirement annuities and medical benefits.

(3) Stock bonus and profit-sharing trusts.

(A) Limits on deductible contributions.

In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501 (a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. If in any taxable year there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess, or if no amount is

paid, the amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust", as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarially as provided in paragraph (1). If the contributions are made to 2 or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for purposes of applying the limitations in this subparagraph.

(B) Profit-sharing plan of affiliated group.

In the case of a profit-sharing plan, or a stock bonus plan in which contributions are determined with reference to profits, of a group of corporations which is an affiliated group within the meaning of section 1504, if any member of such affiliated group is prevented from making a contribution which it would otherwise have made under the plan, by reason of having no current or accumulated earnings or profits or because such earnings or profits are less than the contributions which it would otherwise have made, then so much of the contribution which such member was so prevented from making may be made, for the benefit of the employees of such member, by the other members of the group, to the extent of current or accumulated earnings or profits, except that such contribution by each such other member shall be limited, where the group does not file a consolidated return, to that proportion of its total current and accumulated earnings or profits remaining after adjustment for its contribution deductible without regard to this subparagraph which the total prevented contribution bears to the total current and accumulated earnings or profits of all the members of the group remaining after adjustment for all contributions deductible without regard to this subparagraph. Contributions made under the preceding sentence shall be deductible under subparagraph (A) of this paragraph by the employer making such contribution, and, for the purpose of determining amounts which may be carried forward and deducted under the second sentence of subparagraph (A) of this paragraph in succeeding taxable years, shall be deemed to have been made by the employer on behalf of whose employees such contributions were made.

(4) Trusts created or organized outside the United States.

If a stock bonus, pension, or profit-sharing trust would qualify for exemption under section 501 (a) except for the fact that it is a trust created or organized outside the United States, contributions to such a trust by an employer which is a resident, or corporation, or other entity of the United States, shall be deductible under the preceding paragraphs.

(5) Other plans.

If the plan is not one included in paragraph (1), (2), or (3), in the taxable year in which an amount attributable to the contribution is includible in the gross income of employees participating in the plan, but, in the case of a plan in which more than one employee participates only if separate accounts are maintained for each employee.

(6) Taxpayers on accrual basis.

For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

(7) Limit of deduction.

If amounts are deductible under paragraphs (1) and (3), or (2) and (3), or (1), (2), and (3), in connection with 2 or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 percent of the compensation otherwise paid or accrued during the taxable year to the persons who are the beneficiaries of the trusts or plans. In addition, any amount paid into such trust or under such annuity plans in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this paragraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this paragraph shall not exceed 30 percent of the compensation otherwise paid or accrued during such taxable years to the beneficiaries under the trusts or plans. This paragraph shall not have the effect of reducing the amount otherwise deductible under paragraphs (1), (2), and (3), if no employee is a beneficiary under more than one trust, or a trust and an annuity plan.

(8) Self-employed individuals.

In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1), for purposes of this section—

(A) the term "employee" includes an individual who is an employee within the meaning of

section 401(c)(1), and the employer of such individual is the person treated as his employer under section 401(c)(4);

(B) the term "earned income" has the meaning assigned to it by section 401(c)(2);

(C) the contributions to such plan on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall be considered to satisfy the conditions of section 162 or 212 to the extent that such contributions do not exceed the earned income of such individual derived from the trade or business with respect to which such plan is established, and to the extent that such contributions are not allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance; and

(D) any reference to compensation shall, in the case of an individual who is an employee within the meaning of section 401(c)(1), be considered to be a reference to the earned income of such individual derived from the trade or business with respect to which the plan is established.

(9) Plans benefiting self-employed individuals.

In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1)—

(A) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of employees (other than employees within the meaning of section 401(c)(1)), as if such employees were the only employees for whom contributions and benefits are provided under the plan;

(B) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of employees within the meaning of section 401(c)(1)—

(i) as if such employees were the only employees for whom contributions and benefits are provided under the plan, and

(ii) without regard to paragraph (1)(D), the second and third sentences of paragraph (3), and the second sentence of paragraph (7); and

(C) the amounts deductible under paragraphs (1), (2), (3), and (7), with respect to contributions on behalf of any employee within the meaning of section 401(c)(1), shall not exceed the applicable limitation provided in subsection (e).

(b) Method of contributions, etc., having the effect of a plan.

If there is no plan but a method of employer contributions or compensation has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, subsection (a) shall apply as if there were such a plan.

(c) Certain negotiated plans.

If contributions are paid by an employer—

(1) under a plan under which such contributions are held in trust for the purpose of paying (either from principal or income or both) for the benefit of employees and their families and dependents at least medical or hospital care, and pensions on retirement or death of employees; and

(2) such plan was established prior to January 1, 1954, as a result of an agreement between employee representatives and the Government of the United States during a period of Government operation, under seizure powers, of a major part of the productive facilities of the industry in which such employer is engaged,

such contributions shall not be deductible under this section nor be made nondeductible by this section, but the deductibility thereof shall be governed solely by section 162 (relating to trade or business expenses). This subsection shall have no application with respect to amounts contributed to a trust on or after any date on which such trust is qualified for exemption from tax under section 501 (a).

(d) Carryover of unused deductions.

The amount of any unused deductions or contributions in excess of the deductible amounts for taxable years to which this part does not apply which under section 23 (p) of the Internal Revenue Code of 1939 would be allowable as deductions in later years had such section 23 (p) remained in effect, shall be allowable as deductions in taxable years to which this part applies as if such section 23 (p) were continued in effect for such years. However, the deduction under the preceding sentence shall not exceed an amount which, when added to the deduction allowable under subsection (a) for contributions made in taxable years to which this part applies, is not greater than the amount which would be deductible under subsection (a) if the contributions which give rise to the deduction under the preceding sentence were made in a taxable year to which this part applies.

(e) Special limitations for self-employed individuals.

(1) In general.

In the case of a plan included in subsection (a)(1), (2), or (3), which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1), the amounts deductible under subsection (a) in any taxable year with respect to contributions on behalf of any employee within the meaning of section 401(c)(1) shall, subject to the provisions of paragraph (2), not exceed $2,500, or 10 percent of the earned income derived by such employee from the trade or business with respect to which the plan is established, whichever is the lesser.

(2) Contributions made under more than one plan.

(A) Overall limitation.

In any taxable year in which amounts are deductible with respect to contributions under two or more plans on behalf of an individual who is an employee within the meaning of section 401(c)(1) with respect to such plans, the aggregate amount deductible for such taxable

year under all such plans with respect to contributions on behalf of such employee shall not exceed $2,500, or 10 percent of the earned income derived by such employee from the trades or businesses with respect to which the plans are established, whichever is the lesser.

(B) Allocation of amounts deductible.

In any case in which the amounts deductible under subsection (a) (with the application of the limitations of this subsection) with respect to contributions made on behalf of an employee within the meaning of section 401 (c)(1) under two or more plans are, by reason of subparagraph (A), less than the amounts deductible under such subsection determined without regard to such subparagraph, the amount deductible under subsection (a) with respect to such contributions under each such plan shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(3) Contributions allocable to insurance protection.

For purposes of this subsection, contributions which are allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

(f) Certain loan repayments considered as contributions.

For purposes of this section, any amount paid, directly or indirectly, by an owner-employee (within the meaning of section 401(c)(3)) in repayment of any loan which under section 72(m)(4)(B) was treated as an amount received under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as a part of a plan described in section 403(a) shall be treated as a contribution to which this section applies on behalf of such owner-employee to such trust or to or under such plan. (Aug. 16, 1954, ch. 736, 68A Stat. 138; Sept. 2, 1958, Pub. L. 85–866, title I, § 24, 72 Stat. 1623; Oct. 10, 1962, Pub. L. 87–792, § 3, 76 Stat. 819; Oct. 23, 1962, Pub. L. 87–863, § 2(b), 76 Stat. 1141; Nov. 13, 1966, Pub. L. 89–809, title II, § 204 (a), (b)(2), (3), 80 Stat. 1577; Dec. 30, 1969, Pub. L. 91–172, title III, § 321(b)(3), 83 Stat. 591.)

AMENDMENTS

1969—Subsec. (a)(5). Pub. L. 91–172 substituted "If the plan is not one included in paragraph (1), (2), or (3), in the taxable year in which an amount attributable to the contribution is includible in the gross income of employees participating in the plan, but, in the case of a plan in which more than one employee participates only if separate accounts are maintained for each employee" for "In the taxable year when paid, if the plan is not one included in paragraph (1), (2), or (3), if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid".

1966—Subsec. (a). Pub. L. 89–809, § 204(a), repealed par. (10) which provided for a special limitation on the amount allowed as a deduction for self-employed individuals.

Subsec. (e). Pub. L. 89–809, § 204(b)(2), (3), struck out references to par. (10) of subsec. (a) wherever appearing.

1962—Subsec. (a)(2). Pub. L. 87–863 inserted ", or retirement annuities and medical benefits as described in section 401(h)," following "purchase of retirement annuities", and ", or such retirement annuities and medical benefits" following "such retirement annuities."

Pub. L. 87–792, § 3(a)(1), substituted "(5), (6), (7), and (8), and, if applicable, the requirements of section 401(a) (9) and (10) and of section 401(d) (other than paragraph (1))," for "(5), and (6),".

Subsec. (a) (8)—(10). Pub. L. 87–792, § 3(a)(2), added pars. (8)—(10).

Subsecs. (e), (f). Pub. L. 87–792, § 3(b), added subsecs. (e) and (f).

1958—Subsec. (a). Pub. L. 85–866 substituted "income); but, if" for "income) but if" preceding par. (1).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to contributions made and premiums paid after Aug. 1, 1969, see section 321(d) of Pub. L. 91–172, set out as a note under section 83 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsecs. (a) and (e) of this section by section 204(a), (b) of Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1967, see section 204(d) of Pub. L. 89–809, set out as a note under section 401 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of section by Pub. L. 87–863 applicable to taxable years beginning after Oct. 23, 1962, see section 2(c) of Pub. L. 87–863, set out as a note under section 401 of this title.

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (a) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

CROSS REFERENCES

Non-trade or non-business expenses deductible, see section 212 of this title.

Ordinary necessary business expenses deductible, see section 162 of this title.

Time for filing return, see sections 6072, 6081 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 62, 72, 81, 104, 172, 381, 401, 403, 405, 406, 407, 542, 556, 1348, 1379, 4941 of this title; title 15 sections 78*l*, 80a–3.

§ 405. Qualified bond purchase plans.

(a) Requirements for qualification.

A plan of an employer for the purchase for and distribution to his employees or their beneficiaries of United States bonds described in subsection (b) shall constitute a qualified bond purchase plan under this section if—

(1) the plan meets the requirements of section 401(a) (3), (4), (5), (6), (7), and (8) and, if applicable, the requirements of section 401(a) (9) and (10) and of section 401(d) (other than paragraphs (1), (5)(B), and (8)); and

(2) contributions under the plan are used solely to purchase for employees or their beneficiaries United States bonds described in subsection (b).

(b) Bonds to which applicable.

(1) Characteristics of bonds.

This section shall apply only to a bond issued under the Second Liberty Bond Act, as amended, which by its terms, or by regulations prescribed by the Secretary under such Act—

(A) provides for payment of interest, or investment yield, only upon redemption;

(B) may be purchased only in the name of an individual;

(C) ceases to bear interest, or provide investment yield, not later than 5 years after the death of the individual in whose name it is purchased;

(D) may be redeemed before the death of the individual in whose name it is purchased only if such individual—

(i) has attained the age of 59½ years, or

(ii) has become disabled (within the mean- of section 72(m)(7)); and

(E) is nontransferable.

(2) Must be purchased in name of employee.

This section shall apply to a bond described in paragraph (1) only if it is purchased in the name of the employee.

(c) Deduction for contributions to bond purchase plans.

Contributions paid by an employer to or under a qualified bond purchase plan shall be allowed as a deduction in an amount determined under section 404 in the same manner and to the same extent as if such contributions were made to a trust described in section 401(a) which is exempt from tax under section 501(a).

(d) Taxability of beneficiary of qualified bond purchase plan.

(1) Gross income not to include bonds at time of distribution.

For purposes of this chapter, in the case of a distributee of a bond described in subsection (b) under a qualified bond purchase plan, or from a trust described in section 401(a) which is exempt from tax under section 501(a), gross income does not include any amount attributable to the receipt of such bond. Upon redemption of such bond, the proceeds shall be subject to taxation under this chapter, but the provisions of section 72 (relating to annuities, etc.) and section 1232 (relating to bonds and other evidences of indebtedness) shall not apply.

(2) Basis.

The basis of any bond received by a distributee under a qualified bond purchase plan—

(A) if such bond is distributed to an employee, or with respect to an employee, who at the time of purchase of the bond, was an employee other than an employee within the meaning of section 401(c)(1), shall be the amount of the contributions by the employee which were used to purchase the bond, and

(B) if such bond is distributed to an employee, or with respect to an employee, who, at the time of purchase of the bond, was an employee within the meaning of section 401(c)(1), shall be the amount of the contributions used to purchase the bond which were made on behalf of such employee and were not allowed as a deduction under subsection (c).

The basis of any bond described in subsection (b) reeeived by a distributee from a trust described in section 401(a) which is exempt from tax under section 501(a) shall be determined under regulations prescribed by the Secretary or his delegate.

(e) Capital gains treatment and limitation of tax not to apply to bonds distributed by trusts.

Section 72(n) and section 402(a)(2) shall not apply to any bond described in subsection (b) distributed to any distributee and, for purposes of applying such sections, any such bond distributed to any distributee and any such bond to the credit of any employee shall not be taken into account.

(f) Employee defined.

For purposes of this section, the term "employee" includes an individual who is an employee within the meaning of section 401(c)(1), and the employer of such individual shall be the person treated as his employer under section 401(c)(4).

(g) Proof of purchase.

At the time of purchase of any bond to which this section applies, proof of such purchase shall be furnished in such form as will enable the purchaser, and the employee in whose name such bond is purchased, to comply with the provisions of this section.

(h) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section. (Added Pub. L. 87–792, § 5(a), Oct. 10, 1962, 76 Stat. 826, and amended Pub. L. 89–97, title I, § 106(d)(5), July 30, 1965, 79 Stat. 337; Pub. L. 91–172, title V, § 515(c)(1), Dec. 30, 1969, 83 Stat. 645.)

REFERENCES IN TEXT

The Second Liberty Bond Act, as amended, referred to in subsec. (b)(1), is classified to sections 745, 752—754b, 757, 757b—758, 760, 764—766, 769, 771, 773, 774 and 801 of Title 31, Money and Finance.

AMENDMENTS

1969—Subsec. (e). Pub. L. 91–172 substituted "Capital gains treatment and limitation of tax" for "Capital gains treatment" in subsec. catchline, substituted "Section 72(n) and section 402(a)(2)" for "Section 402(a)(2)" and "sections" for "section."

1965—Subsec. (b)(1)(D)(ii). Pub. L. 89–97 substituted "section 72(m)(7)" for "section 213(g)(3)".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 515(d) of Pub. L. 91–172, set out as a note under section 402 of this title.

EFFECTIVE DATE OF 1965 AMENDMENT

Amendment of this section by Pub. L. 89–97 applicable to taxable years beignning after Dec. 31, 1966, see section 106(e) of Pub. L. 89–97, set out as a note under section 213 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 62, 172, 406, 407, 1379, 3121, 3306, 3401, 3402, 6047 of this title; title 42 section 409.

§ 406. Certain employees of foreign subsidiaries.

(a) Treatment as employees of domestic corporation.

For purposes of applying this part with respect to a pension, profit-sharing, or stock bonus plan described in section 401(a), an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a), of a domestic corporation, an individual who is a citizen of the United States and who is an employee of a foreign subsldi-

ary (as defined in section 3121(*l*)(8)) of such domestic corporation shall be treated as an employee of such domestic corporation, if—

(1) such domestic corporation has entered into an agreement under section 3121(*l*) which applies to the foreign subsidiary of which such individual is an employee;

(2) the plan of such domestic corporation expressly provides for contributions or benefits for individuals who are citizens of the United States and who are employees of its foreign subsidiaries te which an agreement entered into by such domestic corporation under section 3121(*l*) applies; and

(3) contributions under a funded plan of deferred compensation (whether or not a plan described in section 401(a), 403(a), or 405(a)) are not provided by any other person with respect to the remuneration paid to such individual by the foreign subsidiary.

(b) Special rules for application of section 401(a).

(1) Nondiscrimination requirements.

For purposes of applying paragraphs (3)(B) and (4) of section 401(a) with respect to an individual who is treated as an employee of a domestic corporation under subsection (a)—

(A) if such individual is an officer, shareholder, or person whose principal duties consist in supervising the work of other employees of a foreign subsidiary of such domestic corporation, he shall be treated as having such capacity with respect to such domestic corporation; and

(B) the determination of whether such individual is a highly compensated employee shall be made by treating such individual's total compensation (determined with the application of paragraph (2) of this subsection) as compensation paid by such domestic corporation and by determining such individual's status with regard to such domestic corporation.

(2) Determination of compensation.

For purposes of applying paragraph (5) of section 401(a) with respect to an individual who is treated as an employee of a domestic corporation under subsection (a)—

(A) the total compensation of such individual shall be the remuneration paid to such individual by the foreign subsidiary which would constitute his total compensation if his services had been performed for such domestic corporation, and the basic or regular rate of compensation of such individual shall be determined under regulations prescribed by the Secretary or his delegate; and

(B) such individual shall be treated as having paid the amount paid by such domestic corporation which is equivalent to the tax imposed by section 3101.

(c) Termination of status as deemed employee not to be treated as separation from service for purposes of capital gain provisions and limitation of tax.

For purposes of applying section 72(n), section 402(a)(2), and section 403(a)(2) with respect to an individual who is treated as an employee of a domestic corporation under subsection (a), such individual shall not be considered as separated from the service of such domestic corporation solely by reason of the fact that—

(1) the agreement entered into by such domestic corporation under section 3121(*l*) which covers the employment of such individual is terminated under the provisions of such section,

(2) such individual becomes an employee of a foreign subsidiary with respect to which such agreement does not apply,

(3) such individual ceases to be an employee of the foreign subsidiary by reason of which he is treated as an employee of such domestic corporation, if he becomes an employee of another corporation controlled by such domestic corporation, or

(4) the provision of the plan described in subsection (a)(2) is terminated.

(d) Deductibility of contributions.

For purposes of applying sections 404 and 405(c) with respect to contributions made to or under a pension, profit-sharing, stock bonus, annuity, or bond purchase plan by a domestic corporation, or by another corporation which is entitled to deduct its contributions under section 404(a)(3)(B), on behalf of an individual who is treated as an employee of such domestic corporation under subsection (a)—

(1) except as provided in paragraph (2), no deduction shall be allowed to such domestic corporation or to any other corporation which is entitled to deduct its contributions under such sections,

(2) there shall be allowed as a deduction to the foreign subsidiary of which such individual is an employee an amount equal to the amount which (but for paragraph (1)) would be deductible under section 404 (or section 405(c)) by the domestic corporation if he were an employee of the domestic corporation, and

(3) any reference to compensation shall be considered to be a reference to the total compensation of such individual (determined with the application of subsection (b)(2)).

Any amount deductible by a foreign subsidiary under this subsection shall be deductible for its taxable year with or within which the taxable year of such domestic corporation ends.

(e) Treatment as employee under related provisions.

An individual who is treated as an employee of a domestic corporation under subsection (a) shall also be treated as an employee of such domestic corporation, with respect to the plan described in subsection (a)(2), for purposes of applying the following provisions of this title:

(1) Section 72(d) (relating to employees' annuities).

(2) Section 72(f) (relating to special rules for computing employees' contributions).

(3) Section 101(b) (relating to employees' death benefits).

(4) Section 2039 (relating to annuities).

(5) Section 2517 (relating to certain annuities under qualified plans).

(Added Pub. L. 88–272, title II, § 220(a), Feb. 26, 1964, 78 Stat. 58, and amended Pub. L. 91–172, title V, § 515(c)(2), Dec. 30, 1969, 83 Stat. 645.)

AMENDMENTS

1969—Subsec. (c). Pub. L. 91-172 substituted "provisions and limitation of tax" for "provisions" in subsec. catchline, substituted "section 72(n), section 402(a)(2)," for "section 402(a)(2),".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable to taxable years ending after Dec. 31, 1969, see section 515(d) of Pub. L. 91-172, set out as a note under section 402 of this title.

EFFECTIVE DATE

Section 220(d) of Pub. L. 88-272 provided that: "The amendments made by subsections (a) [adding this section], (b) [adding section 407 of this title], and (c)(1) [to the analysis preceding section 401 of this title] shall apply to taxable years ending after December 31, 1963. The amendments made by subsections (c) (2) [to section 3121(a)(5) of this title] and (3) [to section 409(e) of Title 42, Public Health and Welfare] shall apply to remuneration paid after December 31, 1962."

§ 407. Certain employees of domestic subsidiaries engaged in business outside the United States.

(a) Treatment as employees of domestic parent corporation.

(1) In general.

For purposes of applying this part with respect to a pension, profit-sharing, or stock bonus plan described in section 401(a), an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a), of a domestic parent corporation, an individual who is a citizen of the United States and who is an employee of a domestic subsidiary (within the meaning of paragraph (2)) of such domestic parent corporation shall be treated as an employee of such domestic parent corporation, if—

(A) the plan of such domestic parent corporation expressly provides for contributions or benefits for individuals who are citizens of the United States and who are employees of its domestic subsidiaries; and

(B) contributions under a funded plan of deferred compensation (whether or not a plan described in section 401(a), 403(a), or 405(a)) are not provided by any other person with respect to the remuneration paid to such individual by the domestic subsidiary.

(2) Definitions.

For purposes of this section—

(A) Domestic subsidiary.

A corporation shall be treated as a domestic subsidiary for any taxable year only if—

(i) such corporation is a domestic corporation 80 percent or more of the outstanding voting stock of which is owned by another domestic corporation;

(ii) 95 percent or more of its gross income for the three-year period immediately preceding the close of its taxable year which ends on or before the close of the taxable year of such other domestic corporation (or for such part of such period during which the corporation was in existence) was derived from sources without the United States; and

(iii) 90 percent or more of its gross income for such period (or such part) was derived from the active conduct of a trade or business.

If for the period (or part thereof) referred to in clauses (ii) and (iii) such corporation has no gross income, the provisions of clauses (ii) and (iii) shall be treated as satisfied if it is reasonable to anticipate that, with respect to the first taxable year thereafter for which such corporation has gross income, the provisions of such clauses will be satisfied.

(B) Domestic parent corporation.

The domestic parent corporation of any domestic subsidiary is the domestic corporation which owns 80 percent or more of the outstanding voting stock of such domestic subsidiary.

(b) Special rules for application of section 401(a).

(1) Nondiscrimination requirements.

For purposes of applying paragraphs (3) (B) and (4) of section 401(a) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a)—

(A) if such individual is an officer, shareholder, or person whose principal duties consist in supervising the work of other employees of a domestic subsidiary, he shall be treated as having such capacity with respect to such domestic parent corporation; and

(B) the determination of whether such individual is a highly compensated employee shall be made by treating such individual's total compensation (determined with the application of paragraph (2) of this subsection) as compensation paid by such domestic parent corporation and by determining such individual's status with regard to such domestic parent corporation.

(2) Determination of compensation.

For purposes of applying paragraph (5) of section 401(a) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a), the total compensation of such individual shall be the remuneration paid to such individual by the domestic subsidiary which would constitute his total compensation if his services had been performed for such domestic parent corporation, and the basic or regular rate of compensation of such individual shall be determined under regulations prescribed by the Secretary or his delegate.

(c) Termination of status as deemed employee not to be treated as separation from service for purposes of capital gain provisions and limitation of tax.

For purposes of applying section 72(n), section 402(a)(2), and section 403(a)(2) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a), such individual shall not be considered as separated from the service of such domestic parent corporation solely by reason of the fact that—

(1) the corporation of which such individual is an employee ceases, for any taxable year, to be a domestic subsidiary within the meaning of subsection (a)(2)(A),

(2) such individual ceases to be an employee of a domestic subsidiary of such domestic parent corporation, if he becomes an employee of another

corporation controlled by such domestic parent corporation, or

(3) the provision of the plan described in subsection (a)(1)(A) is terminated.

(d) Deductibility of contributions.

For purposes of applying sections 404 and 405(c) with respect to contributions made to or under a pension, profit-sharing, stock bonus, annuity, or bond purchase plan by a domestic parent corporation, or by another corporation which is entitled to deduct its contributions under section 404(a)(3)(B), on behalf of an individual who is treated as an employee of such domestic corporation under subsection (a)—

(1) except as provided in paragraph (2), no deduction shall be allowed to such domestic parent corporation or to any other corporation which is entitled to deduct its contributions under such sections,

(2) there shall be allowed as a deduction to the domestic subsidiary of which such individual is an employee an amount equal to the amount which (but for paragraph (1)) would be deductible under section 404 (or section 405(c)) by the domestic parent corporation if he were an employee of the domestic parent corporation, and

(3) any reference to compensation shall be considered to be a reference to the total compensation of such individual (determined with the application of subsection (b)(2)).

Any amount deductible by a domestic subsidiary under this subsection shall be deductible for its taxable year with or within which the taxable year of such domestic parent corporation ends.

(e) Treatment as employee under related provisions.

An individual who is treated as an employee of a domestic parent corporation under subsection (a) shall also be treated as an employee of such domestic parent corporation, with respect to the plan described in subsection (a)(1)(A), for purposes of applying the following provisions of this title:

(1) Section 72(d) (relating to employees' annuities).

(2) Section 72(f) (relating to special rules for computing employees' contributions).

(3) Section 101(b) (relating to employees' death benefits).

(4) Section 2039 (relating to annuities).

(5) Section 2517 (relating to certain annuities under qualified plans).

(Added Pub. L. 88–272, title II, § 220(b), Feb. 26, 1964, 78 Stat. 60, and amended Pub. L. 91–172, title V, § 515(c)(3), Dec. 30, 1969, 83 Stat. 646.)

AMENDMENTS

1969—Subsec. (c). Pub. L. 91–172 substituted "provisions and limitation of tax" for "provisions" in subsec. catchline, substituted "section 72(n), section 402(a)(2)," for "section 402(a)(2)."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 515(d) of Pub. L. 91–172, set out as a note under section 402 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1963, see section 220(d) of Pub. L. 88–272, set out as a note under section 406 of this title.

PART II.—CERTAIN STOCK OPTIONS

Sec.
421. General rules.
422. Qualified stock options.
423. Employee stock purchase plans.
424. Restricted stock options.
425. Definitions and special rules.

AMENDMENTS

1964—Pub. L. 88–272, title II, § 221(a), Feb. 26, 1964, 78 Stat. 63, substituted "Part II—Certain Stock Options" for "Part II—Miscellaneous Provisions", in the heading to Part II, and "General rules" for "Employee stock options" in Item 421, and added items 422–425.

§ 421 General rules.

(a) Effect of qualifying transfer.

If a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a), 423(a), or 424(a) are met—

(1) except as provided in section 422(c)(1), no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share;

(2) no deduction under section 162 (relating to trade or business expenses) shall be allowable at any time to the employer corporation, a parent or subsidiary corporation of such corporation, or a corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, with respect to the share so transferred; and

(3) no amount other than the price paid under the option shall be considered as received by any of such corporations for the share so transferred.

(b) Effect of disqualifying disposition.

If the transfer of a share of stock to an individual pursuant to his exercise of an option would otherwise meet the requirements of section 422(a), 423(a), or 424(a) except that there is a failure to meet any of the holding period requirements of section 422(a)(1), 423(a)(1), or 424(a)(1), then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, shall be treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

(c) Exercise by estate.

(1) In general.

If an option to which this part applies is exercised after the death of the employee by the estate of the decedent, or by a person who acquired the right to exercise such option by bequest or inheritance or by reason of the death of the decedent, the provisions of subsection (a) shall apply to the same extent as if the option had been exercised by the decedent, except that—

(A) the holding period and employment requirements of sections 422(a), 423(a), and 424(a) shall not apply, and

(B) any transfer by the estate of stock acquired shall be considered a disposition of such stock for purposes of sections 423(c) and 424(c)(1).

(2) Deduction for estate tax.

If an amount is required to be included under section 422(c)(1), 423(c), or 424(c)(1) in gross

income of the estate of the deceased employee or of a person described in paragraph (1), there shall be allowed to the estate or such person a deduction with respect to the estate tax attributable to the inclusion in the taxable estate of the deceased employee of the net value for estate tax purposes of the option. For this purpose, the deduction shall be determined under section 691(c) as if the option acquired from the deceased employee were an item of gross income in respect of the decedent under section 691 and as if the amount includible in gross income under section 422(c)(1), 423(c), or 424(c)(1) were an amount included in gross income under section 691 in respect of such item of gross income.

(3) Basis of shares acquired.

In the case of a share of stock acquired by the exercise of an option to which paragraph (1) applies—

(A) the basis of such share shall include so much of the basis of the option as is attributable to such share; except that the basis of such share shall be reduced by the excess (if any) of (i) the amount which would have been includible in gross income under section 422(c)(1), 423(c), or 424(c)(1) if the employee had exercised the option on the date of his death and had held the share acquired pursuant to such exercise at the time of his death, over (ii) the amount which is includible in gross income under such section; and

(B) the last sentence of sections 422(c)(1), 423(c), and 424(c)(1) shall apply only to the extent that the amount includible in gross income under such sections exceeds so much of the basis of the option as is attributable to such share.

(Aug. 16, 1954, ch. 736, 68A Stat. 142; Feb. 11, 1958, Pub. L. 85–320, § 1, 72 Stat. 4; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 25, 26(a), 72 Stat. 1623, 1624; Feb. 26, 1964, Pub. L. 88–272, title II, § 221(a), 78 Stat. 63.)

AMENDMENTS

1964—Pub. L. 88–272 amended section generally, and among other changes, inserted provisions relating to the effect of a qualifying transfer, and to the basis of shares acquired when an option is exercised by an estate, and omitted provisions relating to treatment of restricted stock options, a special rule where option price was between 85 percent and 95 percent of value of stock, acquisition of new stock, definitions, modification, extension, or renewal of option, and corporate reorganizations, liquidations, etc. See sections 421—425 of this title.

1958—Subsec. (a). Pub. L. 85–866, § 25, added sentence authorizing substitution of "grantor corporation" or "corporation issuing or assuming a stock option in a transaction to which subsection (g) is applicable" for the term "employer corporation".

Subsec. (d)(6)(C). Pub. L. 85–320 added subsec. (d)(6)(C).

Subsec. (d)(1)(A)(ii). Pub. L. 85–866, § 26(a)(1), substituted "in the case of a variable price option" for "in case the purchase price of the stock under the option is fixed or determinable under a formula in which the only variable is the value of the stock at any time during a period of 6 months which includes the time the option is exercised" and inserted "fair" preceding "market value".

Subsec. (d)(7). Pub. L. 85–866, § 26(a)(2), added subsec. (d)(7).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 221(e) of Pub. L. 88–272 provided that:

"(1) Except as provided in paragraphs (2) and (3), the amendments made by this section [adding sections 422–425, and 6039, amending this section and sections 402, 691, 6652, 6678, and the analysis preceding of sections 401 and 6031, and renumbering former section 3039 as 3040 of this title] shall apply to taxable years ending after December 31, 1963.

"(2) The amendments made by paragraphs (1) and (3) of subsection (b) [adding section 3039, renumbering former section 3039 as 3040, and amending section 6678 of this title] and paragraph (2) of section 6652(a) of the Internal Revenue Code of 1954 (as amended by paragraph (2) of subsection (b)), shall apply to stock transferred pursuant to options exercised on or after January 1, 1964.

"(3) In the case of an option granted after December 31, 1963, and before January 1, 1965—

"(A) paragraphs (1) and (2) of section 422(b) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall not apply, and

"(B) paragraph (1) of section 425(h) of such Code (as added by subsection (a)) shall not apply to any change in the terms of such option made before January 1, 1965, to permit such option to qualify under paragraphs (3), (4), and (5) of such section 422(b)."

EFFECTIVE DATE OF 1958 AMENDMENTS

Amendment of subsec. (a) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 26 (b) of Pub. L. 85–866 provided that: "The amendments made by subsection (a) [amending subsec. (d)(1)(A)(ii) and adding subsec. (d)(7) of this section] shall apply with respect to taxable years ending after September 30, 1958."

Section 3 of Pub. L. 85–320 provided that: "The amendments made by this Act [adding subpar. (C) to subsec. (d)(6) of this section and repealing subsec. (d) of section 1014 of this title] shall apply with respect to taxable years ending after December 31, 1956, but only in the case of employees dying after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 81, 422, 423, 424, 691 of this title.

§ 422. Qualified stock options.

(a) In general.

Subject to the provisions of subsection (c)(1), section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if—

(1) no disposition of such share is made by such individual within the 3-year period beginning on the day after the day of the transfer of such share, and

(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, such individual was an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies.

(b) Qualified stock option.

For purposes of this part, the term "qualified stock option" means an option granted to an individual after December 31, 1963 (other than a restricted stock option granted pursuant to a contract described in section 424(c)(3)(A)), for any reason connected with his employment by a corporation, if

granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

(1) the option is granted pursuant to a plan which includes the aggregate number of shares which may be issued under options, and the employees (or class of employees) eligible to receive options, and which is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(2) such option is granted within 10 years from the date such plan is adopted, or the date such plan is approved by the stockholders whichever is earlier;

(3) such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted;

(4) except as provided in subsection (c)(1), the option price is not less than the fair market value of the stock at the time such option is granted;

(5) such option by its terms is not exercisable while there is outstanding (within the meaning of subsection (c)(2)) any qualified stock option (or restricted stock option) which was granted, before the granting of such option, to such individual to purchase stock in his employer corporation or in a corporation which (at the time of the granting of such option) is a parent or subsidiary corporation of the employer corporation, or in a predecessor corporation of any of such corporations;

(6) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

(7) such individual, immediately after such option is granted, does not own stock possessing more than 5 percent of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation; except that if the equity capital of such corporation or corporations (determined at the time the option is granted) is less than $2,000,000, then, for purposes of applying the limitation of this paragraph, there shall be added to such 5 percent the percentage (not higher than 5 percent) which bears the same ratio to 5 percent as the difference between such equity capital and $2,000,000 bears to $1,000,000.

(c) Special rules.

(1) Exercise of option when price is less than value of stock.

If a share of stock is transferred pursuant to the exercise by an individual of an option which fails to qualify as a qualified stock option under subsection (b) because there was a failure in an attempt, made in good faith, to meet the requirement of subsection (b)(4), the requirement of subsection (b)(4) shall be considered to have been met, but there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income for the taxable year in which such option is exercised, an amount equal to the lesser of—

(A) 150 percent of the difference between the option price and the fair market value of the share at the time the option was granted, or

(B) the difference between the option price and the fair market value of the share at the time of such exercise.

The basis of the share acquired shall be increased by an amount equal to the amount included in his gross income under this paragraph in the taxable year in which the exercise occurred.

(2) Certain options treated as outstanding.

For purposes of subsection (b)(5)—

(A) any restricted stock option which is not terminated before January 1, 1965, and

(B) any qualified stock option granted after December 31, 1963,

shall be treated as outstanding until such option is exercised in full or expires by reason of the lapse of time. For purposes of the preceding sentence, a restricted stock option granted before January 1, 1964, shall not be treated as outstanding for any period before the first day on which (under the terms of such option) it may be exercised.

(3) Options granted to certain shareholders.

For purposes of subsection (b)(7)—

(A) the term "equity capital" means—

(i) in the case of one corporation, the sum of its money and other property (in an amount equal to the adjusted basis of such property for determining gain), less the amount of its indebtedness (other than indebtedness to shareholders), and

(ii) in the case of a group of corporations consisting of a parent and its subsidiary corporations, the sum of the equity capital of each of such corporations adjusted, under regulations prescribed by the Secretary or his delegate, to eliminate the effect of intercorporate ownership and transactions among such corporations;

(B) the rules of section 425(d) shall apply in determining the stock ownership of the individual; and

(C) stock which the individual may purchase under outstanding options shall be treated as stock owned by such individual.

If an individual is granted an option which permits him to purchase stock in excess of the limitation of subsection (b)(7) (determined by applying the rules of this paragraph), such option shall be treated as meeting the requirement of subsection (b)(7) to the extent that such individual could, if the option were fully exercised at the time of grant, purchase stock under such option without exceeding such limitation. The portion of such option which is treated as meeting the requirement of subsection (b)(7) shall be deemed to be that portion of the option which is first exercised.

(4) Certain disqualifying dispositions where amount realized is less than value at exercise.

If—

(A) an individual who has acquired a share of stock by the exercise of a qualified stock option makes a disposition of such share within the 3-year period described in subsection (a)(1), and

(B) such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to such individual,

then the amount which is includible in the gross income of such individual, and the amount which is deductible from the income of his employer corporation, as compensation attributable to the exercise of such option shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share.

(5) Certain transfers by insolvent individuals.

If an insolvent individual holds a share of stock acquired pursuant to his exercise of a qualified stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary, in any proceeding under the Bankruptcy Act or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of his creditors in such proceeding, shall constitute a "disposition of such share" for purposes of subsection (a)(1).

(6) Application of subsection (b)(5) where options are for stock of same class in same corporation.

The requirement of subsection (b)(5) shall be considered to have been met in the case of any option (referred to in this paragraph as "new option") granted to an individual if—

(A) the new option and all outstanding options referred to in subsection (b)(5) are to purchase stock of the same class in the same corporation, and

(B) the new option by its terms is not exercisable while there is outstanding (within the meaning of paragraph (2)) any qualified stock option (or restricted stock option) which was granted, before the granting of the new option, to such individual to purchase stock in such corporation at a price (determined as of the date of grant of the new option) higher than the option price of the new option.

(Added Pub. L. 88–272, title II, § 221(a), Feb. 26, 1964, 78 Stat. 64.)

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1963, except in cases of options granted after Dec. 31, 1963, and before Jan. 1, 1965, in which case pars. (1) and (2) of subsec. (b) shall not apply, see section 221(e) of Pub. L. 88–272 set out as a note under section 421 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 421, 425 of this title.

§ 423. Employee stock purchase plans.

(a) General rule.

Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an option granted after December 31, 1963 (other than a restricted stock option granted pursuant to a plan described in section 424(c)(3)(B), under an employee stock purchase plan (as defined in subsection (b)) if—

(1) no disposition of such share is made by him within 2 years after the date of the granting of the option nor within 6 months after the transfer of such share to him; and

(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, he is an employee of the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies.

(b) Employee stock purchase plan.

For purposes of this part, the term "employee stock purchase plan" means a plan which meets the following requirements:

(1) the plan provides that options are to be granted only to employees of the employer corporation or of its parent or subsidiary corporation to purchase stock in any such corporation;

(2) such plan is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(3) under the terms of the plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation. For purposes of this paragraph, the rules of section 425(d) shall apply in determining the stock ownership of an individual, and stock which the employee may purchase under outstanding options shall be treated as stock owned by the employee;

(4) under the terms of the plan, options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation, except that there may be excluded—

(A) employees who have been employed less than 2 years,

(B) employees whose customary employment is 20 hours or less per week,

(C) employees whose customary employment is for not more than 5 months in any calendar year, and

(D) officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees;

(5) under the terms of the plan, all employees granted such options shall have the same rights and privileges, except that the amount of stock which may be purchased by any employee under such option may bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees, and the plan may provide that no employee may purchase more than a maximum amount of stock fixed under the plan;

(6) under the terms of the plan, the option price is not less than the lesser of—

(A) an amount equal to 85 percent of the fair market value of the stock at the time such option is granted, or

(B) an amount which under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time such option is exercised;

(7) under the terms of the plan, such option cannot be exercised after the expiration of—

(A) 5 years from the date such option is granted if, under the terms of such plan, the option price is to be not les than 85 percent of the fair market value of such stock at the time of the exercise of the option, or

(B) 27 months from the date such option is granted, if the option price is not determinable in the manner described in subparagraph (A)

(8) under the terms of the plan, no employee may be granted an option which permits his rights to purchase stock under all such plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. For purposes of this paragraph—

(A) the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

(B) the right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

(C) a right to purchase stock which has accrued under one option granted pursuant to the plan may not be carried over to any other option; and

(9) under the terms of the plan, such option is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him.

For purposes of paragraphs (3) to (9), inclusive, where additional terms are contained in an offering made under a plan, such additional terms shall, with respect to options exercised under such offering, be treated as a part of the terms of such plan.

(c) Special rule where option price is between 85 percent and 100 percent of value of stock.

If the option price of a share of stock acquired by an individual pursuant to a transfer to which subsection (a) applies was less than 100 percent of the fair market value of such share at the time such option was granted, then, in the event of any disposition of such share by him which meets the holding period requirements of subsection (a), or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies, an amount equal to the lesser of—

(1) the excess of the fair market value of the share at the time of such disposition or death over the amount paid for the share under the option, or

(2) the excess of the fair market value of the share at the time the option was granted over the option price.

If the option price is not fixed or determinable at the time the option is granted, then for purposes of this subsection, the option price shall be determined as if the option were exercised at such time. In the case of the disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income. (Added Pub. L. 88–272, title II, § 221(a), Feb. 26, 1964, 78 Stat. 67.)

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1963, see section 221(e) of Pub. L. 88–272, set out as a note under section 421 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 421, 424, 425, 6039 of this title.

§ 424. Restricted stock options.

(a) In general.

Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise after 1949 of a restricted stock option, if—

(1) no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him, and

(2) at the time he exercises such option—

(A) he is an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, or

(B) he ceased to be an employee of such corporations within the 3-month period preceding the time of exercise.

(b) Restricted stock option.

For purposes of this part, the term "restricted stock option" means an option granted after February 26, 1945, and before January 1, 1964 (or, if it meets the requirements of subsection (c)(3), an option granted after December 31, 1963), to an individual, for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

(1) at the time such option is granted—

(A) the option price is at least 85 percent of the fair market value at such time of the stock subject to the option, or

(B) in the case of a variable price option, the option price (computed as if the option had been exercised when granted) is at least 85 percent of the fair market value of the stock at the time such option is granted;

(2) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him;

(3) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation. This paragraph shall not apply if at the time such

option is granted the option price is at least 110 percent of the fair market value of the stock subject to the option, and such option either by its terms is not exercisable after the expiration of 5 years from the date such option is granted or is exercised within one year after August 16, 1954. For purposes of this paragraph, the provisions of section 425(d) shall apply in determining the stock ownership of an individual; and

(4) such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted, if such option has been granted on or after June 22, 1954.

(c) Special rules.

(1) Options under which option price is between 85 percent and 95 percent of value of stock.

If no disposition of a share of stock acquired by an individual on his exercise after 1949 of a restricted stock option is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him, at the time the restricted stock option was granted, the option price (computed under subsection (b)(1)) was less than 95 percent of the fair market value at such time of such share, then, in the event of any disposition of such share by him but, or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies—

(A) in the case of a share of stock acquired under an option qualifying under subsection (b)(1)(A), an amount equal to the amount (if any) by which the option price is exceeded by the lesser of—

(i) the fair market value of the share at the time of such disposition or death, or

(ii) the fair market value of the share at the time the option was granted; or

(B) in the case of stock acquired under an option qualifying under subsection (b)(1)(B), an amount equal to the lesser of—

(i) the excess of the fair market value of the share at the time of such disposition or death over the price paid under the option, or

(ii) the excess of the fair market value of the share at the time the option was granted over the option price (computed as if the option had been exercised at such time).

In the case of a disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income.

(2) Variable price option.

For purposes of subsection (b)(1), the term "variable price option" means an option under which the purchase price of the stock is fixed or determinable under a formula in which the only variable is the fair market value of the stock at any time during a period of 6 months which includes the time the option is exercised; except that in the case of options granted after September 30, 1958, such term does not include any such option in which such formula provides for determining such price by reference to the fair market value of the stock at any time before the option is exercised if such value may be greater than the average fair market value of the stock during the calendar month in which the option is exercised.

(3) Certain options granted after December 31, 1963.

For purposes of subsection (b), an option granted after December 31, 1963, meets the requirements of this paragraph if granted pursuant to—

(A) a binding written contract entered into before January 1, 1964, or

(B) a written plan adopted and approved before January 1, 1964, which (as of January 1, 1964, and as of the date of the granting of the option)—

(i) met the requirements of paragraphs (4) and (5) of section 423(b), or

(ii) was being administered in a way which did not discriminate in favor of officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees.

(Added Pub. L. 88–272, title II, § 221(a), Feb. 26, 1964, 78 Stat. 69.)

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1963, see section 22 (e) of Pub. L. 88–272, set out as a note under section 421 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 421, 422, 423, 425, 6039 of this title.

§ 425. Definitions and special rules.

(a) Corporate reorganizations, liquidations, etc.

For purposes of this part, the term "issuing or assuming a stock option in a transaction to which section 425(a) applies" means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation, if—

(1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

(2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

For purposes of this subsection, the parent-subsidiary relationship shall be determined at the time of any such transaction under this subsection.

(b) Acquisition of new stock.

For purposes of this part, if stock is received by an individual in a distribution to which section

305, 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies, and such distribution was made with respect to stock transferred to him upon his exercise of the option, such stock shall be considered as having been transferred to him on his exercise of such option. A similar rule shall be applied in the case of a series of such distributions.

(c) Disposition.

(1) In general.

Except as provided in paragraph (2), for purposes of this part, the term "disposition" includes a sale, exchange, gift, or a transfer of legal title, but does not include—

(A) a transfer from a decedent to an estate or a transfer by request or inheritance;

(B) an exchange to which section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies; or

(C) a mere pledge or hypothecation.

(2) Joint tenancy.

The acquisition of a share of stock in the name of the employee and another jointly with the right of survivorship or a subsequent transfer of a share of stock into such joint ownership shall not be deemed a disposition, but a termination of such joint tenacy (except to the extent such employee acquires ownership of such stock) shall be treated as a disposition by him occurring at the time such joint tenancy is terminated.

(d) Attribution of stock ownership.

For purposes of this part, in applying the percentage limitations of sections 422(b)(7), 423(b)(3), and 424(b)(3)—

(1) the individual with respect to whom such limitation is being determined shall be considered as owning the stock owned, directly or indirectly, by or for his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(2) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries.

(e) Parent corporation.

For purposes of this part, the term "parent corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(f) Subsidiary corporation.

For purposes of this part, the term "subsidiary corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(g) Special rule for applying subsections (e) and (f).

In applying subsections (e) and (f) for purposes of section 422(a)(2), 423(a)(2), and 424(a)(2), there shall be substituted for the term "employer corporation" wherever it appears in subsection (e) and (f) the term "grantor corporation" or the term "corporation issuing or assuming a stock option in a transaction to which section 425(a) applies" as the case may be.

(b) Modification, extension, or renewal of option.

(1) In general.

For purposes of this part, if the terms of any option to purchase stock are modified, extended, or renewed, such modification, extension, or renewal shall be considered as the granting of a new option.

(2) Special rules for sections 423 and 424 options.

(A) In the case of the transfer of stock pursuant to the exercise of an option to which section 423 or 424 applies and which has been so modified, extended, or renewed, then, except as provided in subparagraph (B), the fair market value of such stock at the time of the granting of such option shall be considered as whichever of the following is the highest:

(i) the fair market value of such stock on the date of the original granting of the option,

(ii) the fair market value of such stock on the date of the making of such modification, extension, or renewal, or

(iii) the fair market value of such stock at the time of the making of any intervening modification, extension, or renewal.

(B) Subparagraph (A) shall not apply with respect to a modification, extension, or renewal of a restricted stock option before January 1, 1964 (or after December 31, 1963, if made pursuant to a binding written contract entered into before January 1, 1964), if the aggregate of the monthly average fair market values of the stock subject to the option for the 12 consecutive calendar months before the date of the modification, extension, or renewal, divided by 12, is an amount less than 80 percent of the fair market value of such stock on the date of the original granting of the option or the date of the making of any intervening modification, extension, or renewal, whichever is the highest.

(3) Definition of modification.

The term "modification" means any change in the terms of the option which gives the employee additional benefits under the option, but such term shall not include a change in the terms of the option—

(A) attributable to the issuance or assumption of an option under subsection (a);

(B) to permit the option to qualify under sections 422(b)(6), 423(b)(9), and 424(b)(2); or

(C) in the case of an option not immediately exercisable in full, to accelerate the time at which the option may be exercised.

If a restricted stock option is exercisable after the expiration of 10 years from the date such option is granted, subparagraph (B) shall not apply unless the terms of the option are also changed to make it not exercisable after the expiration of such period.

(i) Stockholder approval.

For purposes of this part, if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval.

(j) Cross references.

For provisions requiring the reporting of certain acts with respect to a qualified stock option, options granted under employer stock purchase plans, or a restricted stock option, see section 6039.

(Added Pub. L. 88–272, title II, § 221(a), Feb. 26, 1964, 78 Stat. 71.)

EFFECTIVE DATE

Section applicable to taxable years ending after Dec. 31, 1963, except in cases of options granted after Dec. 31, 1963, and before Jan. 1, 1965, in which case par. (1) of subsec. (h) shall not apply to any change in the terms of such option made before Jan. 1, 1965, to permit such option to qualify under pars. (3), (4), and (5) of section 422(b), see section 221(e) of Pub. L. 88–272, set out as a note under section 421 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 402, 421, 422, 423, 424 of this title.

Subchapter E.—Accounting Periods and Methods of Accounting

Part
I. Accounting periods.
II. Methods of accounting.
III. Adjustments.

PART I.—ACCOUNTING PERIODS

Sec.
441. Period for computation of taxable income.
442. Change of annual accounting period.
443. Returns for a period of less than 12 months.

§ 441. Period for computation of taxable income.

(a) Computation of taxable income.

Taxable income shall be computed on the basis of the taxpayer's taxable year.

(b) Taxable year.

For purposes of this subtitle, the term "taxable year" means—

(1) the taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

(2) the calendar year, if subsection (g) applies; or

(3) the period for which the return is made, if a return is made for a period of less than 12 months.

(c) Annual accounting period.

For purposes of this subtitle, the term "annual accounting period" means the annual period on the basis of which the taxpayer regularly computes his income in keeping his books.

(d) Calendar year.

For purposes of this subtitle, the term "calendar year" means a period of 12 months ending on December 31.

(e) Fiscal year.

For purposes of this subtitle, the term "fiscal year" means a period of 12 months ending on the last day of any month other than December. In the case of any taxpayer who has made the election provided by subsection (f) the term means the annual period (varying from 52 to 53 weeks) so elected.

(f) Election of year consisting of 52–53 weeks.

(1) General rule.

A taxpayer who, in keeping his books, regularly computes his income on the basis of an annual period which varies from 52 to 53 weeks and ends always on the same day of the week and ends always—

(A) on whatever date such same day of the week last occurs in a calendar month, or

(B) on whatever date such same day of the week falls which is nearest to the last day of a calendar month,

may (in accordance with the regulations prescribed under paragraph (3)) elect to compute his taxable income for purposes of this subtitle on the basis of such annual period. This paragraph shall apply to taxable years ending after the date of the enactment of this title.

(2) Special rules for 52–53-week year.

(A) Effective dates.

In any case in which the effective date or the applicability of any provision of this title is expressed in terms of taxable years beginning, including, or ending with reference to a specified date which is the first or last day of a month, a taxable year described in paragraph (1) shall (except for purposes of the computation under section 21) be treated—

(i) as beginning with the first day of the calendar month beginning nearest to the first day of such taxable year, or

(ii) as ending with the last day of the calendar month ending nearest to the last day of such taxable year,

as the case may be.

(B) Change in accounting period.

In the case of a change from or to a taxable year described in paragraph (1)—

(i) if such change results in a short period (within the meaning of section 443) of 359 days or more, or of less than 7 days, section 443 (b) (relating to alternative tax computation) shall not apply;

(ii) if such change results in a short period of less than 7 days, such short period shall, for purposes of this subtitle, be added to and deemed a part of the following taxable year; and

(iii) if such change results in a short period to which subsection (b) of section 443 applies, the taxable income for such short period shall be placed on an annual basis for purposes of such subsection by multiplying such income by 365 and dividing the result by the number of days in the short period, and the tax shall be the same part of the tax computed on the annual basis as the number of days in the short period is of 365 days.

(3) Regulations.

The Secretary or his delegate shall prescribe such regulations as he deems necessary for the application of this subsection.

(g) No books kept; no accounting period.

Except as provided in section 443 (relating to returns for periods of less than 12 months), the taxpayer's taxable year shall be the calendar year if—

(1) the taxpayer keeps no books;

(2) the taxpayer does not have an annual accounting period; or

(3) the taxpayer has an annual accounting period, but such period does not qualify as a fiscal year.

(Aug. 16, 1954, ch. 736, 68A Stat. 148; Feb. 26, 1964, Pub. L. 88–272, title II, § 235(c)(3), 78 Stat. 127.)

AMENDMENTS

1964—Subsec. (f)(2)(A). Pub. L. 88–272 inserted ", including," preceding "or ending with reference to."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years ending after Dec. 31, 1963, see section 235(d) of Pub. L. 88–272 set out as a note under section 1551 of this title.

CROSS REFERENCES

Definitions—

Fiscal year, see section 7701 (a) (24) of this title.

Taxable year, see section 7701 (a) (23) of this title.

General requirement of return, statement, or list, see section 6011 of this title.

General rule for methods of accounting, see section 446 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 442 of this title.

§ 442. Change of annual accounting period.

If a taxpayer changes his annual accounting period, the new accounting period shall become the taxpayer's taxable year only if the change is approved by the Secretary or his delegate. For purposes of this subtitle, if a taxpayer to whom section 441 (g) applies adopts an annual accounting period (as defined in section 441 (c)) other than a calendar year, the taxpayer shall be treated as having changed his annual accounting period. (Aug. 16, 1954, ch. 736, 68A Stat. 149.)

§ 443. Returns for a period of less than 12 months.

(a) Returns for short period.

A return for a period of less than 12 months (referred to in this section as "short period") shall be made under any of the following circumstances:

(1) Change of annual accounting period.

When the taxpayer, with the approval of the Secretary or his delegate, changes his annual accounting period. In such a case, the return shall be made for the short period beginning on the day after the close of the former taxable year and ending at the close of the day before the day designated as the first day of the new taxable year.

(2) Taxpayer not in existence for entire taxable year.

When the taxpayer is in existence during only part of what would otherwise be his taxable year.

(3) Termination of taxable year for jeopardy.

When the Secretary or his delegate terminates the taxpayer's taxable year under section 6851 (relating to tax in jeopardy).

(b) Computation of tax on change of annual accounting period.

(1) General rule.

If a return is made under paragraph (1) of subsection (a), the taxable income for the short period shall be placed on an annual basis by multiplying such income by 12 and dividing the result by the number of months in the short period. The tax shall be the same part of the tax computed on the annual basis as the number of months in the short period is of 12 months.

(2) Exception.

(A) Computation based on 12-month period.

If the taxpayer applies for the benefits of this paragraph and establishes the amount of his taxable income for the 12-month period described in subparagraph (B), computed as if that period were a taxable year and under the law applicable to that year, then the tax for the short period, computed under paragraph (1), shall be reduced to the greater of the following:

(i) an amount which bears the same ratio to the tax computed on the taxable income for the 12-month period as the taxable income computed on the basis of the short period bears to the taxable income for the 12-month period; or

(ii) the tax computed on the taxable income for the short period without placing the taxable income on an annual basis.

The taxpayer (other than a taxpayer to whom subparagraph (B) (ii) applies) shall compute the tax and file his return without the application of this paragraph.

(B) 12-month period.

The 12-month period referred to in subparagraph (A) shall be—

(i) the period of 12 months beginning on the first day of the short period, or

(ii) the period of 12 months ending at the close of the last day of the short period, if at the end of the 12 months referred to in clause (i) the taxpayer is not in existence or (if a corporation) has theretofore disposed of substantially all of its assets.

(C) Application for benefits.

Application for the benefits of this paragraph shall be made in such manner and at such time as the regulations prescribed under subparagraph (D) may require; except that the time so prescribed shall not be later than the time (including extensions) for filing the return for the first taxable year which ends on or after the day which is 12 months after the first day of the short period. Such application, in case the return was filed without regard to this paragraph, shall be considered a claim for credit or refund with respect to the amount by which the tax is reduced under this paragraph.

(D) Regulations.

The Secretary or his delegate shall prescribe such regulations as he deems necessary for the application of this paragraph.

(c) Adjustment in deduction for personal exemption.

In the case of a taxpayer other than a corporation, if a return is made for a short period by reason of subsection (a) (1) and if the tax is not computed under subsection (b) (2), then the exemptions allowed as a deduction under section 151 (and any deduction in lieu thereof) shall be reduced to amounts which bear the same ratio to the full exemptions as the number of months in the short period bears to 12.

(d) Adjustment in exclusion for computing minimum tax for tax preferences.

If a return is made for a short period by reason of subsection (a), then the $30,000 amount specified in section 56 (relating to minimum tax for tax preferences), modified as provided by section 58, shall be reduced to the amount which bears the same ratio to such specified amount as the number of days in the short period bears to 365.

(e) Cross references.

For inapplicability of subsection (b) in computing—
(1) Accumulated earnings tax, see section 536.
(2) Personal holding company tax, see section 546.
(3) Undistributed foreign personal holding company income, see section 557.
(4) The taxable income of a regulated investment company, see section 852(b)(2)(E).
(5) The taxable income of a real estate investment trust, see section 857(b)(2)(D).

(Aug. 16, 1954, ch. 736, 68A Stat. 149; Sept. 14, 1960, Pub. L. 86-779, § 10(i), 74 Stat. 1009; Dec. 30, 1969, Pub. L. 91-172, title III, § 301(b)(6), 83 Stat. 585.)

AMENDMENTS

1969—Subsec. (d). Pub. L. 91-172 added subsec. (d). Former subsec. (d) redesignated (e).

Subsec. (e). Pub. L. 91-172 redesignated former subsec. (d) as (e).

1960—Subsec. (d)(5). Pub. L. 86-779 added par. (5).

EFFECTIVE DATE OF 1969 AMENDMENT

Subsec. (d) of this section applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91-172, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86-779 applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86-779, set out as a note under section 856 of this title.

CROSS REFERENCES

Joint return not allowed if taxable year of either spouse is fractional part of year, see section 6013 (a) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 441, 536, 546, 557, 818, 852, 857, 6013 of this title.

PART II.—METHODS OF ACCOUNTING

Subpart
A. Methods of accounting in general.
B. Taxable year for which items of gross income included.
C. Taxable year for which deductions taken.
D. Inventories.

SUBPART A.—METHODS OF ACCOUNTING IN GENERAL

Sec.
446. General rule for methods of accounting.

§ 446. General rule for methods of accounting.

(a) General rule.

Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) Exceptions.

If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) Permissible methods.

Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

(d) Taxpayer engaged in more than one business.

A taxpayer engaged in more than one trade or business may, in computing taxable income, use a different method of accounting for each trade or business.

(e) Requirement respecting change of accounting method.

Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary or his delegate. (Aug. 16, 1954, ch. 736, 68A Stat. 151.)

CROSS REFERENCES

Period for computation of taxable income, see section 441 of this title.

SUBPART B.—TAXABLE YEAR FOR WHICH ITEMS OF GROSS INCOME INCLUDED

Sec.
451. General rule for taxable year of inclusion.
453. Installment method.
454. Obligations issued at discount.
455. Prepaid subscription income.
456. Prepaid dues income of certain membership organizations.

AMENDMENTS

1961—Pub. L. 87-109, § 1(b), July 26, 1961, 75 Stat. 224, added item 456.

1958—Pub. L. 85-866, title I, § 28(b), Sept. 2, 1958, 72 Stat. 1626, added item 455.

1955—Act June 15, 1955, ch. 143, § 2(2), 69 Stat. 135, struck out item 452.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment by Pub. L. 85-866 effective with respect to taxable years beginning after Dec. 31, 1957, see note set out under section 455 of this title.

§ 451. General rule for taxable year of inclusion.

(a) General rule.

The amount of any item of gross income shall be included in the gross income for the taxable year in

which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

(b) Special rule in case of death.

In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued only by reason of the death of the taxpayer shall not be included in computing taxable income for the period in which falls the date of the taxpayer's death.

(c) Special rule for employee tips.

For purposes of subsection (a), tips included in a written statement furnished an employer by an employee pursuant to section 6053(a) shall be deemed to be received at the time the written statement including such tips is furnished to the employer.

(d) Special rule for crop insurance proceeds.

In the case of insurance proceeds received as a result of destruction or damage to crops, a taxpayer reporting on the cash receipts and disbursements method of accounting may elect to include such proceeds in income for the taxable year following the taxable year of destruction or damage, if he establishes that, under his practice, income from such crops would have been reported in a following taxable year. An election under this subsection for any taxable year shall be made at such time and in such manner as the Secretary or his delegate prescribes. (Aug. 16, 1954, ch. 736, 68A Stat. 152; July 30, 1965, Pub. L. 89–97, title III, § 313(b), 79 Stat. 382; Dec. 30, 1969, Pub. L. 91–172, title II, § 215(a), 83 Stat. 573.)

AMENDMENTS

1969—Subsec. (d). Pub. L. 91–172 added subsec. (d).
1965—Subsec. (c). Pub. L. 89–97 added subsec. (c).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 215(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding subsec. (d) of this section] shall apply to taxable years ending after the date of the enactment of this Act [Dec. 30, 1969]."

EFFECTIVE DATE OF 1965 AMENDMENT

Subsec. (c) of this section applicable only with respect to tips received by employees after 1965, see section 313(f) of Pub. L. 89–97, set out as a note under section 6053 of this title.

CROSS REFERENCES

General rule for taxable year of deduction or credit, see section 461 of this title.

Items specifically included in gross income, see section 71 et seq. of this title.

Obligations issued at discount, see section 454 of this title.

Time for filing returns, see sections 6072, 6081 of this title.

Year in which partnership income is includible, see section 706 (a) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 455, 456 of this title.

§ 452. Repealed. June 15, 1955, ch. 143, § 1 (a), 69 Stat. 134.

Section, act Aug. 16, 1954, ch. 736, 68A Stat. 152, related to prepaid income.

EFFECTIVE DATE OF REPEAL

Repeal of this section effective with respect to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see effective date note under section 381 of this title.

SAVINGS PROVISIONS

See note under section 381 of this title.

§ 453. Installment method.

(a) Dealers in personal property.

(1) In general.

Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) Total contract price.

For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan or with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1).

(b) Sales of realty and casual sales of personalty.

(1) General rule.

Income from—

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) Limitation.

Paragraph (1) shall apply—

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition—

(i) there are no payments, or

(ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44 (b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in section 44 (a) of such code.

(3) Purchaser evidences of indebtedness payable on demand or readily tradable.

In applying this subsection, a bond or other evidence of indebtedness which is payable on de-

mand, or which is issued by a corporation or a government or political subdivision thereof (A) with interest coupons attached or in registered form (other than one in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or (B) in any other form designed to render such bond or other evidence of indebtedness readily tradable in an established securities market, shall not be treated as an evidence of indebtedness of the purchaser.

(c) Change from accrual to installment basis.

(1) General rule.

If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his taxable income on the installment basis, then in computing his taxable income for such year (referred to in this subsection as "year of change") or for any subsequent year—

(A) installment payments actually received during any such year on account of sales or other dispositions of property made in any taxable year before the year of change shall not be excluded; but

(B) the tax imposed by this chapter for any taxable year (referred to in this subsection as "adjustment year") beginning after December 31, 1953, shall be reduced by the adjustment computed under paragraph (2).

(2) Adjustment in tax for amounts previously taxed.

In determining the adjustment referred to in paragraph (1) (B), first determine, for each taxable year before the year of change, the amount which equals the lesser of—

(A) the portion of the tax for such prior taxable year which is attributable to the gross profit which was included in gross income for such prior taxable year, and which by reason of paragraph (1) (A) is includible in gross income for the taxable year, or

(B) the portion of the tax for the adjustment year which is attributable to the gross profit described in subparagraph (A).

The adjustment referred to in paragraph (1) (B) for the adjustment year is the sum of the amounts determined under the preceding sentence.

(3) Rule for applying paragraph (2).

For purposes of paragraph (2), the portion of the tax for a prior taxable year, or for the adjustment year, which is attributable to the gross profit described in such paragraph is that amount which bears the same ratio to the tax imposed by this chapter (or by the corresponding provisions of prior revenue laws); other than by section 56, for such taxable year (computed without regard to paragraph (2)) as the gross profit described in such paragraph bears to the gross income for such taxable year. For purposes of the preceding sentence, the provisions of chapter 1 (other than of subchapter D, relating to excess profits tax, and of subchapter E, relating to self-employment income) of the Internal Revenue Code of 1939 shall be treated as the corresponding provisions of the Internal Revenue Code of 1939.

(4) Revocation of election.

An election under paragraph (1) to report taxable income on the installment basis may be revoked by filing a notice of revocation, in such manner as the Secretary or his delegate prescribes by regulations, at any time before the expiration of 3 years following the date of the filing of the tax return for the year of change. If such notice of revocation is timely filed—

(A) the provisions of paragraph (1) and subsection (a) shall not apply to the year of change or for any subsequent year;

(B) the statutory period for the assessment of any deficiency for any taxable year ending before the filing of such notice, which is attributable to the revocation of the election to use the installment basis, shall not expire before the expiration of 2 years from the date of the filing of such notice, and such deficiency may be assessed before the expiration of such 2-year period notwithstanding the provisions of any law or rule of law which would otherwise prevent such assessment; and

(C) if refund or credit of any overpayment, resulting from the revocation of the election to use the installment basis, for any taxable year ending before the date of the filing of the notice of revocation is prevented on the date of such filing, or within one year from such date, by the operation of any law or rule of law (other than section 7121 or 7122), refund or credit of such overpayment may nevertheless be made or allowed if claim therefor is filed within one year from such date. No interest shall be allowed on the refund or credit of such overpayment for any period prior to the date of the filing of the notice of revocation.

(5) Election after revocation.

If the taxpayer revokes under paragraph (4) an election under paragraph (1) to report taxable income on the installment basis, no election under paragraph (1) may be made, except with the consent of the Secretary or his delegate, for any subsequent taxable year before the fifth taxable year following the year of change with respect to which such revocation is made.

(d) Gain or loss on disposition of installment obligations.

(1) General rule.

If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and—

(A) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or

(B) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

(2) Basis of obligation.

The basis of an installment obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

(3) Special rule for transmission at death.

Except as provided in section 691 (relating to recipients of income in respect of decedents), this subsection shall not apply to the transmission of installment obligations at death.

(4) Effect of distribution in certain liquidations.

(A) Liquidations to which section 332 applies.

If—

(i) an installment obligation is distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies, and

(ii) the basis of such obligations in the hands of the distributee is determined under section 334(b)(1),

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation.

(B) Liquidations to which section 337 applies.

If—

(i) an installment obligation is distributed by a corporation in the course of a liquidation, and

(ii) under section 337 (relating to gain or loss on sales or exchanges in connection with certain liquidations) no gain or loss would have been recognized to the corporation if the corporation had sold or exchanged such installment obligation on the day of such distribution,

then no gain or loss shall be recognized to such corporation by reason of such distribution. The preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as a gain to which section 341(f) or section 617(d)(1), 1245(a), 1250(a), 1251(c), or 1252(a) applies.

(5) Life insurance companies.

In the case of a disposition of an installment obligation by any person other than a life insurance company (as defined in section 801 (a)) to such an insurance company or to a partnership of which such an insurance company is a partner, no provision of this subtitle providing for the nonrecognition of gain shall apply with respect to any gain resulting under paragraph (1). If a corporation which is a life insurance company for the taxable year was (for the preceding taxable year) a corporation which was not a life insurance company, such corporation shall, for purposes of this paragraph and paragraph (1), be treated as having transferred to a life insurance company, on the last day of the preceding taxable year, all installment obligations which it held on such last day. A partnership of which a life insurance company becomes a partner shall, for purposes of this paragraph and paragraph (1), be treated as having transferred to a life insurance company, on the last day of the preceding taxable year of such partnership, all installment obligations which it holds at the time such insurance company becomes a partner.

(e) Carrying charges not included in total contract price.

If the carrying charges or interest with respect to sales of personal property, the income from which is returned under subsection (a)(1), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest. This subsection shall not apply with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in subsection (a)(1). (Aug. 16, 1954, ch. 736, 68A Stat. 154; Sept. 2, 1958, Pub. L. 85–866, title I, § 27(a), 72 Stat. 1624; Oct. 16, 1962, Pub. L. 87–834, § 13(f)(5), 76 Stat. 1035; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 222(a), 231(b)(5), 78 Stat. 75, 105; Aug. 22, 1964, Pub. L. 88–484, § 1(b)(2), 78 Stat. 597; Aug. 31, 1964, Pub. L. 88–539, § 3(a), (b), 78 Stat. 746; Sept. 12, 1966, Pub. L. 89–570, § 1(b)(5), 80 Stat. 762; Nov. 13, 1966, Pub. L. 89–809, title II, § 202(c), 80 Stat. 1576; Dec. 30, 1969, Pub. L. 91–172, title II, § 211(b)(5), title III, § 301(b)(7), title IV, § 412(a), title IX, § 916(a), 83 Stat. 570, 585, 608, 723.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91–172, § 412(a), added par. (3).

Subsec. (c). Pub. L. 91–172, § 916(a), added pars. (4) and (5).

Subsec. (c)(3). Pub. L. 91–172, § 301(b)(7), inserted ", other than by section 56," after "prior revenue laws)".

Subsec. (d)(4)(B). Pub. L. 91–172, § 211(b)(5), substituted "1250(a), 1251(c), or 1252(a)", for "or 1250(a)".

1966—Subsec. (d)(4)(A). Pub. L. 89–809 substituted "distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies" for "distributed by a corporation in the course of a liquidation" in clause (I) and "the basis of such obligation in the hands of the distributee is determined under section 334(b)(1)" for "under section 332 (relating to complete liquidations of subsidiaries) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation" in clause (ii), and, in the material following clause (ii), struck out provision requiring special treatment if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2).

Subsec. (d)(4)(A), (B). Pub. L. 89–570 included reference to section 617(d)(1).

1964—Subsec. (a). Pub. L. 88–539, § 3(a), designated existing provisions as par. (1) and added par. (2).

Subsec. (d)(4). Pub. L. 88–484 inserted references to section 341(f) in clauses (A) and (B).

Pub. L. 88–272, § 231(b)(5), inserted references to section 1250(a) in pars. (A) and (B).

Subsec. (e). Pub. L. 88–539, § 3(b), substituted provisions relating to carrying charges or interest with respect to sales of personal property for provisions which included revolving credit type loans within the definition of "installment plan."

Pub. L. 88–272, § 222(a), added subsec. (e).

1962—Subsec. (d)(4)(A). Pub. L. 87–834, § 13(f)(5)(A), inserted sentence making subpar. (A) inapplicable, if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2), to the extent that under par. (1) gain to the distributing corporation would be considered as gain to which section 1245(a) applies.

Subsec. (d)(4)(B). Pub. L. 87–834, § 13(f)(5)(B), inserted sentence making subpar. (B) inapplicable to the extent that under par. (1) gain to the distributing corporation would be considered as gain to which section 1245(a) applies.

1958—Subsec. (d)(5). Pub. L. 85–866 added subsec. (d)(5).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 412(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding subsec. (b)(3)] shall apply to sales or other dispositions occurring after May 27, 1969, which are not made pursuant to a binding written contract entered into on or before such date."

Amendment of subsec. (c)(3) of this section by section 301(b)(7) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 301(o) of Pub. L. 91–172, set out as a note under section 56 of this title.

Section 916(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding pars. (4) and (5) to subsec. (c) of this section] shall apply to an election made for any year of change (as defined in section 453(c)(1) of the Internal Revenue Code of 1954 [subsec. (c)(1) of this section]) ending on or after the date of the enactment of this Act [Dec. 30, 1969], and shall also apply to any such year of change which ended before such date if the 3-year statutory period for assessment of any deficiency for such year has not expired on the date of the enactment of this Act [Dec. 30, 1969]."

Amendment of subsec. (d)(4)(B) by section 211(b)(5) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 211(c) of Pub. L. 91–172, set out as a note under section 1251 of this title.

EFFECTIVE DATE OF 1966 AMENDMENTS

Amendment of subsec. (d)(4)(A) of this section by section 202(c) of Pub. L. 89–809 applicable only with respect to distributions made after Nov. 13, 1966, see section 202(d) of Pub. L. 89–809, set out as a note under section 334 of this title.

Amendment of section by Pub. L. 89–570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 39–570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Section 3(c) of Pub. L. 88–539 provided that: "The amendment made by subsection (a) [to subsec (a) of this section] shall apply in respect to sales made in taxable years beginning on or after January 1, 1960. The amendment made by subsection (b) [to subsec. (e) of this section] shall apply in respect of sales made during taxable years beginning after December 31, 1963."

Amendment of section by Pub. L. 88–484 applicable with respect to transactions after Aug. 22, 1964, in taxable years ending after such date, see section 2 of Pub. L. 88–484, set out as a note under section 341 of this title.

Amendment of subsec. (d)(4) by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 231(c) of Pub. L. 88–272, set out as a note under section 1250 of this title.

Section 222(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to this section] shall apply in respect of sales made during taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (d)(4) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 27 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [adding subsec. (d)(5) of this section] shall apply to taxable years ending after December 31, 1957, but only as to transfers or other dispositions of installment obligations occurring after such date."

CROSS REFERENCES

Adjustments required by changes in method of accounting not to apply to changes under this section, see section 481 (d) of this title.

Inclusion in gross income, installment obligations acquired from decedent, see section 691 (a)(4) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 311, 336, 381, 392, 481, 691, 1201 of this title.

§ 454. Obligations issued at discount.

(a) Non-interest-bearing obligations issued at a discount.

If, in the case of a taxpayer owning any non-interest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals or owning an obligation described in paragraph (2) of subsection (c), the increase in the redemption price of such obligation occurring in the taxable year does not (under the method of accounting used in computing his taxable income) constitute income to him in such year, such taxpayer may, at his election made in his return for any taxable year, treat such increase as income received in such taxable year. If any such election is made with respect to any such obligation, it shall apply also to all such obligations owned by the taxpayer at the beginning of the first taxable year to which it applies and to all such obligations thereafter acquired by him and shall be binding for all subsequent taxable years, unless on application by the taxpayer the Secretary or his delegate permits him, subject to such conditions as the Secretary or his delegate deems necessary, to change to a different method. In the case of any such obligations owned by the taxpayer at the beginning of the first taxable year to which his election applies, the increase in the redemption price of such obligations occurring between the date of acquisition (or, in the case of an obligation described in paragraph (2) of subsection (c), the date of acquisition of the series E bond involved) and the first day of such taxable year shall also be treated as income received in such taxable year.

(b) Short-term obligations issued on discount basis.

In the case of any obligation—

(1) of the United States; or

(2) of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia,

which is issued on a discount basis and payable without interest at a fixed maturity date not exceeding 1 year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue until the date on which such obligation is paid at maturity, sold, or otherwise disposed of.

(c) Matured United States savings bonds.

In the case of a taxpayer who—

(1) holds a series E United States savings bond at the date of maturity, and

(2) pursuant to regulations prescribed under the Second Liberty Bond Act (A) retains his investment in such series E bond in an obligation of the United States, other than a current income obligation, or (B) exchanges such series E bond for another nontransferable obligation of the United States in an exchange upon which gain or loss is not recognized because of section 1037 (or so much of section 1031 as relates to section 1037),

the increase in redemption value (to the extent not previously includible in gross income) in excess of the amount paid for such series E bond shall be includible in gross income in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier. This subsection shall not apply to a corporation, and shall not apply in the case of any taxable year for which the taxpayer's taxable income is computed under an accrual method of accounting or for which an election made by the taxpayer under subsection (a) applies. (Aug. 16, 1954, ch. 736, 68A Stat. 156; Sept. 22, 1959, Pub. L. 86-346, title I, § 102, 73 Stat. 621.)

REFERENCES IN TEXT

The Second Liberty Bond Act, referred to in subsec. (c)(2), is classified to sections 745, 752—754b, 757, 757b—758, 760, 764—766, 769, 771, 773, 774, and 780 of Title 31, Money and Finance.

AMENDMENTS

1959—Subsec. (c). Pub. L. 86-346 designated existing provisions as par. (2)(A), inserted "of the United States" following "an obligation" and deleted "the maturity value of" preceding "such series E bond" and "which matures not more than 10 years from the date of maturity of such series E bond" following "income obligation" in such par. (2)(A), and added par. (2)(B).

FREEDOM SHARES AS UNITED STATES SERIES E BONDS

For purposes of maturity of United States Savings Bonds, freedom shares issued not later than one year after Dec. 1, 1969 to be treated as United States series E bonds, see section 3 of Pub. L. 91-130, set out as a note under section 757c of Title 31, Money and Finance.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1037 of this title.

§ 455. Prepaid subscription income.

(a) Year in which included.

Prepaid subscription income to which this section applies shall be included in gross income for the taxable years during which the liability described in subsection (d)(2) exists.

(b) Where taxpayer's liability ceases.

In the case of any prepaid subscription income to which this section applies—

(1) If the liability described in subsection (d)(2) ends, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which the liability ends.

(2) If the taxpayer dies or ceases to exist, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which such death, or such cessation of existence, occurs.

(c) Prepaid subscription income to which this section applies.

(1) Election of benefits.

This section shall apply to prepaid subscription income if and only if the taxpayer makes an election under this section with respect to the trade or business in connection with which such income is received. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. No election may be made with respect to a trade or business if in computing taxable income the cash receipts and disbursements method of accounting is used with respect to such trade or business.

(2) Scope of election.

An election made under this section shall apply to all prepaid subscription income received in connection with the trade or business with respect to which the taxpayer has made the election; except that the taxpayer may, to the extent permitted under regulations prescribed by the Secretary or his delegate, include in gross income for the taxable year of receipt the entire amount of any prepaid subscription income if the liability from which it arose is to end within 12 months after the date of receipt. An election made under this section shall not apply to any prepaid subscription income received before the first taxable year for which the election is made.

(3) When election may be made.

(A) With consent.

A taxpayer may, with the consent of the Secretary or his delegate, make an election under this section at any time.

(B) Without consent.

A taxpayer may, without the consent of the Secretary or his delegate, make an election under this section for his first taxable year (i) which begins after December 31, 1957, and (ii) in which he receives prepaid subscription income in the trade or business. Such election shall be made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof) with respect to which such election is made.

(4) Period to which election applies.

An election under this section shall be effective for the taxable year with respect to which it is first made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary or his delegate to the revocation of such election. For purposes of this title, the computation of taxable income under an election made under this section shall be treated as a method of accounting.

(d) Definitions.

For purposes of this section—

(1) Prepaid subscription income.

The term "prepaid subscription income" means any amount (includible in gross income) which is received in connection with, and is directly attributable to, a liability which extends beyond the close of the taxable year in which such amount is received, and which is income from a subscription to a newspaper, magazine, or other periodical.

(2) Liability.

The term "liability" means a liability to furnish or deliver a newspaper, magazine, or other periodical.

(3) Receipt of prepaid subscription income.

Prepaid subscription income shall be treated as received during the taxable year for which it is includible in gross income under section 451 (without regard to this section).

(e) Deferral of income under established accounting procedures.

Notwithstanding the provisions of this section, any taxpayer who has, for taxable years prior to the first taxable year to which this section applies, reported his income under an established and consistent method or practice of accounting for prepaid subscription income (to which this section would apply if an election were made) may continue to report his income for taxable years to which this title applies in accordance with such method or practice. (Added Pub. L. 85–866, title I, § 28 (a), Sept. 2, 1958, 72 Stat. 1625.)

EFFECTIVE DATE

Section 28 (c) of Pub. L. 85–866 provided that: "The amendments made by subsections (a) and (b) [adding this section and conforming analysis to the addition] shall apply with respect to taxable years beginning after December 31, 1957."

§ 456. Prepaid dues income of certain membership organizations.

(a) Year in which included.

Prepaid dues income to which this section applies shall be included in gross income for the taxable years during which the liability described in subsection (e)(2) exists.

(b) Where taxpayer's liability ceases.

In the case of any prepaid dues income to which this section applies—

(1) If the liability described in subsection (e)(2) ends, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which the liability ends.

(2) If the taxpayer ceases to exist, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which such cessation of existence occurs.

(c) Prepaid dues income to which this section applies.

(1) Election of benefits.

This section shall apply to prepaid dues income if and only if the taxpayer makes an election under this section with respect to the trade or business in connection with which such income is received. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. No election may be made with respect to a trade or business if in computing taxable income the cash receipts and disbursements method of accounting is used with respect to such trade or business.

(2) Scope of election.

An election made under this section shall apply to all prepaid dues income received in connection with the trade or business with respect to which the taxpayer has made the election; except that the taxpayer may, to the extent permitted under regulations prescribed by the Secretary or his delegate, include in gross income for the taxable year of receipt the entire amount of any prepaid dues income if the liability from which it arose is to end within 12 months after the date of receipt. Except as provided in subsection (d), and election made under this section shall not apply to any prepaid dues income received before the first taxable year for which the election is made.

(3) When election may be made.

(A) With consent.

A taxpayer may, with the consent of the Secretary or his delegate, make an election under this section at any time.

(B) Without consent.

A taxpayer may, without the consent of the Secretary or his delegate, make an election under this section for its first taxable year (i) which begins after December 31, 1960, and (ii) in which it receives prepaid dues income in the trade or business. Such election shall be made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof) with respect to which such election is made.

(4) Period to which election applies.

An election under this section shall be effective for the taxable year with respect to which it is first made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary or his delegate to the revocation of such election. For purposes of this title, the computation of taxable income under an election made under this section shall be treated as a method of accounting.

(d) Transitional rule.

(1) Amount includible in gross income for election years.

If a taxpayer makes an election under this section with respect to prepaid dues income, such taxpayer shall include in gross income, for each taxable year to which such election applies, not only that portion of prepaid dues income received in such year otherwise includible in gross income for such year under this section, but shall also include in gross income for such year an additional amount equal to the amount of prepaid dues income received in the 3 taxable years preceding the first taxable year to which such election applies which would have been included in gross income in the taxable year had the election been effective 3 years earlier.

(2) Deductions of amounts included in income more than once.

A taxpayer who makes an election with respect to prepaid dues income, and who includes in gross income for any taxable year to which the election applies an additional amount computed under paragraph (1), shall be permitted to deduct, for such taxable year and for each of the 4 succeeding taxable years, an amount equal to one-fifth of such additional amount, but only to the extent that such additional amount was also included in the taxpayer's gross income during any of the 3 taxable years preceding the first taxable year to which such election applies.

(e) Definitions.

For purposes of this section—

(1) Prepaid dues income.

The term "prepaid dues income" means any amount (includible in gross income) which is received by a membership organization in connection with, and is directly attributable to, a liability to render services or make available membership privileges over a period of time which extends beyond the close of the taxable year in which such amount is received.

(2) Liability.

The term "liability" means a liability to render services or make available membership privileges over a period of time which does not exceed 36 months, which liability shall be deemed to exist ratably over the period of time that such services are required to be rendered, or that such membership privileges are required to be made available.

(3) Membership organization.

The term "membership organization" means a corporation, association, federation, or other organization—

(A) organized without capital stock of any kind, and

(B) no part of the net earnings of which is distributable to any member.

(4) Receipt of prepaid dues income.

Prepaid dues income shall be treated as received during the taxable year for which it is includible in gross income under section 451 (without regard to this section).

(Added Pub. L. 87–109, § 1(a), July 26, 1961, 75 Stat. 222.)

EFFECTIVE DATE

Section 2 of Pub. L. 87–109 provided that: "The amendments made by this Act [adding this section] shall apply with respect to taxable years beginning after December 31, 1960."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 277 of this title.

SUBPART C.—TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

Sec.
461. General rule for taxable year of deduction.

AMENDMENTS

1955—Act June 15, 1955, ch. 143, § 2(3), 69 Stat. 135, struck out item 462.

§ 461. General rule for taxable year of deduction.

(a) General rule.

The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

(b) Special rule in case of death.

In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued as a deduction or credit only by reason of the death of the taxpayer shall not be allowed in computing taxable income for the period in which falls the date of the taxpayer's death.

(c) Accrual of real property taxes.

(1) In general.

If the taxable income is computed under an accrual method of accounting, then, at the election of the taxpayer, any real property tax which is related to a definite period of time shall be accrued ratably over that period.

(2) Special rules.

Paragraph (1) shall not apply to any real property tax, to the extent that such tax was allowable as a deduction under the Internal Revenue Code of 1939 for a taxable year which began before January 1, 1954. In the case of any real property tax which would, but for this subsection, be allowable as a deduction for the first taxable year of the taxpayer which begins after December 31, 1953, then, to the extent that such tax is related to any period before the first day of such first taxable year, the tax shall be allowable as a deduction for such first taxable year.

(3) When election may be made.

(A) Without consent.

A taxpayer may, without the consent of the Secretary or his delegate, make an election under this subsection for his first taxable year which begins after December 31, 1953, and ends after the date of enactment of this title in which the taxpayer incurs real property taxes. Such an election shall be made not later than the time prescribed by law for filing the return for such year (including extensions thereof).

(B) With consent.

A taxpayer may, with the consent of the Secretary or his delegate, make an election under this subsection at any time.

(d) Limitation on acceleration of accrual of taxes.

(1) General rule.

In the case of a taxpayer whose taxable income is computed under an accrual method of accounting, to the extent that the time for accruing taxes is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, then, under regulations prescribed by the Secretary or his delegate, such taxes shall be treated as accruing at the time they would have accrued but for such action by such taxing jurisdiction.

(2) Limitation.

Under regulations prescribed by the Secretary or his delegate, paragraph (1) shall be inapplicable to any item of tax to the extent that its application would (but for this paragraph) prevent all persons (including successors in interest) from ever taking such item into account.

(e) Dividends or interest paid on certain deposits or withdrawable accounts.

Except as provided in regulations prescribed by the Secretary or his delegate, amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts (if such amounts paid or credited are withdrawable on demand subject only to customary notice to withdraw) by a mutual savings bank not having capital stock represented by

shares, a domestic building and loan association, or a cooperative bank shall not be allowed as a deduction for the taxable year to the extent such amounts are paid or credited for periods representing more than 12 months. Any such amount not allowed as a deduction as the result of the application of the preceding sentence shall be allowed as a deduction for such other taxable year as the Secretary or his delegate determines to be consistent with the preceding sentence.

(f) Contested liabilities.

If—

(1) the taxpayer contests an asserted liability,

(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

(3) the contest with respect to the asserted liability exists after the time of the transfer, and

(4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year),

then the deduction shall be allowed for the taxable year of the transfer. This subsection shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States. (Aug. 16, 1954, ch. 736, 68A Stat. 157; Sept. 14, 1960, Pub. L. 86–781, § 6(a), 74 Stat. 1020; Oct. 24, 1962, Pub. L. 87–876, § 3(a), 76 Stat. 1199; Feb. 26, 1964, Pub. L. 88–272, title II, § 223(a)(1), 78 Stat. 76.)

AMENDMENTS

1964—Subsec. (f). Pub. L. 88–272 added subsec. (f).
1962—Subsec. (e). Pub. L. 87–876 added subsec. (e).
1960—Subsec. (d). Pub. L. 86–781 added subsec. (d).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 223(b) of Pub. L. 88–272 provided that:

"Except as provided in subsections (c) and (d) [set out as notes under this section]—

"(1) the amendment made by subsection (a)(1) [to this section] shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954, and

"(2) the amendment made by subsection (a)(2) [to section 43, Internal Revenue Code of 1939] shall apply to taxable years to which the Internal Revenue Code of 1939 applies."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 3(b) of Pub. L. 87–876 provided that: "The amendment made by subsection (a) [adding subsec. (e) of this section] shall apply only with respect to taxable years ending after December 31, 1962."

EFFECTIVE DATE OF 1960 AMENDMENT

Section 6(b) of Pub. L. 86–781 provided that: "The amendment made by subsection (a) [adding subsec. (d) of this section] shall apply to taxable years ending after December 31, 1960."

ELECTION AS TO TRANSFERS IN TAXABLE YEARS BEGINNING BEFORE JAN. 1, 1964

Section 223(c) of Pub. L. 88–272 provided that:

"(1) The amendments made by subsection (a) [to this section, and section 43, Internal Revenue Code of 1939] shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if the taxpayer elects, in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate, to have this paragraph apply. Such an election—

"(A) must be made within one year after the date of the enactment of this Act [Feb. 26, 1964],

"(B) may not be revoked after the expiration of such one-year period, and

"(C) shall apply to all transfers described in the first sentence of this paragraph (other than transfers described in paragraph (2)).

In the case of any transfer to which this paragraph applies, the deduction shall be allowed only for the taxable year in which the contest with respect to such transfer is settled.

"(2) Paragraph (1) shall not apply to any transfer if the assessment of any deficiency which would result from the application of the election in respect of such transfer is, on the date of the election under paragraph (1), prevented by the operation of any law or rule of law.

"(3) If the taxpayer makes an election under paragraph (1), and if, on the date of such election, the assessment of any deficiency which results from the application of the election in respect of any transfer is not prevented by the operation of any law or rule of law, the period within which assessment of such deficiency may be made shall not expire earlier than 2 years after the date of the enactment of this Act [Feb. 26, 1964]."

CERTAIN OTHER TRANSFERS IN TAXABLE YEARS BEGINNING BEFORE JAN. 1, 1964

Section 223(d) of Pub. L. 88–272 provided that:

"The amendments made by subsection (a) [to this section, and section 43, Internal Revenue Code of 1939] shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if—

"(1) no deduction has been allowed in respect of such transfer for any taxable year before the taxable year in which the contest with respect to such transfer is settled, and

"(2) refund or credit of any overpayment which would result from the application of such amendments to such transfer is prevented by the operation of any law or rule of law.

In the case of any transfer to which this subsection applies, the deduction shall be allowed for the taxable year in which the contest with respect to such transfer is settled."

CROSS REFERENCES

Additional itemized deductions for individuals, see section 211 et seq. of this title.

Itemized deductions for individuals and corporations, see section 161 et seq. of this title.

Items not paid within 2½ months after close of taxable year as not deductible, see section 267 (a) (2) of this title.

Special deductions for corporations, see section 241 et seq. of this title.

Time for filing returns, see sections 6072, 6081 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 164 of this title.

§ 462. Repealed. June 15, 1955, ch. 143, § 1 (b), 69 Stat. 134.

Section, act Aug. 16, 1954, ch. 736 68A Stat. 158, related to reserves for estimated expenses.

EFFECTIVE DATE OF REPEAL

Repeal of this section effective with respect to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see effective date note under section 381 of this title.

SAVINGS PROVISIONS

See note under section 381 of this title.

SUBPART D.—INVENTORIES

Sec.
471. General rule for inventories.
472. Last-in, first-out inventories.

§ 471. General rule for inventories.

Whenever in the opinion of the Secretary or his delegate the use of inventories is necessary in order

clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary or his delegate may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income. (Aug. 16, 1954, ch. 736, 68A Stat. 159.)

CROSS REFERENCES

Basis of property included in inventory, see section 1013 of this title.

LIFO inventory, taxability of corporation on distribution, see section 311 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 311, 472 of this title.

§ 472. Last-in, first-out inventories.

(a) Authorization.

A taxpayer may use the method provided in subsection (b) (whether or not such method has been prescribed under section 471) in inventorying goods specified in an application to use such method filed at such time and in such manner as the Secretary or his delegate may prescribe. The change to, and the use of, such method shall be in accordance with such regulations as the Secretary or his delegate may prescribe as necessary in order that the use of such method may clearly reflect income.

(b) Method applicable.

In inventerying goods specified in the application described in subsection (a), the taxpayer shall:

(1) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof; and second, those acquired in the taxable year;

(2) Inventory them at cost; and

(3) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(c) Condition.

Subsection (a) shall apply only if the taxpayer establishes to the satisfaction of the Secretary or his delegate that the taxpayer has used no procedure other than that specified in paragraphs (1) and (3) of subsection (b) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in subsection (b) is to be used, for the purpose of a report or statement covering such taxable year—

(1) to shareholders, partners, or other proprietors, or to beneficiaries, or

(2) for credit purposes.

(d) Preceding closing inventory.

In determining income for the taxable year preceding the taxable year for which the method described in subsection (b) is first used, the closing inventory of such preceding year of the goods specified in the application referred to in subsection (a) shall be at cost.

(e) Subsequent inventories.

If a taxpayer, having complied with subsection (a), uses the method described in subsection (b) for any taxable year, then such method shall be used in all subsequent taxable years unless—

(1) with the approval of the Secretary or his delegate a change to a different method is authorized; or,

(2) the Secretary or his delegate determines that the taxpayer has used for any such subsequent taxable year some procedure other than that specified in paragraph (1) of subsection (b) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (A) to shareholders, partners, or other proprietors, or beneficiaries, or (B) for credit purposes; and requires a change to a method different from that prescribed in subsection (b) beginning with such subsequent taxable year or any taxable year thereafter.

If paragraph (1) or (2) of this subsection applies, the change to, and the use of, the different method shall be in accordance with such regulations as the Secretary or his delegate may prescribe as necessary in order that the use of such method may clearly reflect income.

(f) Cross reference.

For provisions relating to involuntary liquidation and replacement of LIFO inventories, see section 1321.

(Aug. 16, 1954, ch. 736, 68A Stat. 159.)

CROSS REFERENCES

LIFO inventory, taxability of corporations on distribution, see section 311 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 311 of this title.

PART III.—ADJUSTMENTS

Sec.

481. Adjustments required by changes in method of accounting.

482. Allocation of income and deductions among taxpayers.

483. Interest on certain deferred payments.

AMENDMENTS

1964—Pub. L. 88-272, title II, § 224(b), Feb. 26, 1964, 78 Stat. 79, added item 483.

§ 481. Adjustments required by changes in method of accounting.

(a) General rule.

In computing the taxpayer's taxable income for any taxable year (referred to in this section as the "year of the change")—

(1) if such computation is under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed, then

(2) there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted, except there shall not be taken into account any adjustment in respect of any taxable year to which this section does not apply unless the adjustment is attributable to a change in the method of accounting initiated by the taxpayer.

(b) Limitation on tax where adjustments are substantial.

(1) Three year allocation.

If—

(A) the method of accounting from which the change is made was used by the taxpayer in computing his taxable income for the 2 taxable years preceding the year of the change, and

(B) the increase in taxable income for the year of the change which results solely by reason of the adjustments required by subsection (a)(2), other than the amount of such adjustments to which paragraph (4) or (5) applies, exceeds $3,000,

then the tax under this chapter attributable to such increase in taxable income shall not be greater than the aggregate increase in the taxes under this chapter (or under the corresponding provisions of prior revenue laws) which would result if one-third of such increase in taxable income were included in taxable income for the year of the change and one-third of such increase were included for each of the 2 preceding taxable years.

(2) Allocation under new method of accounting.

If—

(A) the increase in taxable income for the year of the change which results solely by reason of the adjustments required by subsection (a) (2), other than the amount of such adjustments to which paragraph (4) or (5) applies, exceeds $3,000, and

(B) the taxpayer establishes his taxable income (under the new method of accounting) for one or more taxable years consecutively preceding the taxable year of the change for which the taxpayer in computing taxable income used the method of accounting from which the change is made,

then the tax under this chapter attributable to such increase in taxable income shall not be greater than the net increase in the taxes under this chapter (or under the corresponding provisions of prior revenue laws) which would result if the adjustments required by subsection (a) (2), other than the amount of such adjustments to which paragraph (4) or (5) applies, were allocated to the taxable year or years specified in subparagraph (B) to which they are properly allocable under the new method of accounting and the balance of the adjustments required by subsection (a) (2), other than the amount of such adjustments to which paragraph (4) or (5) applies, was allocated to the taxable year of the change.

(3) Special rules for computations under paragraphs (1) and (2).

For purposes of this subsection—

(A) There shall be taken into account the increase or decrease in tax for any taxable year preceding the year of the change to which no adjustment is allocated under paragraph (1) or (2) but which is affected by a net operating loss (as defined in section 172) or by a capital loss carryback or carryover (as defined in section 1212), determined with reference to taxable years with respect to which adjustments under paragraph (1) or (2) are allocated.

(B) The increase or decrease in the tax for any taxable year for which an assessment of any deficiency, or a credit or refund of any overpayment, is prevented by any law or rule of law, shall be determined by reference to the tax previously determined (within the meaning of section 1314 (a)) for such year.

(C) In applying section 7807 (b) (1), the provisions of chapter 1 (other than subchapter E, relating to self-employment income) and chapter 2 of the Internal Revenue Code of 1939 shall be treated as the corresponding provisions of the Internal Revenue Code of 1939.

(4) Special rule for pre-1954 adjustments generally.

Except as provided in paragraphs (5) and (6)—

(A) Amount of adjustments to which paragraph applies.

The net amount of the adjustments required by subsection (a), to the extent that such amount does not exceed the net amount of adjustments which would have been required if the change in method of accounting had been made in the first taxable year beginning after December 31, 1953, and ending after August 16, 1954, shall be taken into account by the taxpayer in computing taxable income in the manner provided in subparagraph (B), but only if such net amount of such adjustment would increase the taxable income of such taxpayer by more than $3,000.

(B) Years in which amounts are to be taken into account.

One-tenth of the net amount of the adjustments described in subparagraph (A) shall (except as provided in subparagraph (C)) be taken into account in each of the 10 taxable years beginning with the year of the change. The amount to be taken into account for each taxable year in the 10-year period shall be taken into account whether or not for such year the assessment of tax is prevented by operation of any law or rule of law. If the year of the change was a taxable year ending before January 1, 1958, and if the taxpayer so elects (at such time and in such manner as the Secretary or his delegate shall by regulations prescribe), the 10-year period shall begin with the first taxable year which begins after December 31, 1957. If the taxpayer elects under the preceding sentence to begin the 10-year period with the first taxable year which begins after December 31, 1957, the 10-year period shall be reduced by the number of years, beginning with the year of the change, in respect of which assessment of tax is prevented by operation of any law or rule of law on the date of the enactment of the Technical Amendments Act of 1958.

(C) Limitation on years in which adjustments can he taken into account.

The net amount of any adjustments described in subparagraph (A), to the extent not

taken into account in prior taxable years under subparagraph (B)—

(i) in the case of a taxpayer who is an individual, shall be taken into account in the taxable year in which he dies or ceases to engage in a trade or business,

(ii) in the case of a taxpayer who is a partner, his distributive share of such net amount shall be taken into account in the taxable year in which the partnership terminates, or in which the entire interest of such partner is transferred or liquidated, or

(iii) in the case of a taxpayer who is a corporation, shall be taken into account in the taxable year in which such corporation ceases to engage in a trade or business unless such net amount of such adjustment is required to be taken into account by the acquiring corporation under section 381 (c) (21).

(D) Termination of application of paragraph.

The provisions of this paragraph shall not apply with respect to changes in methods of accounting made in taxable years beginning after December 31, 1963.

(5) Special rule for pre-1954 adjustments in case of certain decedents.

A change from the cash receipts and disbursements method to the accrual method in any case involving the use of inventories, made on or after August 16, 1954, and before January 1, 1958, for a taxable year to which this section applies, by the executor or administrator of a decedent's estate in the first return filed by such executor or administrator on behalf of the decedent, shall be given effect in determining taxable income (other than for the purpose of computing a net operating loss carryback to any prior taxable year of the decedent), and, if the net amount of any adjustments required by subsection (a) in respect of taxable years to which this section does not apply would increase the taxable income of the decedent by more than $3,000, then the tax attributable to such net adjustments shall not exceed an amount equal to the tax that would have been payable on the cash receipts and disbursements method for the years for which the executor or administrator filed returns on behalf of the decedent, computed for each such year as though a ratable portion of the taxable income for such year had been received in each of 10 taxable years beginning and ending on the same dates as the taxable year for which the tax is being computed.

(6) Application of paragraph (4).

Paragraph (4) shall not apply with respect to any taxpayer, if the taxpayer elects to take the net amount of the adjustments described in paragraph (4) (A) into account in the manner provided by paragraph (1) or (2). An election to take the net amount of such adjustments into account in the manner provided by paragraph (1) or (2) may be made only if the taxpayer consents in writing to the assessment, within such period as may be agreed on with the Secretary or his delegate, of any deficiency for the year of the change, to the extent attributable to taking the net amount of the adjustments described in paragraph (4) (A) into account in the manner provided by paragraph (1) or (2), even though at the time of filing such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law. An election under this paragraph shall be made at such time and in such manner as the Secretary or his delegate shall by regulations prescribe.

(c) Adjustments under regulations.

In the case of any change described in subsection (a), the taxpayer may, in such manner and subject to such conditions as the Secretary or his delegate may by regulations prescribe, take the adjustments required by subsection (a) (2) into account in computing the tax imposed by this chapter for the taxable year or years permitted under such regulations.

(d) Exception for change to installment basis.

This section shall not apply to a change to which section 453 (relating to change to installment method) applies. (Aug. 16, 1954, ch. 736, 68A Stat. 160; Sept. 2, 1958, Pub. L. 85–866, title I, § 29 (a), (b), 72 Stat. 1626—1628; Dec. 30, 1969, Pub. L. 91–172, title V, § 512(f) (4), 83 Stat. 641.)

REFERENCES IN TEXT

The date of the enactment of the Technical Amendments Act of 1958, referred to in subsec. (b) (4) (B), means the date of enactment of Pub. L. 85–866, which was enacted on September 2, 1958.

AMENDMENTS

1969—Subsec. (b) (3) (A). Pub. L. 91–172 substituted "loss carryback or carryover" for "loss carryover."

1958—Subsec. (a) (2). Pub. L. 85–866, § 29(a) (1), added "unless the adjustment is attributable to a change in the method of accounting initiated by the taxpayer", following "does not apply".

Subsec. (b) (1). Pub. L. 85–866, § 29(b) (1)–(3), inserted after "subsection (a) (2)" the words ", other than the amount of such adjustments to which paragraph (4) or (5) applies," and substituted "the aggregate increase in the taxes" for "the aggregate of the taxes" and "which would result if one-third of such increase in taxable income" for "which would result if one-third of such increase".

Subsec. (b) (2). Pub. L. 85–866, § 29(b) (1), (4), inserted after "subsection (a) (2)", wherever appearing "otber than the amount of such adjustments to which paragraph (4) or (5) applies," and "(or under the corresponding provisions of prior revenue laws)" after "the net increase in the taxes under this Chapter".

Subsec. (b) (3) (A). Pub. L. 85–866, § 29(b) (5), substituted "paragraph (1) or (2)" for "paragraph (2)", wherever appearing.

Subsec. (b) (4)—(6). Pub. L. 85–866, § 29(a) (2), added subsec. (b) (4)—(6).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to net capital losses sustained in taxable years beginning after Dec. 31, 1969, see section 512(g) of Pub. L. 91–172, set out as a note under section 1212 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 29 (d) of Pub. L. 85–866 provided that:

"(1) In general.—The amendments made by this section [amending subsec. (a) (2), (b) (1), (2), (3A), (4—6) of this section and adding section 381 (c) (21) of this title] shall apply with respect to any change in a method of accounting where the year of the change (within the meaning of section 481 of the Internal Revenue Code of 1954 [this section]) is a taxable year beginning after December 31, 1953, and ending after August 16, 1954.

"(2) Exception for certain agreements.—The amendments made by subsections (a), (b) (I), and (c) [amending subsec. (a) (2) and (b) (4—6) of this section and adding section 381 (c) (21) of this title] shall not apply if before the date of the enactment of this Act [Sept. 2, 1958]—

"(A) the taxpayer applied for a change in the method of accounting in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate, and

"(B) the taxpayer and the Secretary of the Treasury or his delegate agreed to the terms and conditions for making the change."

ELECTION TO RETURN TO FORMER METHOD OF ACCOUNTING

Section 29 (e) of Pub L. 85-866 provided that:

"(1) Election.—Any taxpayer who for any taxable year beginning after December 31, 1953, and ending after August 16, 1954, and before the date of enactment of this Act [Sept. 2, 1958], computed his taxable income under a method of accounting different from the method under which his taxable income for the preceding taxable year was computed, may elect to recompute his taxable income, beginning with the taxable year for which taxable income was computed under such different method of accounting, under the method of accounting under which taxable income was computed for such preceding taxable year. An election under this paragraph shall be made within 6 months after the date of the enactment of this Act [Sept. 2, 1958], and shall be made in such manner as the Secretary of the Treasury or his delegate may provide. This paragraph shall not apply to any taxpayer—

"(A) to whom subsection (d) (2) [set out as note under this section] applies, or

"(B) who was required, before the date of the enactment of this Act [Sept. 2, 1958], by the Secretary of the Treasury or his delegate to change his method of accounting.

"(2) Statute of limitations.—If assessment of any deficiency for any taxable year resulting from an election under paragraph (1) is prevented on the date on which such election is made, or at any time within one year after such date, by the operation of any law or rule of law, such assessment may, nevertheless, be made if made within one year after such date. An election by a taxpayer under paragraph (1) shall be considered as a consent to the assessment pursuant to this paragraph of any such deficiency. If refund or credit of any overpayment of income tax resulting from an election under paragraph (1) is prevented on the date on which such election is made, or at any time within one year after such date, by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year after such date."

TRANSITIONAL PROVISIONS FOR INCOME TAX TREATMENT OF DEALER RESERVE INCOME

Pub. L. 86-459, May 13, 1960, 74 Stat. 124, provided:

"SECTION 1. SHORT TITLE.

"This Act may be cited as the 'Dealer Reserve Income Adjustment Act of 1960.'

"SEC. 2. PERSONS TO WHOM THIS ACT APPLIES.

"This Act shall apply to any person who, for his most recent taxable year ending on or before June 22, 1959—

"(1) computed, or was required to compute, taxable income under an accrual method of accounting,

"(2) treated any dealer reserve income, which should have been taken into account (under the accrual method of accounting) for such taxable year, as accruable for a subsequent taxable year, and

"(3) before September 1, 1960, makes an election under section 3(a) or 4(a) of this Act.

"SEC. 3. ELECTION TO HAVE SECTION 481 APPLY.

"(a) General rule.—If—

"(1) for the year of the change (determined under subsection (b)), the treatment of dealer reserve income by any person to whom this Act applies is changed to a method proper under the accrual method of accounting (whether or not such person initiated the change),

"(2) such person makes an election under this subsection, and

"(3) such person does not make the election provided by section 4(a),

then, for purposes of section 481 of the Internal Revenue Code of 1954 [this section], the change described in paragraph (1) shall be treated as a change in method of accounting not initiated by the taxpayer.

"(b) Year of change, etc.—In applying section 481 of the Internal Revenue Code of 1954 [this section] for purposes of this section, the 'year of the change' in the case of any person is—

"(1) except as provided in paragraph (2), the first taxable year ending after June 22, 1959, or

"(2) the earliest taxable year (whether the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939 applies to such year) for which—

"(A) on or before June 22, 1959—

"(i) the Secretary of the Treasury or his delegate issued a notice of deficiency, or a written notice of a proposed deficiency, with respect to dealer reserve income, or

"(ii) such person filed with the Secretary or his delegate a claim for refund or credit with respect to dealer reserve income, and

"(B) the assessment of any deficiency, or the refund or credit of any overpayment, whichever is applicable, was not, on June 21, 1959, prevented by the operation of any law or rule of law.

For purposes of this section, section 481 of such Code [this section] shall be treated as applying to any year of the change to which the Internal Revenue Code of 1939 applies.

"SEC. 4. ELECTION TO HAVE SECTION 481 NOT APPLY; PAYMENT IN INSTALLMENTS.

"(a) General rule.—If a person to whom this Act applies makes an election under this subsection, then for purposes of chapter 1 of the Internal Revenue Code of 1954 (and the corresponding provisions of prior law) a change in the treatment of dealer reserve income to a method proper under the accrual method of accounting shall be treated as not a change in method of accounting in respect of which section 481 of the Internal Revenue Code of 1954 [this section] applies. Any election under this subsection shall apply to all taxable years ending on or before June 22, 1959 (whether the provisions of the Internal Revenue Code of 1954 or the corresponding provisions of prior law apply), for which the assessment of any deficiency, or for which refund or credit of any overpayment, whichever is applicable, was not, on June 21, 1959, prevented by the operation of any law or rule of law.

"(b) Election to pay tax in installments.—

"(1) *Eligibility.*—If the net increase in tax (as defined in paragraph (2)) which results solely from the effect of the election provided by subsection (a) exceeds $2,500, then the taxpayer may elect (at the time the election is made under subsection (a)) to pay in two or more (but not to exceed 10) equal annual installments any portion of such net increase which (on the date of such election) is unpaid.

"(2) *Net increase in tax defined.*—For purposes of this section, the term 'net increase in tax' means the amount (if any) by which—

"(A) the sum of the increases in tax (including interest) for all taxable years to which the election applies and which is attributable to the election, exceeds

"(B) the sum of the decreases in tax (including interest) for all taxable years to which the election applies and which is attributable to the election.

For purposes of this paragraph, interest for the period before the date of the election shall be computed as provided in chapter 67 of the Internal Revenue Code of 1954 (or the corresponding provisions of prior revenue laws).

"(c) Due date for installments.—If an election is made under subsection (b), the first installment shall be paid on or before the date prescribed by section 6151(a) of the Internal Revenue Code of 1954 [section 6151(a) of this title] for payment of the tax for the taxable year in which the election was made, and each succeeding installment shall be paid on or before the date which is one year after the date prescribed by this subsection for payment of the preceding installment.

"(d) Effect of subsequent redetermination of tax.—

"(1) *Redetermination.*—If—

"(A) the taxpayer makes an election under subsection (b), and

"(B) there is a redetermination of the taxpayer's tax for any taxable year to which the election provided by subsection (a) applies,

then the net increase in tax (as defined in subsection (b)(2)) shall be redetermined.

"(2) *Effect of increase.*—If the redetermination described in paragraph (1)(B) results in an increase in the net increase in tax (as defined in subsection (b)(2)), the resulting increase shall be prorated to all the installments. The part of such resulting increase so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of such resulting increase so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary of the Treasury or his delegate.

"(3) *Effect of decrease.*—

"For treatment of a decrease in the net increase in tax as the result of a redetermination described in paragraph (1)(B), see section 6403 of the Internal Revenue Code of 1954 [section 6403 of this title] (relating to overpayment of installment).

"(e) Suspension of interest.—

"(1) *In general.*—If an election under subsection (a) applies and there is a net increase in tax (as defined in subsection (b)(2)), no interest shall be imposed on any underpayment (and no interest shall be paid on any overpayment) attributable to such election for the period beginning on the date of such election and ending on the date prescribed by section 6151(a) of the Internal Revenue Code of 1954 [section 6151(a) of this title] for payment of the tax for the taxable year in which the election was made.

"(2) *No interest during installment period.*—If an election under subsection (b) applies, no interest shall be imposed for the period on or after the date fixed for payment of the first installment unless payment of unpaid installments is accelerated under subsection (f) or (g).

"(3) *Interest where payment is accelerated.*—If payment is accelerated under subsection (f) or (g), interest determined in accordance with the provisions of section 6601 of the Internal Revenue Code of 1954 [section 6601 of this title] on the entire unpaid tax shall be payable—

"(A) if payment is accelerated under subsection (f), from the date of notice and demand provided by such subsection to the date such tax is paid, or

"(B) if payment is accelerated under subsection (g), from the date fixed for paying the unpaid installment to the date such tax is paid.

"(f) Termination of installment payment privilege.—The extension of time provided by this section for payment of tax shall cease to apply, and any unpaid installments shall be paid upon notice and demand from the Secretary of the Treasury or his delegate, if—

"(1) in the case of a taxpayer who is an individual, he dies or ceases to engage in a trade or business,

"(2) in the case of a taxpayer who is a partner, the entire interest of such partner is transferred or liquidated or the partnership terminates, or

"(3) in the case of a taxpayer which is a corporation, the taxpayer ceases to engage in a trade or business, unless the unpaid portion of the tax payable in installments is required to be taken into account by the acquiring corporation under section 5(d).

"(g) Failure to pay installment.—If any installment under this section is not paid on or before the date fixed for its payment by this section (including any extension of time for payment of such installment), the unpaid installments shall be paid upon notice and demand from the Secretary of the Treasury or his delegate.

"(h) Suspension of running of periods of limitation.—The running of the periods of limitation provided by section 6502 of the Internal Revenue Code of 1954 [section 6502 of this title] (or corresponding provision of prior law) for the collection of any amount of tax payable in installments under this section shall be suspended for the period of any extension of time for payment granted under this section.

"SEC. 5. DEFINITIONS; SPECIAL RULES.

"(a) Dealer reserve income.—For purposes of this Act, the term 'dealer reserve income' means—

"(1) that part of the consideration derived by any person from the sale or other disposition of customers' sales contracts, notes, and other evidences of indebtedness (or derived from customers' finance charges connected with such sales or other dispositions) which is—

"(A) attributable to the sale by such person to such customers, in the ordinary course of his trade or business, of real property or tangible personal property, and

"(B) held in a reserve account, by the financial institution to which such person disposed of such evidences of indebtedness, for the purpose of securing obligations of such person or of such customers, or both; and

"(2) that part of the consideration—

"(A) derived by any person from a sale described in paragraph (1)(A) in respect of which part or all of the purchase price of the property sold is provided by a financial institution to or for the customer to whom such property is sold, or

"(B) derived by such person from finance charges connected with the financing of such sale,

which is held in a reserve account by such financial institution for the purpose of securing obligations of such person or of such customer, or both.

"(b) Financial institution.—For purposes of this Act, the term 'financial institution' means any person regularly engaged in the business of acquiring evidences of indebtedness of the kind described in subsection (a)(1), or of financing sales of the kind described in subsection (a)(2), or both.

"(c) Other terms; application of other laws.—Except where otherwise distinctly expressed or manifestly intended, terms used in this Act shall have the same meaning as when used in the Internal Revenue Code of 1954 and all provisions of law shall apply with respect to this Act as if this Act were a part of such Code.

"(d) Acquiring corporation.—In the case of the acquisition of assets of a corporation by another corporation in a distribution or transfer described in section 381(a) of the Internal Revenue Code of 1954 [section 381(a) of this title], the acquiring corporation shall, for purposes of this Act, be treated as if it were the distributor or transferor corporation.

"(e) Statutes of limitations.—

"(1) *Extension of period for assessment and refund or credit.*—For purposes of applying sections 3 and 4 of this Act, if the assessment of any deficiency, or the refund or credit of any overpayment, for any taxable year was not prevented on June 21, 1959, by the operation of any law or rule of law, but would be so prevented prior to September 1, 1961, the period within which such assessment, or such refund or credit, may be made shall not expire prior to September 1, 1961. An election by a taxpayer under section 3 or 4 of this Act shall be considered as a consent to the application of the provisions of this subsection.

"(2) *Years closed by closing agreement or compromise.*—For purposes of this Act, if the assessment of any deficiency, or the refund or credit of any overpayment, for any taxable year is prevented on the date of an election under section 3 or 4 of this Act by the operation of the provisions of chapter 74 of the Internal Revenue Code of 1954 (relating to closing agreements and compromises) or by the corresponding provisions of the Internal Revenue Code of 1939, such assessment, or such refund or credit, shall be considered as having been prevented on June 21, 1959.

"(f) Regulations.—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this Act, including regulations relating to—

"(1) the application of the provisions of this Act in the case of partnerships, and

"(2) the manner in which the elections provided by this Act are to be made."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 381, 1251 of this title; title 42 section 401.

§ 482. Allocation of income and deductions among taxpayers.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. (Aug. 16, 1954, ch. 736, 68A Stat. 162.)

§ 483. Interest on certain deferred payments.

(a) Amount constituting interest.

For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

(b) Total unstated interest.

For purposes of this section, the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of—

(1) the sum of the payments to which this section applies which are due under the contract, over

(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary or his delegate. Such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment.

(c) Payments to which section applies.

(1) In general.

Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract—

(A) under which some or all of the payments are due more than one year after the date of such sale or exchange and

(B) under which, using a rate provided by regulations prescribed by the Secretary or his delegate for purposes of this subparagraph, there is total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

(2) Treatment of evidence of indebtedness.

For purposes of this section, an evidence of indebtedness of the purchaser given in consideration for the sale or exchange of property shall not be considered a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

(d) Payments that are indefinite as to time, liability, or amount.

In the case of a contract for the sale or exchange of property under which the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, this section shall be separately applied to such portion as if it (and any amount of interest attributable to such portion) were the only payments due under the contract; and such determinations of liability, amount, and due date shall be made at the time payment of such portion is made.

(e) Change in terms of contract.

If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed, the "total unstated interest" under the contract shall be recomputed and allocated (with adjustment for prior interest (including unstated interest) payments) under regulations prescribed by the Secretary or his delegate.

(f) Exceptions and limitations.

(1) Sales price of $3,000 or less.

This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed $3,000.

(2) Carrying charges.

In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

(3) Treatment of seller.

In the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to this section if no part of any gain on such sale or exchange would be considered as gain from the sale or exchange of a capital asset or property described in section 1231.

(4) Sales or exchanges of patents.

This section shall not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchange of patents).

(5) Annuities.

This section shall not apply to any amount the liability for which depends in whole or in part on the life expectancy of one or more individuals and which constitutes an amount received as an annuity to which section 72 applies.

(Added Pub. L. 88-272, title II, § 224(a), Feb. 26, 1964, 78 Stat. 77.)

EFFECTIVE DATE

Section applicable to payments made after Dec. 31, 1963, on account of sales or exchanges of property after June 30, 1963, other than a sale or exchange pursuant to written contract, including an irrevocable written option, entered into before July 1, 1963, see section 224(d) of Pub. L. 88-272, set out as a note under section 163 of this title.

Subchapter F.—Exempt Organizations

Part
I. General rule.
II. Private foundations.
III. Taxation of business income of certain exempt organizations.
IV. Farmers' cooperatives.
V. Shipowners' protection and indemnity associations.

AMENDMENTS

1969—Pub. L. 91-172, title I, § 101(j)(58), Dec. 30, 1969, 83 Stat. 532, added Part II heading, and redesignated former Parts II, III and IV as Parts III, IV and V, respectively.

SUBCHAPTER REFERRED TO IN OTHER SECTIONS

This subchapter is referred to in section 532, 542, 552 of this title.

PART I.—GENERAL RULE

Sec.
501. Exemption from tax on corporations, certain trusts, etc.
502. Feeder organizations.
503. Requirements for exemption.

AMENDMENTS

1969—Pub. L. 91-172, title I, § 101(j)(61), Dec. 30, 1969, 83 Stat. 532, struck out item 504.

§ 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation.

An organization described in subsection (c) or (d) or section 401 (a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

(b) Tax on unrelated business income and certain other activities.

An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in parts II and III of this subchapter, but (notwithstanding parts II and III of this subchapter) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(c) List of exempt organizations.

The following organizations are referred to in subsection (a):

(1) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes.

(2) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players) not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

(8) Fraternal beneficiary societies, orders, or associations—

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

(10) Domestic fraternal societies, orders, or associations, operating under the lodge system—

(A) the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and

(B) which do not provide for the payment of life, sick, accident, or other benefits.

(11) Teachers' retirement fund associations of a purely local character, if—

(A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries

of members, and income in respect of investments.

(12) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(13) Cemetery companies owned and oporated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(14) (A) Credit unions without capital stock organized and operated for mutual purposes and without profit.

(B) Corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of shares or deposits in—

(i) domestic building and loan associations,

(ii) cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

(iii) mutual savings banks not having capital stock represented by shares.

(C) Corporations or associations organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for associations or banks described in clause (i), (ii), or (iii) of subparagraph (B); but only if 85 percent or more of the income is attributable to providing such reserve funds and to investments. This subparagraph shall not apply to any corporation or association entitled to exemption under subparagraph (B).

(15) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from the items described in section 822 (b) (other than paragraph (1) (D) thereof) and premiums (including deposits and assessments) does not exceed $150,000.

(16) Corporations organized by an association subject to part IV of this subchapter or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, on dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

(17) (A) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if—

(i) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities, with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits,

(ii) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees, and

(iii) such benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. A plan shall not be considered discriminatory within the meaning of this clause merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(B) In determining whether a plan meets the requirements of subparagraph (A), any benefits provided under any other plan shall not be taken into consideration, except that a plan shall not be considered discriminatory—

(i) merely because the benefits under the plan which are first determined in a nondiscriminatory manner within the meaning of subparagraph (A) are then reduced by any sick, accident, or unemployment compensation benefits received under State or Federal law (or reduced by a portion of such benefits if determined in a nondiscriminatory manner), or

(ii) merely because the plan provides only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under State or Federal law the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such laws if such employees were eligible for such benefits, or

(iii) merely because the plan provides only for employees who are not eligible under another plan (which meets the requirements of subparagraph (A)) of supplemental unemployment compensation benefits provided wholly by the employer the same benefits (or a portion of such benefits if determined in a nondiscriminatory

manner) which such employees would receive under such other plan if such employees were eligible under such other plan, but only if the employees eligible under both plans would make a classification which would be nondiscriminatory within the meaning of subparagraph (A).

(C) A plan shall be considered to meet the requirements of subparagraph (A) during the whole of any year of the plan if on one day in each quarter it satisfies such requirements.

(D) The term "supplemental unemployment compensation benefits" means only—

(i) benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and

(ii) sick and accident benefits subordinate to the benefits described in clause (i).

(E) Exemption shall not be denied under subsection (a) to any organization entitled to such exemption as an association described in paragraph (9) of this subsection merely because such organization provides for the payment of supplemental unemployment benefits (as defined in subparagraph (D)(i)).

(18) A trust or trusts created before June 25, 1959, forming part of a plan providing for the payment of benefits under a pension plan funded only by contributions of employees, if—

(A) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of benefits under the plan,

(B) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees, and

(C) such benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. A plan shall not be considered discriminatory within the meaning of this subparagraph merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(d) Religious and apostolic organizations.

The following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(e) Cooperative hospital service organizations.

For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

(f) Cross reference.

For nonexemption of Communist-controlled organizations, see section 11 (b) of the Internal Security Act of 1950 (64 Stat. 997; 50 U. S. C. 790 (b)).

(Aug. 16, 1954, ch. 736, 68A Stat. 163; Mar. 13, 1956, ch. 83, § 5(2), 70 Stat. 49; Apr. 22, 1960, Pub. L. 86–428, § 1, 74 Stat. 54; July 14, 1960, Pub. L. 86–667, § 1, 74 Stat. 534; Oct. 16, 1962, Pub. L. 87–834, § 8(d), 76 Stat. 997; Feb. 2, 1966, Pub. L. 89–352, § 1, 80 Stat. 4; Nov. 8, 1966, Pub. L. 89–800, § 6(a), 80 Stat. 1515; June 28, 1968, Pub. L. 90–364, title I, § 109(a), 82 Stat. 269; Dec. 30, 1969, Pub. L. 91–172, title I, §§ 101(j)(3)–(6), 121(b)(5)(A), (6)(A), 83 Stat. 526,

527, 541; Dec. 31, 1970, Pub. L. 91–618, § 1, 84 Stat. 1855.)

AMENDMENTS

1970—Subsec. (c)(13). Pub. L. 91–618 substituted "corporation chartered solely for the purpose of disposal of bodies by burial or cremation which is not permitted" for "corporation chartered solely for burial purposes as a cemetery corporation and is not permitted."

1969—Subsec. (a). Pub. L. 91–172, § 101(j)(8), removed reference to section 504.

Subsec. (b). Pub. L. 91–172, § 101(j)(4), added reference to certain other activities in the heading and to part III in text, and struck out reference to tax on unrelated income.

Subsec. (c). Pub. L. 91–172, §§ 101(j)(5), 121(b)(6)(A), substituted "part IV" for "part III", following "Corporations organized by an association subject to" and added par. 18.

Subsec. (c)(9). Pub. L. 91–172, § 121(b)(5)(A), inserted reference to designated beneficiaries and struck out reference to 85 percent or more income of voluntary employees' beneficiary associations.

Subsec. (c)(10). Pub. L. 91–172, § 121(b)(5)(A), substituted provisions concerning domestic fraternal societies, orders, or associations, operating under the lodge system, for provisions covering voluntary employees' beneficiary associations which would pay benefits to designated beneficiaries of members.

Subsec. (e) Pub. L. 91–172, § 101(j)(6), substituted "section 170(b)(1)(A)(iii)" for "section 503(b)(5)" in last sentence.

1968—Subsec. (e). Pub. L. 90–364 added subsec. (e). Former subsec. (e) redesignated (f).

Subsec. (f). Pub. L. 90–364 redesignated former subsec. (e) as (f).

1966—Subsec. (c)(6). Pub. L. 89–800 inserted reference to professional football leagues (whether or not administering a pension fund for football players).

Subsec. (c)(14). Pub. L. 89–352 denominated as subpar. (A) provisions covering credit unions which were formerly set out preceding subpar. (A), denominated as subpar. (B) and clauses (i), (ii), and (iii) thereunder provisions covering corporation or associations without capital stock organized before Sept. 1, 1957, which formerly were set out as provisions preceding subpar. (A) and as subpars. (A), (B), and (C) respectively, and added subpar. (C).

1962—Subsec. (c)(15). Pub. L. 87–834 substituted "$150,000" for "$75,000."

1960—Subsec. (c)(14). Pub. L. 86–428 substituted "September 1, 1957" for "September 1, 1951."

Subsec. (c)(17). Pub. L. 86–667 added subsec. (c)(17).

1956—Subsec. (c)(15). Act Mar. 13, 1956, substituted "the items described in section 822(b) (other than paragraph (1)(D) thereof)" for "interest, dividends, rents,".

EFFECTIVE DATE OF 1970 AMENDMENT

Section 2 of Pub. L. 91–618 provided that: "The amendment made by the first section of this Act [to subsec. (c)(13) of this section] shall apply to taxable years ending after the date of enactment of this Act [Dec. 31, 1970]."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 101(j)(3) of Pub. L. 91–172 to take effect on Jan. 1, 1970, except for the amendment of subsec. (a) of this section by section 101(j)(3) of Pub. L. 91–172, which shall apply to taxable years beginning after Dec. 31, 1969, see section 101(k)(1), (2)(B) of Pub. L. 91–172, set out as a note under section 4940 of this title.

Amendment of section by section 121(b)(5)(A), (8)(A) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

EFFECTIVE DATE OF 1968 AMENDMENT

Section 109(b) of Pub. L. 90–364 provided that: "The amendments made by subsection (a) [adding subsec. (e) of this section] shall apply to taxable years ending after the date of the enactment of this Act [June 28, 1968]."

EFFECTIVE DATE OF 1966 AMENDMENTS

Section 6(c) of Pub. L. 89–800 provided that: "The amendment made by subsection (a) [amending subsec. (c)(6) of this section] shall apply to taxable years ending after the date of the enactment of this Act [Nov. 8, 1966]."

Section 3 of Pub. 89–352 provided in part that: "The amendment made by the first section of this Act [amending subsec. (c)(14) of this section] shall apply to taxable years ending after the date of the enactment of this Act [Feb. 2, 1966]."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (c)(15) of this section by Pub. L. 87–634 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87–834, set out as a note under section 821 of this title.

EFFECTIVE DATE OF 1960 AMENDMENTS

Section 2 of Pub. L. 86–428 provided that: "The amendment made by this Act [to subsec. (c)(14) of this section] shall apply only with respect to taxable years beginning after December 31, 1959."

Section 6 of Pub. L. 86–667 provided that:

"(a) Except as provided in subsection (b), the amendments made by this Act [to this section and sections 503, 511, 513 and 514 of this title] shall apply to taxable years beginning after December 31, 1959.

"(b) In the case of loans, the amendments made by section 2 of this Act [to section 503 of this title] shall apply only to loans made, renewed, or continued after December 31, 1959."

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956, applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

EXCHANGES FOR SALE OF POULTRY

Pub. L. 89–44, title VIII, § 811, June 21, 1965, 79 Stat. 169, provided that:

"(a) Exemption from tax.—

"A corporation, association, or organization organized and operated exclusively for the purpose of providing an exchange for the sale of poultry for the poultry growers of a particular locality shall be treated for purposes of the Internal Revenue Code of 1954 as an organization described in section 501(c) (relating to list of exempt organizations) of such Code if—

"(1) such corporation, association, or organization has no capital stock and is not organized for profit,

"(2) no member of the governing body of such corporation, association, or organization receives any compensation from such corporation, association, or organization,

"(3) the net earnings of such corporation, association, or organization (except for reasonable additions to reserves for the operation of such exchange) are devoted exclusively to disseminating information as to the best methods of poultry culture and to other agriculture purposes, and

"(4) at all times on and after June 10, 1965, and before the close of its last taxable year beginning before January 1, 1966, all of the net assets of such corporation, association, or organization must, on liquidation for any reason, be transferred to an educational organization which is exempt from tax under section 501(a) of such Code or which is an agency or instrumentality of, or is owned or operated by, a State.

"(b) Application to subsection (a).—

"Subsection (a) shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954, which begin before January 1, 1966."

CROSS REFERENCES

Business lease indebtedness, see section 514 of this title.

Constructive ownership of stock rule inapplicable to tax exempt employees' trust, see section 318 of this title.

Corporate deductions for dividends received inapplicable to dividends from corporation exempt from tax under this section, see section 246 of this title.

Deduction for contributions of employer to employees' trust or annuity plan and compensation under a deferred-payment plan, see section 404 of this title.

Denial of exemption, see section 504 of this title.

Disallowance of losses with respect to transactions between persons and certain tax exempt educational and charitable organizations, see section 267 of this title.

Exclusion of services performed in employ of organization exempt from tax under this section—

Employment under Federal Unemployment Tax Act, see section 3306 of this title.

Employment under title II of the Social Security Act, see section 410 of Title 42, The Public Health and Welfare.

Facilities and services excise tax exemption to certain organizations exempt from tax under this section, see section 4233 of this title.

Feeder organizations, see section 502 of this title.

Imposition of tax on unrelated business income of charitable, etc., organizations, see section 511 of this title.

Includible corporation relative to consolidated returns as excluding corporation exempt from tax under this section, see section 1504 of this title.

Lottery under wagering taxes as excluding drawings conducted by organization exempt from tax under this section, see section 4421 of this title.

Nonforfeitable rights relative to employees' death benefits, see section 101 of this title.

Partial exclusion of dividends received by individuals inapplicable to dividends from corporation exempt from tax under this section, see section 116 of this title.

Prohibition on interests in nonbanking organizations inapplicable to certain bank holding companies exempt under this section, see section 1843 (c) (7) of Title 12, Banks and Banking.

Requirements for exemption, see section 503 of this title.

Returns by exempt organizations, see section 6033 of this title.

Scholarships and fellowship grants to individuals who are not candidates for degrees as excludible from gross income where grantor is an organization described in this section, see section 117 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 72, 101, 103, 104, 116, 117, 170, 246, 274, 318, 401, 402, 403, 404, 405, 501, 502, 503, 507, 508, 509, 511, 512, 513, 514, 542, 642, 805, 871, 1054, 1563, 2039, 2517, 3121, 3303, 3306, 3401, 4221, 4251, 4253, 4294, 4421, 4914, 4920, 4940, 4941, 4942, 4945, 4947, 4948, 5214, 6033, 6043, 6047, 6104, 6420, 6421, 6424, 6427, 6501 of this title; title 5 sections 3102, 4111; title 12 section 1843; title 15 sections 77c, 1291; title 18 sections 1511, 1955; title 28 section 41; title 29 section 303; title 40 section 484; title 42 sections 409, 410, 1395x, 1760, 1784, 2000e; title 50 section 790.

SECTION REFERRED TO IN D.C. CODE

This section is referred to in section 46–301 of the District of Columbia Code.

§ 502. Feeder organizations.

(a) Geueral rule.

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

(b) Special rule.

For purposes of this section, the term "trade or business" shall not include—

(1) the deriving of rents which would be excluded under section 512(b) (3), if section 512 applied to the organization,

(2) any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or

(3) any trade or business which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

(Aug. 16, 1954, ch. 736, 68A Stat. 166; Dec. 30, 1969, Pub. L. 91–172, title I, § 121(b) (7), 83 Stat. 542.)

AMENDMENTS

1969—Pub. L. 91–172 redesignated first sentence of existing provisions as subsec. (a), and substantial portion of second sentence as subsec. (b) (1), and, in subsec. (b) (1) as so redesignated, inserted reference to section 512 of this title, and added pars. (2) and (3).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 501 of this title.

SECTION REFERRED TO IN D.C. CODE

This section is referred to in section 46–301 of the District of Columbia Code.

§ 503. Requirements for exemption.

(a) Denial of exemption to organizations engaged in prohibited transactions.

(1) General rule.

(A) An organization described in section 501 (c) (17) or (18) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after December 31, 1959.

(B) An organization described in section 401 (a) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.

(C) An organization described in section 501 (c) (18) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after December 31, 1969.

(2) Taxable years affected.

An organization described in section 501(c) (17) or (18) or section 401(a) shall be denied exemption from taxation under section 501 (a) by reason of paragraph (1) only for taxable years after the taxable year during which it is notified by the Secretary or his delegate that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.

(b) Prohibited transactions.

For purposes of this section, the term "prohibited transaction" means any transaction in which an organization subject to the provisions of this section—

(1) lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to;

(2) pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(3) makes any part of its services available on a preferential basis to;

(4) makes any substantial purchase of securities or any other property, for more than

adequate consideration in money or money's worth, from;

(5) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

(6) engages in any other transaction which results in a substantial diversion of its income or corpus to;

the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 267 (c) (4)) of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(c) Future status of organizations denied exemption.

Any organization described in section 501(c) (17) or (18) or section 401(a) which is denied exemption under section 501(a) by reason of subsection (a) of this section, with respect to any taxable year following the taxable year in which notice of denial of exemption was received, may, under regulations prescribed by the Secretary or his delegate, file claim for exemption, and if the Secretary or his delegate, pursuant to such regulations, is satisfied that such organization will not knowingly again engage in a prohibited transaction, such organization shall be exempt with respect to taxable years after the year in which such claim is filed.

(d) Special rule for loans.

For purposes of the application of subsection (b) (1), in the case of a loan by a trust described in section 401(a), the following rules shall apply with respect to a loan made before March 1, 1954, which would constitute a prohibited transaction if made on or after March 1, 1954:

(1) If any part of the loan is repayable prior to December 31, 1955, the renewal of such part of the loan for a period not extending beyond December 31, 1955, on the same terms, shall not be considered a prohibited transaction.

(2) If the loan is repayable on demand, the continuation of the loan without the receipt of adequate security and a reasonable rate of interest beyond December 31, 1955, shall be considered a prohibited transaction.

(e) Special rules.

For purposes of subsection (b) (1), a bond, debenture, note, or certificate or other evidence of indebtedness (hereinafter in this subsection referred to as "obligation") shall not be treated as a loan made without the receipt of adequate security if—

(1) such obligation is acquired—

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the trust than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the trust than the price paid currently for a substantial portion of the same issue by persons independent of the issuer;

(2) immediately following acquisition of such obligation—

(A) not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the trust, and

(B) at least 50 porcent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer; and

(3) immediately following acquisition of the obligation, not more than 25 percent of the assets of the trust is invested in obligations of persons described in subsection (b).

(f) Loans with respect to which employers are prohibited from pledging certain assets.

Subsection (b) (1) shall not apply to a loan made by a trust described in section 401 (a) to the employer (or to a renewal of such a loan or, if the loan is repayable upon demand, to a continuation of such a loan) if the loan bears a reasonable rate of interest, and if (in the case of a making or renewal)—

(1) the employer is prohibited (at the time of such making or renewal) by any law of the United States or regulation thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets;

(2) the making or renewal, as the case may be, is approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and no other such trustee had previously refused to give such written approval; and

(3) immediately following the making or renewal, as the case may be, the aggregate amount loaned by the trust to the employer, without the receipt of adequate security, does not exceed 25 percent of the value of all the assets of the trust.

For purposes of paragraph (2), the term "trustee" means, with respect to any trust for which there is more than one trustee who is independent of the employer, a majority of such independent trustees. For purposes of paragraph (3), the determination as to whether any amount loaned by the trust to the employer is loaned without the receipt of adequate security shall be made without regard to subsection (e).

(g) Trusts benefiting certain owner-employees.

(1) Prohibited transactions.

In the case of a trust described in section 401(a) which is part of a plan providing contribu-

tions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)) who control (within the meaning of section 401(d)(9)(B)) the trade or business with respect to which the plan is established, the term "prohibited transaction" also means any transaction in which such trust, directly or indirectly—

(A) lends any part of the corpus or income of the trust to;

(B) pays any compensation for personal services rendered to the trust to;

(C) makes any part of its services available on a preferential basis to; or

(D) acquires for the trust any property from, or sells any property to;

any person described in subsection (b) or to any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(2) Special rule for loans.

For purposes of the application of paragraph (1)(A), the following rules shall apply with respect to a loan made before the date of the enactment of this subsection which would be a prohibited transaction if made in a taxable year beginning after December 31, 1962:

(A) If any part of the loan is repayable prior to December 31, 1965, the renewal of such part of the loan for a period not extending beyond December 31, 1965, on the same terms, shall not be considered a prohibited transaction.

(B) If the loan is repayable on demand, the continuation of the loan beyond December 31, 1965, shall be considered a prohibited transaction.

(Aug. 16, 1954, ch. 736, 68A Stat. 166; Sept. 2, 1958, Pub. L. 85–866, title I, § 30(a), (b), 72 Stat. 1629; July 14, 1960, Pub. L. 86–667, § 2, 74 Stat. 535; Oct. 10, 1962, Pub. L. 87–792, § 6, 76 Stat. 827; Dec. 30, 1969, Pub. L. 91–172, title I, §§ 101(j)(7)–(14), 121(b)(6)(B), 83 Stat. 527, 542.)

REFERENCES IN TEXT

The date of the enactment of this subsection, referred to in subsec. (j)(2), means the date of enactment of Pub. L. 87–792, which was approved on Oct. 10, 1962.

AMENDMENTS

1969—Subsec. (a)(1)(A). Pub. L. 91–172, §§ 101(j)(7), 121(b)(6)(B)(ii), redesignated former subsec. (a)(1)(B) as subsec. (a)(1)(A), and, in subsec. (a)(1)(A) as so redesignated, inserted reference to section 501(c)(18). Former subsec. (a)(1)(A), referring to organizations described in section 501(c)(3) and to prohibited transactions engaged in after July 1, 1950, was stricken.

Subsec. (a)(1)(B). Pub. L. 91–172, § 101(j)(7), redesignated former subsec. (a)(1)(C) as subsec. (a)(1)(B). Former subsec. (a)(1)(B), referring to organizations described in section 501(c)(17) was amended by addition of a reference to section 501(c)(18), and redesignated as subsec. (a)(1)(A).

Subsec. (a)(1)(C). Pub. L. 91–172, §§ 101(j)(7), 121(b)(6)(B)(i), added subsec. (a)(1)(C). Former subsec. (a)(1)(C), dealing with organizations described in section 401(a) and with prohibited transactions engaged in after Mar. 1, 1954, was redesignated as subsec. (a)(1)(B).

Subsec. (a)(2). Pub. L. 91–172, §§ 101(j)(8), 121(b)(6)(B)(ii), removed reference to organizations described in section 501(c)(3), and added references to organizations described in section 501(c)(18).

Subsec. (b). Pub. L. 91–172, § 101(j)(14), redesignated former subsec. (c) as subsec. (b). Former subsec. (b), setting out the organizations to which section applied, was stricken.

Subsec. (c). Pub. L. 91–172, §§ 101(j)(9), (14), 121(b)(6)(B)(ii), redesignated former subsec. (d) as subsec. (c) and, in subsec. (c) as so redesignated, removed reference to organizations described in section 501(c)(3) and added reference to organizations described in section 501(c)(17). Former subsec. (c) was redesignated subsec. (b).

Subsec. (d). Pub. L. 91–172, § 101(j)(10), (14), redesignated former subsec. (g) as subsec. (d), and, in subsec. (d) as so redesignated, substituted "subsection (b)(1)" for "subsection (c)(1)." Former subsec. (d) was redesignated subsec. (c).

Subsec. (e). Pub. L. 91–172, § 101(j)(11), (14), redesignated former subsec. (h) as subsec. (e), and, in subsec. (e) as so redesignated, modified section heading to read: "Special rules"; substituted "subsection (b)(1)" for "subsection (c)(1)" in material preceding par. (1) and in par. (3), and in material preceding par. (1) struck out "acquired by a trust described in section 401(a) or section 501(c)(17)". Former subsec. (e), covering the disallowance of certain charitable deductions was stricken.

Subsec. (f). Pub. L. 91–172, § 101(j)(12), (14), redesignated former subsec. (i) as subsec. (f), and, in subsec. (f) as so redesignated, substituted "Subsection (b)(1)" for "Subsection (c)(1)", and "subsection (e)" for "subsection (h)". Former subsec. (f) defining "gift or bequest" was stricken.

Subsec. (g). Pub. L. 91–172, § 101(j)(13), (14), redesignated former subsec. (j) as subsec. (g), and, in subsec. (g) as so redesignated, substituted "subsection (b)" for "subsection (c)" in par. (1). Former subsec. (g) was redesignated subsec. (d).

Subsecs. (h)–(j). Pub. L. 91–172, § 101(j)(14), redesignated former subsecs. (h), (i) and (j) as subsecs. (e), (f) and (g). Former subsecs. (e) and (f) were stricken and former subsec. (g) was redesignated subsec. (d).

1962—Subsec. (j). Pub. L. 87–792 added subsec. (j).

1960—Subsec. (a)(1). Pub. L. 86–667, § 2(a)(1), denied the exemption to an organization described in section 501(c)(17) if it has engaged in a prohibited transaction after Dec. 31, 1959.

Subsec. (a)(2). Pub. L. 86–667, § 2(a)(2), included organizations described in section 501(c)(17).

Subsec. (b). Pub. L. 86–667, § 2(b), included organizations described in section 501(c)(17).

Subsec. (d). Pub. L. 86–667, § 2(c), included organizations described in section 501(c)(17).

Subsec. (h). Pub. L. 86–667, § 2(d), included trusts described in section 501(c)(17).

1958—Subsec. (h). Pub. L. 85–866, § 30(a), added subsec. (h).

Subsec. (i). Pub. L. 85–866, § 30(b), added subsec. (i).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 101(j)(7)–(14) of Pub. L. 91–172 to take effect on Jan. 1, 1970, see section 101(k)(1) of Pub. L. 91–172, set out as a note under section 4940 of this title.

Amendment of section by section 121(b)(6)(B) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–667 applicable to taxable years beginning after Dec. 31, 1959, and in the case of loans, the amendments to this section made by Pub. L. 86–667 are applicable only to loans made, renewed, or continued after Dec. 31, 1959, see section 6 of

Pub. L. 86-667, set out as a note under section 501 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 30 (c) of Pub. L. 85-866 provided that:

"(1) In general.—Except as provided in paragraph (2), the amendment made by subsection (a) [adding subsec. (h) of this section] shall apply with respect to taxable years ending after March 15, 1956. The amendment made by subsection (b) [adding subsec. (l) of this section] shall apply with respect to taxable years ending after the date of the enactment of this Act [Sept. 2, 1958], but only with respect to periods after such date.

"(2) Exceptions.—Nothing in subsection (a) [adding subsec. (h) of this section] shall be construed to make any transaction a prohibited transaction which, under announcements of the Internal Revenue Service made with respect to section 503 (c) (1) of the Internal Revenue Code of 1954 before the date of the enactment of this Act [Sept. 2, 1958], would not constitute a prohibited transaction. In the case of any bond, debenture, note, or certificate or other evidence of indebtedness acquired before the date of the enactment of this Act [Sept. 2, 1958], by a trust described in section 401 (a) of such Code which is held on such date, paragraphs (2) and (3) of section 503 (h) of such Code shall be treated as satisfied if such requirements would have been satisfied if such obligation had been acquired on such date of enactment [Sept. 2, 1958]."

CROSS REFERENCES

Denial of exemption, see section 504 of this title.

Gifts and inheritances excluded from gross income, see section 102 of this title.

Limitation on charitable deduction, see section 681 of this title.

Personal holding company definition, organization described in this section as individual for purposes of, see section 542 of this title.

Rules and regulations, see section 7805 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 501, 2039, 2517, 4253 of this title.

§ 504. Repealed. Pub. L. 91-172, title I, § 101(j)(15), Dec. 30, 1969, 83 Stat. 527.

Section, act Aug. 16, 1954, ch. 736, 63A Stat. 168, provided for the denial of exemption in specified cases.

EFFECTIVE DATE OF REPEAL

Repeal of section applicable for taxable years beginning after Dec. 31, 1969, see section 101(h)(2)(B) of Pub. L. 91-172, set out as a note under section 4940 of this title.

PART II.—PRIVATE FOUNDATIONS

Sec.
507. Termination of private foundation status.
508. Special rules with respect to section 501(c)(3) organizations.
509. Private foundation defined.

AMENDMENTS

1969—Pub. L. 91-172, title I, § 101(a), Dec. 30, 1969, 83 Stat. 492, added the Part heading and analysis for Part II.

§ 507. Termination of private foundation status.

(a) General rule.

Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if—

(1) such organization notifies the Secretary or his delegate (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) of its intent to accomplish such termination, or

(2) (A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary or his delegate notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

(b) Special rules.

(1) Transfer to, or operation as, public charity.

The status as a private foundation of any organization, with respect to which there have not been either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under chapter 42, shall be terminated if—

(A) such organization distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding such distribution, or

(B) (i) such organization meets the requirements of paragraph (1), (2), or (3) of section 509(a) by the end of the 12-month period beginning with its first taxable year which begins after December 31, 1969, or for a continuous period of 60 calendar months beginning with the first day of any taxable year which begins after December 31, 1969,

(ii) such organization notifies the Secretary or his delegate (in such manner as the Secretary or his delegate may by regulations prescribe) before the commencement of such 12-month or 60-month period (or before the 90th day after the day on which regulations first prescribed under this subsection become final) that it is terminating its private foundation status, and

(iii) such organization establishes to the satisfaction of the Secretary or his delegate (in such manner as the Secretary or his delegate may by regulations prescribe) immediately after the expiration of such 12-month or 60-month period that such organization has complied with clause (i).

If an organization gives notice under subparagraph (B)(ii) of the commencement of a 60-month period and such organization fails to meet the requirements of paragraph (1), (2), or (3) of section 509(a) for the entire 60-month period, this part and chapter 42 shall not apply to such organization for any taxable year within such 60-month period for which it does meet such requirements.

(2) Transferee foundations.

For purposes of this part, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

(c) Imposition of tax.

There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of—

(1) the amount which the private foundation substantiates by adequate records or other corroboratmg evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or

(2) the value of the net assets of such foundation.

(d) Aggregate tax benefit.

(1) In general.

For purposes of subsection (c), the aggregate tax benefit resulting from the section 501(c)(3) status of any private foundation is the sum of—

(A) the aggregate increases in tax under chapters 1, 11, and 12 (or the corresponding provisions of prior law) which would have been imposed with respect to all substantial contributors to the foundation if deductions for all contributions made by such contributors to the foundation after February 28, 1913, had been disallowed, and

(B) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law) which would have been imposed with respect to the income of the private foundation for taxable years beginning after December 31, 1912, if (i) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (ii) in the case of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without the benefit of section 642(c) but with the benefit of section 170(b)(1)(A)), and

(C) interest on the increases in tax determined under subparagraphs (A) and (B) from the first date on which each such increase would have been due and payable to the date on which the organization ceases to be a private foundation.

(2) Substantial contributor.

(A) Definition.

For purposes of paragraph (1), the term "substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust.

(B) Special rules.

For purposes of subparagraph (A)—

(i) each contribution or bequest shall be valued at fair market value on the date it was received,

(ii) in the case of a foundation which is in existence on October 9, 1969, all contributions and bequests received on or before such date shall be treated (except for purposes of clause (i)) as if received on such date,

(iii) an individual shall be treated as making all contributions and bequests made by his spouse, and

(iv) any person who is a substantial contributor on any date shall remain a substantial contributor for all subsequent periods.

(3) Regulations.

For purposes of this section, the determination as to whether and to what extent there would have been any increase in tax shall be made in accordance with regulations prescribed by the Secretary or his delegate.

(e) Value of assets.

For purposes of subsection (c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

(f) Liability in case of transfers of assets from private foundation.

For purposes of determining liability for the tax imposed by subsection (c) in the case of assets transferred by the private foundation, such tax shall be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation.

(g) Abatement of taxes.

The Secretary or his delegate may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if—

(1) the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months, or

(2) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary or his delegate, in such manner as the Secretary or his delegate may by regulations prescribe, that corrective action has been initiated pursuant to State law to insure that the assets of such private foundation are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary or his delegate receives certification from the appropriate State officer that such action has resulted in such preservation of assets.

(Added Pub. L. 91–172, title I, § 101(a), Dec. 30, 1969, 83 Stat. 492.)

EFFECTIVE DATE

Section effective Jan. 1, 1970, see section 101(k)(1) of Pub. L. 91–172, set out as a note under section 4940 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 508, 509, 4946, 4947, 4948, 6056, 6104, 6214, 6501, 6503 of this title.

§ 508. Special rules with respect to section 501(c)(3) organizations.

(a) New organizations must notify Secretary that they are applying for recognition of section 501(c)(3) status.

Except as provided in subsection (c), an organization organized after October 9, 1969, shall not be treated as an organization described in section 501 (c)(3)—

(1) unless it has given notice to the Secretary or his delegate, in such manner as the Secretary or his delegate may by regulations prescribe, that it is applying for recognition of such status, or

(2) for any period before the giving of such notice, if such notice is given after the time prescribed by the Secretary or his delegate by regulations for giving notice under this subsection.

For purposes of paragraph (2), the time prescribed for giving notice under this subsection shall not expire before the 90th day after the day on which regulations first prescribed under this subsection become final.

(b) Presumption that organizations are private foundations.

Except as provided in subsection (c), any organization (including an organization in existence on October 9, 1969) which is described in section 501(c)(3) and which does not notify the Secretary or his delegate, at such time and in such manner as the Secretary or his delegate may by regulations prescribe, that it is not a private foundation shall be presumed to be a private foundation. The time prescribed for giving notice under this subsection shall not expire before the 90th day after the day on which regulations first prescribed under this subsection become final.

(c) Exceptions.

(1) Mandatory exceptions.

Subsections (a) and (b) shall not apply to—

(A) churches, their integrated auxiliaries, and conventions or associations of churches, or

(B) any organization which is not a private foundation (as defined in section 509(a)) and the gross receipts of which in each taxable year are normally not more than $5,000.

(2) Exceptions by regulations.

The Secretary or his delegate may by regulations exempt (to the extent and subject to such conditions as may be prescribed in such regulations) from the provisions of subsection (a) or (b) or both—

(A) educational organizations which normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where their educational activities are regularly carried on; and

(B) any other class of organizations with respect to which the Secretary or his delegate determines that full compliance with the provisions of subsections (a) and (b) is not necessary to the efficient administration of the provisions of this title relating to private foundations.

(d) Disallowance of certain charitable, etc., deductions.

(1) Gift or bequest to organizations subject to section 507(c) tax.

No gift or bequest made to an organization upon which the tax provided by section 507(c) has been imposed shall be allowed as a deduction under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106 (a)(2), or 2522, if such gift or bequest is made—

(A) by any person after notification is made under section 507(a), or

(B) by a substantial contributor (as defined in section 507(d)(2)) in his taxable year which includes the first day on which action is taken by such organization which culminates in the imposition of tax under section 507(c) and any subsequent taxable year.

(2) Gift or bequest to taxable private foundation, section 4947 trust, etc.

No gift or bequest made to an organization shall be allowed as a deduction under section 170, 545 (b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, if such gift or bequest is made—

(A) to a private foundation or a trust described in section 4947 in a taxable year for which it fails to meet the requirements of subsection (e) (determined without regard to subsection (e)(2) (B) and (C)), or

(B) to any organization in a period for which it is not treated as an organization described in section 501(c)(3) by reason of subsection (a).

(3) Exception.

Paragraph (1) shall not apply if the entire amount of the unpaid portion of the tax imposed by section 507(c) is abated by the Secretary or his delegate under section 507(g).

(e) Governing instruments.

(1) General rule.

A private foundation shall not be exempt from taxation under section 501(a) unless its governing instrument includes provisions the effects of which are—

(A) to require its income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under section 4942, and

(B) to prohibit the foundation from engaging in any act of self-dealing (as defined in section 4941(d)), from retaining any excess business holdings (as defined in section 4943(c)), from making any investments in such manner as to subject the foundation to tax under section 4944, and from making any taxable expenditures (as defined in section 4945(d)).

(2) Special rules for existing private foundations.

In the case of any organization organized before January 1, 1970, paragraph (1) shall not apply—

(A) to any taxable year beginning before January 1, 1972,

(B) to any period after December 31, 1971, during the pendency of any judicial proceeding begun before January 1, 1972, by the private foundation which is necessary to reform, or to excuse such foundation from compliance with, its governing instrument or any other instru-

ment in order to meet the requirements of paragraph (1), and

(C) to any period after the termination of any judicial proceeding described in subparagraph (B) during which its governing instrument or any other instrument does not permit it to meet the requirements of paragraph (1).

(Added Pub. L. 91–172, title I, § 101(a), Dec. 30, 1969, 83 Stat. 494.)

EFFECTIVE DATE

Section effective Jan. 1, 1970, except that subsecs. (a), (b) and (c) of this section effective Oct. 9, 1969, see section 101(k)(1), (3) of Pub. L. 91–172, set out as a note under section 4940 of this title.

SAVINGS PROVISION

Limits on inclusion of provisions inconsistent with subsec. (e) of this section in governing instruments, see section 101(*l*)(6) of Pub. L. 91–172, set out as a note under section 4940 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 663, 2055, 2522, 4947, 4948, 6104 of this title.

§ 509. Private foundation defined.

(a) General rule.

For purposes of this title, the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than—

(1) an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii));

(2) an organization which—

(A) normally receives more than one-third of its support in each taxable year from any combination of—

(i) gifts, grants, contributions, or membership fees, and

(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of $5,000 or 1 percent of the organization's support in such taxable year, from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and

(B) normally receives not more than one-third of its support in each taxable year from gross investment income (as defined in subsection (e));

(3) an organization which—

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) or (2),

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in paragraph (1) or (2), and

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2); and

(4) an organization which is organized and operated exclusively for testing for public safety.

For purposes of paragraph (3), an organization described in paragraph (2) shall be deemed to include an organization described in section 501(c)(4), (5), or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3).

(b) Continuation of private foundation status.

For purposes of this title, if an organization is a private foundation (within the meaning of subsection (a)) on October 9, 1969, or becomes a private foundation on any subsequent date, such organization shall be treated as a private foundation for all periods after October 9, 1969, or after such subsequent date, unless its status as such is terminated under section 507.

(c) Status of organization after termination of private foundation status.

For purposes of this part, an organization the status of which as a private foundation is terminated under section 507 shall (except as provided in section 507(b)(2)) be treated as an organization created on the day after the date of such termination.

(d) Definition of support.

For purposes of this part and chapter 42, the term "support" includes (but is not limited to)—

(1) gifts, grants, contributions, or membership fees,

(2) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in any activity which is not an unrelated trade or business (within the meaning of section 513),

(3) net income from unrelated business activities, whether or not such activities are carried on regularly as a trade or business,

(4) gross investment income (as defined in subsection (e)),

(5) tax revenues levied for the benefit of an organization and either paid to or expended on behalf of such organization, and

(6) the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit referred to in section 170(c)(1) to an organization without charge.

Such term does not include any gain from the sale or other disposition of property which would be considered as gain from the sale or exchange of a capital asset, or the value of exemption from any Federal, State, or local tax or any similar benefit.

(e) Definition of gross investment income.

For purposes of subsection (d), the term "gross investment income" means the gross amount of income from interest, dividends, rents, and royalties, but not including any such income to the extent included in computing the tax imposed by section 511.

(Added Pub. L. 91–172, title I, § 101(a), Dec. 30, 1969, 83 Stat. 496.)

EFFECTIVE DATE

Section effective Jan. 1, 1970, see section 101(k)(1) of Pub. L. 91–172, set out as a note under section 4940 of this title.

SAVINGS PROVISION

Applicability of subsec. (a) of this section to testamentary trusts, see section 101(*l*)(7) of Pub. L. 91–172, set out as a note under section 4940 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 507, 508, 542, 4942, 4945, 4947, 6048, 6056, 6104 of this title.

PART III.—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

Sec.

511. Imposition of tax on unrelated business income of charitable organizations, etc.
512. Unrelated business taxable income.
513. Unrelated trade or business.
514. Unrelated debt-financed income.
515. Taxes of foreign countries and possessions of the United States.

AMENDMENTS

1969—Pub. L. 91–172, title I, §§ 101(a), 121(d)(8)(C), Dec. 30, 1969, 83 Stat. 492, 548, substituted "Part III" for "Part II" as the Part designation and substituted "Unrelated debt-financed income" for "Business leases" in item 514.

CROSS REFERENCES

Organization considered as exempt from income taxes for purpose of any law referring thereto, notwithstanding its taxability under this part, see section 501 of this title.

§ 511. Imposition of tax on unrelated business income of charitable, etc., organizations.

(a) Charitable, etc., organizations taxable at corporation rates.

(1) Imposition of tax.

There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a normal tax and a surtax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income".

(2) Organizations subject to tax.

(A) Organizations described in sections 401(a) and 501(c).

The taxes imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a).

(B) State colleges and universities.

The taxes imposed by paragraph (1) shall apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions. Such taxes shall also apply in the case of any corporation wholly owned by one or more such colleges or universities.

(b) Tax on charitable, etc., trusts.

(1) Imposition of tax.

There is hereby imposed for each taxable year on the unrelated business taxable income of every trust described in paragraph (2) a tax computed as provided in section 1(d). In making such computation for purposes of this section, the term "taxable income" as used in section 1 shall be read as "unrelated business taxable income" as defined in section 512.

(2) Charitable, etc., trusts subject to tax.

The tax imposed by paragraph (1) shall apply in the case of any trust which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a) and which, if it were not for such exemption, would be subject to subchapter J (sec. 641 and following, relating to estates, trusts, beneficiaries, and decedents).

(c) Special rule for section 501(c)(2) corporations.

If a corporation described in section 501(c)(2)—

(1) pays any amount of its net income for a taxable year to an organization exempt from taxation under section 501(a) (or which would pay such an amount but for the fact that the expenses of collecting its income exceed its income), and

(2) such corporation and such organization file a consolidated return for the taxable year,

such corporation shall be treated, for purposes of the tax imposed by subsection (a), as being organized and operated for the same purposes as such organization, in addition to the purposes described in section 501(c)(2).

(d) Tax preferences.

The tax imposed by section 56 shall apply to an organization subject to tax under this section with respect to items of tax preference which enter into the computation of unrelated business taxable income. (Aug. 16, 1954, ch. 736, 68A Stat. 169; July 14, 1960, Pub. L. 86–667, § 3, 74 Stat. 535; Feb. 2, 1966, Pub. L. 89–352, § 2, 80 Stat. 4; Dec. 30, 1969, Pub. L. 91–172, title I, § 121(a)(1)–(3), title III, § 301(b)(8), title VIII, § 803(d)(2), 83 Stat. 536, 585, 684.)

AMENDMENTS

1969—Subsec. (a)(2)(A). Pub. L. 91–172, § 121(a)(1), removed reference, in subpar. catchline, to pars. (2), (3), (5), (6), (14)(B), (C), and (17) of section 501(c) of this title, and, in text, struck out the exemptions to churches, conventions, or associations of churches, from the imposition of tax on their unrelated business income, made corporations organized under section 501(c)(1) of this title (i.e. organized under Acts of Congress), exempt from such tax, but made all such exemptions subservient to the exceptions in part II and section 501(a) of this title.

Subsec. (b)(1). Pub. L. 91–172, § 803(d)(2), substituted section 1(d) for section 1 in the reference to the section under which the computation of the tax dealing with the imposition of tax on the unrelated business taxable income of trusts, is computed.

Subsec. (b)(2). Pub. L. 91–172, § 121(a)(2), pluralized the word "trust" in par. catchline, and, in text, made the imposition of tax on the unrelated business income of exempt trusts subject to the provisions of part II, and, for the purposes of determining trusts exempt from taxation, substituted reference to section 501(a) for reference to "section 501(c)(3) or (17) or section 401(a)".

Subsec. (c). Pub. L. 91–172, § 121(a)(3), added subsec. (c). Former subsec. (c), covering the effective date, was stricken.

Subsec. (d). Pub. L. 91–172, § 301(b)(8), added subsec. (d).

1966—Subsec. (a)(2)(A). Pub. L. 89–352 inserted "(14)(B) or (C)," after "(6)," in the heading and in the text.

1960—Subsec. (a)(2). Pub. L. 86–667, § 3(a), included organizations described in section 501(c)(17) within subpar. (A).

Subsec. (b). Pub. L. 86–667, § 3(b), inserted a reference to section 501(c)(17).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 121(g) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section, and sections 48, 501, 502, 503, 512, 513, 514, 681, 801, 810, 1443, 1504 and 7605 of this title] (other than by subsections (b)(3) and (e) [enacting sections 277 and 6050 of this title]) shall apply to taxable years beginning after December 31, 1969. The amendments made by subsection (b)(3) [enacting section 277 of this title] shall apply to taxable years beginning after December 31, 1970. The amendments made by subsection (e) [enacting section 6050 of this title] shall apply with respect to transfers of property after December 31, 1969. Where an organization makes a bargain purchase of property before October 9, 1969, which is subject to a mortgage which was placed on the property more than 5 years before the purchase, and the organization paid the seller a total amount no greater than the amount of the seller's cost (including attorneys' fees) directly related to the transfer of such property to the organizaion (but in any event no more than 10 percent of the value of the seller's equity in the property), the indebtedness secured by such mortgage shall not be treated, notwithstanding the amendments made by subsection (d)(1) [amending section 514 of this title], as acquisition indebtedness for purposes of section 514(c)(1) [section 514(c)(1) of this title] of the Internal Revenue Code of 1954 [this title] during a period of 10 years following the date of the transaction."

Amendment of subsec. (b)(1) of this section by section 803(d)(2) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1970, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

Subsec. (d) of this section applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 3 of Pub. L. 89–352 provided in part that: "The amendment made by section 2 [amending subsec. (a)(2)(A) of this section] shall apply to taxable years beginning after the date of the enactment of this Act [Feb. 2, 1966]."

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–667 applicable to taxable years beginning after Dec. 31, 1959, see section 6 of Pub. L. 86–667, set out as a note under section 501 of this title.

CROSS REFERENCES

Alternative capital gains tax, see section 1201 of this title.

Taxes of foreign countries and possessions of United States as credit against tax under this section, see section 515 of this title.

Unrelated trade or business, see section 513 of this title.

Withholding of tax on foreign tax-exempt organizations, see section 1443 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 12, 48, 512, 513, 514, 515, 1201, 1443, 1562, 1563, 4940, 6050 of this title.

§ 512. Unrelated business taxable income.

(a) Definition.

For purposes of this title—

(1) General rule.

Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

(2) Special rule for foreign organizations.

In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be—

(A) its unrelated business taxable income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, plus

(B) its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States.

(3) Special rules applicable to organizations described in section 501(c)(7) or (9)

(A) General rule

In the case of an organization described in section 501(c)(7) or (9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b).

(B) Exempt function income.

For purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (1)), which is set aside—

(i) for a purpose specified in section 170(c)(4), or

(ii) in the case of an organization described in section 501(c)(9), to provide for the payment of life, sick, accident, or other benefits,

including reasonable costs of administration directly connected with a purpose described in clause (i) or (ii). If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described in clause (i) or (ii), such amount shall be included, under subparagraph (A), in unrelated business taxable income for the taxable year.

(C) Applicability to certain corporations described in section 501(c)(2).

In the case of a corporation described in section 501(c)(2), the income of which is payable to an organization described in section 501(c)(7) or (9), subparagraph (A) shall apply as if such corporation were the organization to which

the income is payable. For purposes of the preceding sentence, such corporation shall be treated as having exempt function income for a taxable year only if it files a consolidated return with such organization for such year.

(D) Nonrecognition of gain.

If property used directly in the performance of the exempt function of an organization described in section 501(c) (7) or (9) is sold by such organization, and within a period beginning 1 year before the date of such sale, and ending 3 years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property. For purposes of this subparagraph, the destruction in whole or in part, theft, seizure, requisition, or condemnation of property, shall be treated as the sale of such property, and rules simllar to the rules provided by subsections (b), (c), (e), and (j) of section 1034 shall apply.

(b) Modifications.

The modifications referred to in subsection (a) are the following:

(1) There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.

(2) There shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

(3) In the case of rents—

(A) Except as provided in subparagraph (B), there shall be excluded—

(i) all rents from real property (including property described in section 1245(a)(3)(C)), and

(ii) all rents from personal property (including for purposes of this paragraph as personal property any property described in section 1245(a)(3)(B)) leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

(B) Subparagraph (A) shall not apply—

(i) if more than 50 percent of the total rent received or accrued under the lease is attributable to personal property described in subparagraph (A)(ii), or

(ii) if the determination of the amount of such rent depends in whole or in part on the income or profits derived by any person from the property leased (other than an amount based on a fixed percentage or percentages of receipts or sales).

(C) There shall be excluded all deductions directly connected with rents excluded under subparagraph (A).

(4) Notwithstanding paragraph (1), (2), (3), or (5), in the case of debt-financed property (as defined in section 514) there shall be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1), and there shall be allowed, as a deduction, the amount ascertained under section 514(a)(2).

(5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than—

(A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or

(B) property held primarily for sale to customers in the ordinary course of the trade or business.

This paragraph shall not apply with respect to the cutting of timber which is considered, on the application of section 631, as a sale or exchange of such timber.

(6) The net operating loss deduction provided in section 172 shall be allowed, except that—

(A) the net operating loss for any taxable year, the amount of the net operating loss carryback or carryover to any taxable year, and the net operating loss deduction for any taxable year shall be determined under section 172 without taking into account any amount of income or deduction which is excluded under this part in computing the unrelated business taxable income; and

(B) the terms "preceding taxable year" and "preceding taxable years" as used in section 172 shall not include any taxable year for which the organization was not subject to the provisions of this part.

(7) There shall be excluded all income derivod from research for (A) the United States, or any of its agencies or instrumentalities, or (B) any State or political subdivision thereof; and there shall be excluded all deductions directly connected with such income.

(8) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(9) In the case of an organization oporated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(10) In the case of any organization described in section 511 (a), the deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), but shall not exceed 5 percent of the unrelated business taxable income computed without the benefit of this paragraph.

(11) In the case of any trust described in section 511 (b), the deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or

business), and for such purpose a distribution made by the trust to a beneficiary described in section 170 shall be considered as a gift or contribution. The deduction allowed by this paragraph shall be allowed with the limitations prescribed in section 170 (b) (1) (A) and (B) determined with reference to the unrelated business taxable income computed without the benefit of this paragraph (in lieu of with reference to adjusted gross income).

(12) Except for purposes of computing the net operating loss under section 172 and paragraph (6), there shall be allowed a specific deduction of $1,000. In the case of a diocese, province of a religious order, or a convention or association of churches, there shall also be allowed, with respect to each parish, individual church, district, or other local unit, a specific deduction equal to the lower of—

(A) $1,000, or

(B) the gross income derived from any unrelated trade or business regularly carried on by such local unit.

(13) In the case of a trust—

(A) created by virtue of the provisions of the will of an individual who died after August 16, 1954, and before January 1, 1957,

(B) which, by virtue of the provisions of such will, is a limited partner in a partnership created under the laws of a State (i) providing for the creation of limited partnerships, and (ii) under which a limited partner has no right to take part in the control of the business without becoming liable as a general partner,

(C) which, at no time before or during a taxable year of the partnership ending within or with the taxable year of the trust, was (or was liable as) a general partner in such partnership, and

(D) which is required to distribute all of its income (within the meaning of section 643 (b)) currently exclusively for religious, charitable, scientific, literary, or educational purposes, and which is required to distribute all of the corpus exclusively for such purposes,

there shall be excluded its share (determined under subsection (c) without regard to this paragraph and paragraph (11)) of gross income of the partnership as such limited partner and of the partnership deductions directly connected with such income, but, if such share of gross income exceeds such share of deductions, only to the extent that the partnership makes distributions during its taxable year which are attributable to such gross income. For purposes of the preceding sentence (i) any distribution made after the close of a partnership taxable year and on or before the 15th day of the fourth calendar month after the close of such taxable year shall be treated as made on the last day of such taxable year, and (ii) distributions shall be treated as attributable first to gross income other than gross income described in the preceding sentence, and shall be properly adjusted (under regulations prescribed by the Secretary or his delegate) to the extent necessary to reflect capital contributions to the partnership made by the trust, income of the partnership exempt from tax under this title, and other items.

(14) In the case of an organization which is described in section 501(c)(5), there shall be excluded all income used to establish, maintain, or operate a retirement home, hospital, or other similar facility for the exclusive use and benefit of the aged and infirm members of such an organization, which is derived from agricultural pursuits conducted on a ground contiguous to the retirement home, hospital, or similar facility and further provided that such income does not provide more than 75 percent of the cost of maintaining and operating the retirement home, hospital, or similar facility; and there shall be excluded all deductions directly connected with such income.

(15) Notwithstanding paragraphs (1), (2), or (3), amounts of interest, annuities, royalties, and rents derived from any organization (in this paragraph called the "controlled organization") of which the organization deriving such amounts (in this paragraph called the "controlling organization") has control (as defined in section 368(c)) shall be included as an item of gross income (whether or not the activity from which such amounts are derived represents a trade or business or is regularly carried on) in an amount which bears the same ratio as—

(A) (i) in the case of a controlled organization which is not exempt from taxation under section 501(a), the excess of the amount of taxable income of the controlled organization over the amount of such organization's taxable income which if derived directly by the controlling organization would not be unrelated business taxable income, or

(ii) in the case of a controlled organization which is exempt from taxation under section 501(a), the amount of unrelated business taxable income of the controlled organization, bears to

(B) the taxable income of the controlled organization (determined in the case of a controlled organization to which subparagraph (A) (ii) applies as if it were not an organization exempt from taxation under section 501(a)), but not less than the amount determined in clause (i) or (ii), as the case may be, of subparagraph (A),

both amounts computed without regard to amounts paid directly or indirectly to the controlling organization. There shall be allowed all deductions directly connected with amounts included in gross income under the preceding sentence.

(16) Except as provided in paragraph (4), in the case of a church, or convention or association of churches, for taxable years beginning before January 1, 1976, there shall be excluded all gross income derived from a trade or business and all deductions directly connected with the carrying on of such trade or business if such trade or business was carried on by such organization or its predecessor before May 27, 1969.

(17) Except as provided in paragraph (4), in the case of a trade or business—

(A) which consists of providing services under license issued by a Federal regulatory agency,

(B) which is carried on by a religious order or by an educational institution (as defined in section 151(e)(4)) maintained by such religious order, and which was so carried on before May 27, 1959, and

(C) less than 10 percent of the net income of which for each taxable year is used for activities which are not related to the purpose constituting the basis for the religious order's exemption,

there shall be excluded all gross income derived from such trade or business and all deductions directly connected with the carrying on of such trade or business, so long as it is established to the satisfaction of the Secretary or his delegate that the rates or other charges for such services are competitive with rates or other charges charged for similar services by persons not exempt from taxation.

(c) Special rules applicable to partnerships.

If a trade or business regularly carried on by a partnership of which an organization is a member is an unrelated trade or business with respect to such organization, such organization in computing its unrelated business taxable income shall, subject to the exceptions, additions, and limitations contained in subsection (b), include its share (whether or not distributed) of the gross income of the partnership from such unrelated trade or business and its share of the partnership deductions directly connected with such gross income. If the taxable year of the organization is different from that of the partnership, the amounts to be so included or deducted in computing the unrelated business taxable income shall be based upon the income and deductions of the partnership for any taxable year of the partnership ending within or with the taxable year of the organization. (Aug. 16, 1954, ch. 736, 68A Stat. 170; Apr. 7, 1958, Pub. L. 85–367, § 1(a), 72 Stat. 80; July 17, 1964, Pub. L. 88–380, § 1, 78 Stat. 333; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(g), 80 Stat. 1559; Dec. 30, 1969, Pub. L. 91–172, title I, § 121(b)(1), (2), 83 Stat. 537, 538.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 121(b)(1), designated existing provisions as pars. (1) and (2)(B), and added pars. (2)(A) and (3).

Subsec. (b). Pub. L. 91–172, § 121(b)(2)(D), substituted "Modifications" for "Exceptions, additions, and limitations", in subsec. catchline, and, in material preceding par. (1) substituted "The modifications referred to in subsection (a)" for "The exceptions, additions, and limitations applicable in determining unrelated business taxable income".

Subsec. (b)(3)(A). Pub. L. 91–172, § 121(b)(2)(A), added reference to exceptions set out in subsec. (b)(3)(B) in material preceding cl. (i), substituted "property described in section 1245(a)(3)(C)" for "personal property leased with the real property" in the parenthetical material of cl. (i), and added cl. (ii).

Subsec. (b)(3)(B). Pub. L. 91–172, § 121(b)(2)(A), added subsec. (b)(3)(B).

Subsec. (b)(3)(C). Pub. L. 91–172, § 121(b)(2)(A), substituted "rents excluded under subparagraph (A)" for "such rents".

Subsec. (b)(4). Pub. L. 91–172, § 121(b)(2)(A), inserted reference to pars. (1), (3) and (5) of this subsec., and substituted "debt financed property" for "a business lease".

Subsec. (b)(12). Pub. L. 91–172, § 121(b)(2)(B), made the allowance of the specific $1,000 deduction inapplicable for the purposes of computing the net operating loss under section 172 of this title and par. (6) of this subsec., and provided for the allowance of specific deductions equal to the lower of $1,000 or the gross income derived from any unrelated trade or business carried on by a parish, individual church, district, or other local unit.

Subsecs. (b)(15)–(17). Pub. L. 91–172, § 121(b)(2)(C), added subsecs. (b)(15)–(17).

1966—Subsec. (a). Pub. L. 89–809 substituted ", the unrelated business taxable income shall be its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States" for ", the unrelated business taxable income shall be its unrelated business taxable income derived from sources within the United States determined under subchapter N (sec. 861 and following, relating to tax based on income from sources within or without the United States".

1964—Subsec. (b). Pub. L. 88–380 added par. (14).

1958—Subsec. (b)(13). Pub. L. 85–367 added subsec. (b)(13).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 121(b)(1), (2) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 39–809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 2 of Pub. L. 88–380 provided that: "The amendment made by the first section of this Act [adding par. (14) to subsec. (b) of this section] shall apply with respect to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 1 (b) of Pub. L. 85–367 provided that: "The amendment made by subsection (a) [adding subsec. (b)(13) of this section] shall apply to taxable years of trusts beginning after December 31, 1955".

CROSS REFERENCES

Limitation on charitable deduction, see section 681 of this title.

Nonresident aliens and foreign corporations, income taxes of, see section 871 et seq. of this title.

Withholding of tax on foreign tax-exempt organizations, see section 1443 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 502, 511, 513, 514, 681, 1443, 4943 of this title.

§ 513. Unrelated trade or business.

(a) General rule.

The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511 (a) (2) (B), to the exercise

or performance of any purpose or function described in section 501 (c) (3)), except that such term does not include any trade or business—

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) which is carried on, in the case of an organization described in section 501 (c) (3) or in the case of a college or university described in section 511 (a) (2) (B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 501(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

(b) Special rule for trusts.

The term "unrelated trade or business" means, in the case of—

(1) a trust computing its unrelated business taxable income under section 512 for purposes of section 681; or

(2) a trust described in section 401 (a), or section 501(c)(17), which is exempt from tax under section 501 (a);

any trade or business regularly carried on by such trust or by a partnership of which it is a member.

(c) Advertising, etc., activities.

For purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit. (Aug. 16, 1954, ch. 736, 68A Stat. 172; July 14, 1960, Pub. L. 86–667, § 4, 74 Stat. 536; Dec. 30, 1969, Pub. L. 91–172, title I, § 121(b)(4), (c), 83 Stat. 541, 542.)

AMENDMENTS

1969—Subsec. (a)(2). Pub. L. 91–172, § 121(b)(4), added reference to local associations of employees described in section 501(c)(4) of this title and organized before May 27, 1969.

Subsec. (c). Pub. L. 91–172, § 121(c), substituted "Advertising, etc., activities" for "Special rule for certain publishing businesses", in subsec. catchline, and, in text, substituted provisions extending the definition of trade or business to include any activity carried on for the production of income from the sale of goods or the performance of services, for provisions referring to publishing businesses carried on by an organization during a taxable year beginning before Jan. 1, 1953.

1960—Subsec. (b)(2). Pub. L. 86–667 included trusts described in section 501(c)(17).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 121(c) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–667 applicable to taxable years beginning after Dec. 31, 1959, see section 6 of Pub. L. 86–667, set out as a note under section 501 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 103, 509, 512, 514, 4942 of this title.

§ 514. Unrelated debt-financed income.

(a) Unrelated debt-financed income and deductions.

In computing under section 512 the unrelated business taxable income for any taxable year—

(1) Percentage of income taken into account.

There shall be included with respect to each debt-financed property as an item of gross income derived from an unrelated trade or business an amount which is the same percentage (but not in excess of 100 percent) of the total gross income derived during the taxable year from or on account of such property as (A) the average acquisition indebtedness (as defined in subsection (c)(7)) for the taxable year with respect to the property is of (B) the average amount (determined under regulations prescribed by the Secretary or his delegate) of the adjusted basis of such property during the period it is held by the organization during such taxable year.

(2) Percentage of deductions taken into account.

There shall be allowed as a deduction with respect to each debt-financed property an amount determined by applying (except as provided in the last sentence of this paragraph) the percentage derived under paragraph (1) to the sum determined under paragraph (3). The percentage derived under this paragraph shall not be applied with respect to the deduction of any capital loss resulting from the carryback or carryover of net capital losses under section 1212.

(3) Deductions allowable.

The sum referred to in paragraph (2) is the sum of the deductions under this chapter which are directly connected with the debt-financed property or the income therefrom, except that if the debt-financed property is of a character which is subject to the allowance for depreciation provided in section 167, the allowance shall be computed only by use of the straight-line method.

(b) Definition of debt-financed property.

(1) In general.

For purposes of this section, the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year (or, if the property was disposed of during the taxable year, with respect to which there was an acquisition indebtedness at any time during the 12-month period ending with the date of such disposition), except that such term does not include—

(A) (i) any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function designated in section 501(c)(3)), or (ii) any property to which clause (i) does not apply, to the extent that its use is so substantially related;

(B) except in the case of income excluded under section 512(b)(5), any property to the extent that the income from such property is taken into account in computing the gross income of any unrelated trade or business;

(C) any property to the extent that the income from such property is excluded by reason of the provisions of paragraph (7), (8), or (9) of section 512(b) in computing the gross income of any unrelated trade or business; or

(D) any property to the extent that it is used in any trade or business described in paragraph (1), (2), or (3) of section 513(a).

For purposes of subparagraph (A), substantially all the use of a property shall be considered to be substantially related to the exercise or performance by an organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 if such property is real property subject to a lease to a medical clinic entered into primarily for purposes which are substantially related (aside from the need of such organization for income or funds or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

(2) Special rule for related uses.

For purposes of applying paragraphs (1) (A), (C), and (D), the use of any property by an exempt organization which is related to an organization shall be treated as use by such organization.

(3) Special rules when land is acquired for exempt use within 10 years.

(A) Neighborhood land.

If an organization acquires real property for the principal purpose of using the land (commencing within 10 years of the time of acquisition) in the manner described in paragraph (1)(A) and at the time of acquisition the property is in the neighborhood of other property owned by the organization which is used in such manner, the real property acquired for such future use shall not be treated as debt-financed property so long as the organization does not abandon its intent to so use the land within the 10-year period. The preceding sentence shall not apply for any period after the expiration of the 10-year period, and shall apply after the first 5 years of the 10-year period only if the organization establishes to the satisfaction of the Secretary or his delegate that it is reasonably certain that the land will be used in the described manner before the expiration of the 10-year period.

(B) Other cases.

If the first sentence of subparagraph (A) is inapplicable only because—

(i) the acquired land is not in the neighborhood referred to in subparagraph (A), or

(ii) the organization (for the period after the first 5 years of the 10-year period) is unable to establish to the satisfaction of the Secretary or his delegate that it is reasonably certain that the land will be used in the manner described in paragraph (1)(A) before the expiration of the 10-year period,

but the land is converted to such use by the organization within the 10-year period, the real property (subject to the provisions of subparagraph (D)) shall not be treated as debt-financed property for any period before such conversion. For purposes of this subparagraph, land shall not be treated as used in the manner described in paragraph (1)(A) by reason of the use made of any structure which was on the land when acquired by the organization.

(C) Limitations.

Subparagraphs (A) and (B)—

(i) shall apply with respect to any structure on the land when acquired by the organization, or to the land occupied by the structure, only if (and so long as) the intended future use of the land in the manner described in paragraph (1)(A) requires that the structure be demolished or removed in order to use the land in such manner;

(ii) shall not apply to structures erected on the land after the acquisition of the land; and

(iii) shall not apply to property subject to a lease which is a business lease as (defined in subsection (f)).

(D) Refund of taxes when suhparagraph (B) applies.

If an organization for any taxable year has not used land in the manner to satisfy the actual use condition of subparagraph (B) before the time prescribed by law (including extensions thereof) for filing the return for such taxable year, the tax for such year shall be computed without regard to the application of subparagraph (B), but if and when such use condition is satisfied, the provisions of subparagraph (B) shall then be applied to such taxable year. If the actual use condition of subparagraph (B) is satisfied for any taxable year after such time for filing the return, and if credit or refund of any overpayment for the taxable year resulting from the satisfaction of such use condition is prevented at the close of the taxable year in which the use condition is satisfied, by the operation of any law or rule of law (other than chapter 74, relating to closing agreements and compromises), credit or refund of such overpayment may nevertheless be allowed or made if claim therefor is filed before the expiration of 1 year after the close of the taxable year in

which the use condition is satisfied. Interest on any overpayment for a taxable year resulting from the application of subparagraph (B) after the actual use condition is satisfied shall be allowed and paid at the rate of 4 percent per annum in lieu of 6 percent per annum.

(E) Special rule for churches.

In applying this paragraph to a church or convention or association of churches, in lieu of the 10-year period referred to in subparagraphs (A) and (B) a 15-year period shall be applied, and subparagraphs (A) and (B)(ii) shall apply whether or not the acquired land meets the neighborhood test.

(c) Acquisition indebtedness.

(1) General rule.

For purposes of this section, the term "acquisition indebtedness" means, with respect to any debt-financed property, the unpaid amount of—

(A) the indebtedness incurred by the organization in acquiring or improving such property;

(B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement,

except that in the case of any taxable year beginning before January 1, 1972, any indebtedness incurred before June 28, 1966, shall not be taken into account. In the case of an organization (other than a church or convention or association of churches) such indebtedness incurred before June 28, 1966, shall be taken into account if such indebtedness constitutes business lease indebtedness (as defined in subsection (g)).

(2) Property acquired subject to mortgage, etc.

For purposes of this subsection—

(A) General rule.

Where property (no matter how acquired) is acquired subject to a mortgage or other similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered as an indebtedness of the organization incurred in acquiring such property even though the organization did not assume or agree to pay such indebtedness.

(B) Exceptions.

Where property subject to a mortgage is acquired by an organization by bequest or devise, the indebtedness secured by the mortgage shall not be treated as acquisition indebtedness during a period of 10 years following the date of the acquisition. If an organization acquires property by gift subject to a mortgage which was placed on the property more than 5 years before the gift, which property was held by the donor more than 5 years before the gift, the indebtedness secured by such mortgage shall not be treated as acquisition indebtedness during a period of 10 years following the date of such gift. This subparagraph shall not apply if the organization, in order to acquire the equity in the property by bequest, devise, or gift, assumes and agrees to pay the indebtedness secured by the mortgage, or if the organization makes any payment for the equity in the property owned by the decedent or the donor.

(3) Extension of obligations.

For purposes of this section, an extension, renewal, or refinancing of an obligation evidencing a pre-existing indebtedness shall not be treated as the creation of a new indebtedness.

(4) Indehtedness incurred in performing exempt purpose.

For purposes of this section, the term "acquisition indebtedness" does not include indebtedness the incurrence of which is inherent in the performance or exercise of the purpose or function constituting the basis of the organization's exemption, such as the indebtedness incurred by a credit union described in section 501(c)(14) in accepting deposits from its members.

(5) Annuities.

For purposes of this section, the term "acquisition indebtedness" does not include an obligation to pay an annuity which—

(A) is the sole consideration (other than a mortgage to which paragraph (2)(B) applies) issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90 percent of the value of the property received in the exchange,

(B) is payable over the life of one individual in being at the time the annuity is issued, or over the lives of two individuals in being at such time, and

(C) is payable under a contract which—

(i) does not guarantee a minimum amount of payments or specify a maximum amount of payments, and

(ii) does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or any other property.

(6) Certain federal financing.

For purposes of this section, the term "acquisition indebtedness" does not include an obligation, to the extent that it is insured by the Federal Housing Administration, to finance the purchase, rehabilitation, or construction of housing for low and moderate income persons.

(7) Average acquisition indebtedness.

For purposes of this section, the term "average acquisition indebtedness" for any taxable year with respect to a debt-financed property means the average amount, determined under regulations prescribed by the Secretary or his delegate, of the acquisition indebtedness during the period the property is held by the organization during the taxable year, except that for the purpese of computing the percentage of any gain or loss to be

taken into account on a sale or other disposition of debt-financed property, such term means the highest amount of the acquisition indebtedness with respect to such property during the 12-month period ending with the date of the sale or other disposition.

(d) Basis of debt-financed property acquired in corporate liquidation.

For purposes of this subtitle, if the property was acquired in a complete or partial liquidation of a corporation in exchange for its stock, the basis of the property shall be the same as it would be in the hands of the transferor corporation, increased by the amount of gain recognized to the transferor corporation upon such distribution and by the amount of any gain to the organization which was included, on account of such distribution, in unrelated business taxable income under subsection (a).

(e) Allocation rules.

Where debt-financed property is held for purposes described in subsection (b)(1) (A), (B), (C), or (D) as well as for other purposes, proper allocation shall be made with respect to basis, indebtedness, and income and deductions. The allocations required by this section shall be made in accordance with regulations prescribed by the Secretary or his delegate to the extent proper to carry out the purposes of this section.

(f) Definition of business lease.

(1) General rule.

For purposes of this section, the term "business lease" means a lease for a term of more than 5 years of real property by an organization (or by a partnership of which it is a member), if at the close of the lessor's taxable year there is a business lease indebtedness (as defined in subsection (g)) with respect to such property.

(2) Special rules for applying paragraph (1).

For purposes of paragraph (1)—

(A) In computing the term of a lease which contains an option for renewal or extension, the term of such lease shall be considered as including any period for which such option may be exercised; and the term of any lease made pursuant to an exercise of such option shall include the period during which the prior lease was in effect. If real property is acquired subject to a lease, the term of such lease shall be considered to begin on the date of such acquisition.

(B) If the property has been occupied by the same lessee for a total period of more than 5 years commencing not earlier than the date of acquisition of the property by the organization or trust (whether such occupancy is under one or more leases, renewals, extensions, or continuations thereof), the occupancy of such lessee shall be considered to be under a lease for a term of more than 5 years within the meaning of paragraph (1). However, subsection (a) shall apply in the case of a tenancy described in this subparagraph (and not within subparagraph (A)) only with respect to the sixth and succeeding years of occupancy by the same lessee. For purposes of this subparagraph, the term "same lessee" shall include any lessee of the property whose relationship with a lessee of the same property is such that losses in respect of sales or exchanges of property between the 2 lessees would be disallowed under section 267 (a).

(3) Exceptions.

(A) No lease shall be considered a business lease if—

(i) such lease is entered into primarily for purposes which are substantially related (aside from the need of such organization for income or funds or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501, or

(ii) the lease is of premises in a building primarily designed for occupancy, and occupied, by the organization.

(B) If a lease for more than 5 years to a tenant is for only a portion of the real property, and space in the real property is rented during the taxable year under a lease for not more than 5 years to any other tenant of the organization, leases of the real property for more than 5 years shall be considered as business leases during the taxable year only if—

(i) the rents derived from the real property during the taxable year under leases for more than 5 years (not including, as a lease for more than 5 years, an occupancy which is considered as such a lease by reason of paragraph (2) (B)) represent 50 percent or more of the total rents derived during the taxable year from the real property; or the area of the premises occupied under leases for more than 5 years (not including, as a lease for more than 5 years, an occupancy which is considered as such a lease by reason of paragraph (2) (B)) represents, at any time during the taxable year, 50 percent or more of the total area of the real property rented at such time; or

(ii) the rent derived from the real property during the taxable year from any tenant under a lease for more than 5 years (including as a lease for more than 5 years an occupancy which is considered as such a lease by reason of paragraph (2) (B)), or from a group of tenants (under such leases) who are either members of an affiliated group (as defined in section 1504) or partners, represents more than 10 percent of the total rents derived during the taxable year from such property; or the area of the premises occupied by any one such tenant, or by any such group of tenants, represents at any time during the taxable year more than 10 percent of the total area of the real property rented at such time.

In the application of clause (i), if during the last half of the term of a lease a new lease is made to take effect after the expiration of such lease, the unexpired portion of such lease on the

date the second lease is made shall not be treated as a part of the term of the second lease.

(g) Business lease indebtedness.

(1) General rule.

The term "business lease indebtedness" means, with respect to any real property leased for a term of more than 5 years, the unpaid amount of—

(A) the indebtedness incurred by the lessor in acquiring or improving such property;

(B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

(2) Property acquired subject to mortgage, etc.

Where real property is acquired subject to a mortgage or other similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered (whether the acquisition was by gift, devise, or purchase) as an indebtedness of the lessor incurred in acquiring such property even though the lessor did not assume or agree to pay such indebtedness, except that where real property was acquired by gift, bequest, or devise before July 1, 1950, subject to a mortgage or other similar lien, the amount of such mortgage or other similar lien shall not be considered as an indebtedness of the lessor incurred in acquiring such property.

(3) Certain property acquired by gift, etc.

Where real property was acquired by gift, bequest, or devise before July 1, 1950, subject to a lease requiring improvements in such property on the happening of stated contingencies, indebtedness incurred in improving such property in accordance with the terms of such lease shall not be considered as an indebtedness for purposes of this subsection.

(4) Certain corporations described in section 501 (c) (2).

In the case of a corporation described in section 501 (c) (2), all of the stock of which was acquired before July 1, 1950, by an organization described in paragraph (3), (5), or (6) of section 501 (c) (and more than one-third of such stock was acquired by such organization by gift or bequest), any indebtedness incurred by such corporation before July 1, 1950, and any indebtedness incurred by such corporation on or after such date in improving real property in accordance with the terms of a lease entered into before such date, shall not be considered as an indebtedness with respect to such corporation or such organization for purposes of this subsection.

(5) Certain trusts described in section 401 (a).

In the case of a trust described in section 401 (a), or in the case of a corporation described in section 501 (c) (2) all of the stock of which was acquired prior to March 1, 1954, by a trust described in section 401 (a), any indebtedness incurred by such trust or such corporation before March 1, 1954, in connection with real property which is leased before March 1, 1954, and any indebtedness incurred by such trust or such corporation on or after such date necessary to carry out the terms of such lease, shall not be considered as an indebtedness with respect to such trust or such corporation for purposes of this subsection.

(6) Business lease on portion of property.

In determining the amount of the business lease indebtedness where only a portion of the real property is subject to a business lease, proper allocation to the premises covered by such lease shall be made of the indebtedness incurred by the lessor with respect to the real property.

(7) Special rule applicable to trusts described in section 401 (a).

In the application of paragraph (1), if a trust described in section 401 (a) forming part of a stock bonus, pension, or profit-sharing plan of an employer lends any money to another trust described in section 401 (a) forming part of a stock bonus, pension, or profit-sharing plan of the same employer, such loan shall not be treated as an indebtedness of the borrowing trust, except to the extent that the loaning trust—

(A) incurs any indebtedness in order to make such loan;

(B) incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan; or

(C) incurred indebtedness after the making of such loan which would not have been incurred but for the making of such loan and which was reasonably foreseeable at the time of making such loan.

(8) Trusts described in section 501(c)(17).

(A) In the case of a trust described in section 501(c)(17), or in the case of a corporation described in section 501(c)(2), all of the stock of which was acquired before January 1, 1960, by a trust described in section 501(c)(17), any indebtedness incurred by such trust or such corporation before January 1, 1960, in connection with real property which is leased before January 1, 1960, and any indebtedness incurred by such trust or such corporation on or after such date necessary to carry out the terms of such lease, shall not be considered as an indebtedness with respect to such trust or such corporation for purposes of this subsection.

(B) In the application of paragraph (1), if a trust described in section 501(c)(17) forming part of a supplemental unemployment compensation benefit plan lends any money to another trust described in section 501(c)(17) forming part of the same plan, such loan shall not be treated as an indebtedness of the borrowing trust, except to the extent that the loaning trust—

(i) incurs any indebtedness in order to make such loan,

(ii) incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan, or

(iii) incurred indebtedness after the making of such loan which would not have been incurred but for the making of such loan and which was reasonably foreseeable at the time of making such loan.

(h) Personal property leased with real property.

For purposes of this section, the term "real property" and the term "premises" include personal property of the lessor leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate. (Aug. 16. 1954, ch. 736, 68A Stat. 172; July 14, 1960, Pub. L. 86–667, § 5, 74 Stat. 436; Dec. 30, 1969, Pub. L. 91–172, title I, § 121(d)(1), (3)(A), (B), 83 Stat. 543, 548.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 121(d)(1), substituted "Unrelated debt-financed income" for "Business leases" in catchline and substituted in the text material covering unrelated debt-financed income and deductions for material covering business lease rents and deductions.

Subsecs. (b)–(e). Pub. L. 91–172, § 121(d)(1), (3)(A), added subsecs. (b), (c), (d) and (e). Former subsecs. (b), (c) and (d) were redesignated as subsecs. (f), (g) and (h), respectively.

Subsec. (f). Pub. L. 91–172, § 121(d)(3(A), (B), redesignated subsec. (b) as subsec. (f), and, in par. (1) of subsec. (f) as so redesignated, substituted reference to subsec. (g) for reference to subsec. (c).

Subsecs. (g), (h). Pub. L. 91–172, § 121(d)(3)(A), redesignated subsecs. (c) and (d) as subsecs. (g) and (h), respectively.

1960—Subsec. (c)(8). Pub. L. 86–667 added subsec. (c)(8).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 121(d)(1) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, and to the manner of treatment to be accorded indebtednesses secured by certain mortgages on properties bargain-purchased before Oct. 9, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–667 applicable to taxable years beginning after Dec. 31, 1959, see section 6 of Pub. L. 86–667, set out as a note under section 501 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 512, 4942 of this title.

§ 515. Taxes of foreign countries and possessions of the United States.

The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax of an organization subject to the tax imposed by section 511 to the extent provided in section 901; and in the case of the tax imposed by section 511, the term "taxable income" as used in section 901 shall be read as "unrelated business taxable income". (Aug. 16, 1954, ch. 736, 68A Stat. 176.)

PART IV.—FARMERS' COOPERATIVES

Sec.
521. Exemption of farmers' cooperatives from tax.

AMENDMENTS

1969—Pub. L. 91–172, title I, § 101(a), Dec. 30, 1969, 83 Stat. 492, substituted "Part IV" for "Part III" as the Part designation.

1962—Pub. L. 87–834, § 17(b)(5), Oct. 16, 1962, 76 Stat. 1051, struck out item 522.

§ 521. Exemption of farmers' cooperatives from tax.

(a) Exemption from tax.

A farmers' cooperative organization described in subsection (b)(1) shall be exempt from taxation under this subtitle except as otherwise provided in part I of subchapter T (sec. 1381 and following). Notwithstanding part I of subchapter T (sec. 1381 and following), such an organization shall be considered an organization exempt from income taxes for purposes of any law which refers to organizations exempt from income taxes.

(b) Applicable rules.

(1) Exempt farmers' cooperatives.

The farmers' cooperatives exempt from taxation to the extent provided in subsection (a) are farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

(2) Organizations having capital stock.

Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association.

(3) Organizations maintaining reserve.

Exemption shall not be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

(4) Transactions with nonmembers.

Exemption shall not be denied any such association which markets the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, or which purchases supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases.

(5) Business for the United States.

Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this section.

(Aug. 16, 1954, ch. 736, 68A Stat. 176; Oct. 16, 1962, Pub. L. 87–834, § 17(b)(1), 76 Stat. 1051.)

AMENDMENTS

1962—Subsec. (a). Pub. L. 87–834 substituted "part I of subchapter T (sec. 1381 and following)" for "section 522" in two instances.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (a) of this section applicable, except as otherwise provided, to taxable years of organizations described in section 1381(a) of this title beginning after Dec. 31, 1962, see section 17(c) of Pub. L. 87–834, set out as a note under section 1331 of this title.

CROSS REFERENCES

Corporate deductions for dividends received inapplicable to dividends from corporation exempt from tax under this section, see section 246 of this title.

Corporations organized for purpose of financing ordinary crop operations of members of associations subject to this part, exemption of, see section 501 of this title.

Documentary stamp taxes inapplicable to farmers', fruit growers' or cooperative associations, see section 4382 of this title.

Employment under Federal Insurance Contributions Act and Federal Unemployment Tax Act as excluding services performed in employ of organization exempt from tax under this section, see sections 3121, 3306 of this title.

Lottery under wagering taxes as excluding drawings conducted by organization exempt from tax under this section, see section 4421 of this title.

Partial exclusion of dividends received by individuals inapplicable to dividends from corporation exempt from tax under this section, see section 116 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 116, 246, 1245, 1250, 1251, 1381, 3121, 3306, 4382, 4421, 4920, 6044 of this title; title 15 section 77c.

SECTION REFERRED TO IN D.C. CODE

This section is referred to in section 46–301 of the District of Columbia Code.

§ 522. Repealed. Pub. L. 87–834, § 17(b)(2), Oct. 16, 1962, 76 Stat. 1051.

Section, act Aug. 16, 1954, ch. 736, 68A Stat. 177, related to tax on farmers' cooperatives.

EFFECTIVE DATE OF REPEAL

Repeal of section applicable, except as otherwise provided, to taxable years of organizations described in section 1381(a) of this title beginning after Dec. 31, 1962, see section 17(c) of Pub. L. 87–834, set out as a note under section 1381 of this title.

PART V.—SHIPOWNERS' PROTECTION AND INDEMNITY ASSOCIATIONS

Sec.
526. Shipowners' protection and indemnity associations.

AMENDMENTS

1969—Pub. L. 91–172, title I, § 101(a), Dec. 30, 1969, 83 Stat. 492, substituted "Part V" for "Part IV" as the Part designation.

§ 526. Shipowners' protection and indemnity associations.

There shall not be included in gross income the receipts of shipowners' mutual protection and indemnity associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such corporations shall be subject as other persons to the tax on their taxable income from interest, dividends, and rents. (Aug. 16, 1954, ch. 736, 68A Stat. 178.)

Subchapter G.—Corporations Used to Avoid Income Tax on Shareholders

Part
I. Corporations improperly accumulating surplus.
II. Personal holding companies.
III. Foreign personal holding companies.
IV. Deduction for dividends paid.

PART I.—CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

Sec.
531. Imposition of accumulated earnings tax.
532. Corporations subject to accumulated earnings tax.
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§ 531. Imposition of accumulated earnings tax.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

(Aug. 16, 1954, ch. 736, 68A Stat. 179.)

CROSS REFERENCES

Adjustments for—
Accumulated taxable income as excluding deduction for tax imposed by this section, see section 535 of this title.
Undistributed foreign personal holding company income as excluding deduction for tax imposed by this section, see section 556 of this title.
Undistributed personal holding company income as excluding deduction for tax imposed by this section, see section 545 of this title.

Foreign tax credit disallowed for tax imposed by this section, see section 901 of this title.

Notification by Secretary or his delegate informing taxpayer that proposed notice of deficiency includes an amount with respect to tax imposed by this section, see section 534 of this title.

Provisions for computation of tax on change of annual accounting period upon making returns for period less than 12 months as inapplicable in computation of tax imposed by this section, see section 536 of this title.

Recovery exclusion with respect to recovery of bad debts, prior taxes, and delinquency amounts, see section 111 of this title.

Unincorporated business enterprises electing to be taxed as domestic corporations as subject to tax imposed by this section, see section 1361 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 12, 46, 56, 111, 532, 534, 535, 536, 545, 556, 563, 901 of this title.

§ 532. Corporations subject to accumulated earnings tax.

(a) General rule.

The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(b) Exceptions.

The accumulated earnings tax imposed by section 531 shall not apply to—

(1) a personal holding company (as defined in section 542)

(2) a foreign personal holding company (as defined in section 552), or

(3) a corporation exempt from tax under subchapter F (section 501 and following).

(Aug. 16, 1954, ch. 736, 68A Stat. 179.)

CROSS REFERENCES

Construction reserve fund deposits under Merchant Marine Act of 1936 as not constituting accumulation of earnings or profits, see section 1161 (f) of Title 46, Shipping.

Evidence of purpose to avoid income tax, see section 533 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 531, 533 of this title.

§ 533. Evidence of purpose to avoid income tax.

(a) Unreasonable accumulation determinative of purpose.

For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

(b) Holding or investment company.

The fact that any corporation is a mere holding or investment company shall be prima facie evidence of the purpose to avoid the income tax with respect to shareholders. (Aug. 16, 1954, ch. 736, 68A Stat. 179.)

CROSS REFERENCES

Reasonable needs of the business, see section 537 of this title.

§ 534. Burden of proof.

(a) General rule.

In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) Notification by Secretary.

Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by certified mail or registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (e) (2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) Statement by taxpayer.

Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

(d) Jeopardy assessment.

If pursuant to section 6861 (a) a jeopardy assessment is made before the mailing of the notice of deficiency referred to in subsection (a), for purposes of this section such notice of deficiency shall, to the extent that it informs the taxpayer that such deficiency includes the accumulated earnings tax imposed by section 531, constitute the notification described in subsection (b), and in that event the statement described in subsection (c) may be included in the taxpayer's petition to the Tax Court.

(e) Application of section.

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

(Aug. 16, 1954, ch. 736, 68A Stat. 180; Aug. 11, 1955, ch. 805, §§ 4, 5, 69 Stat. 690, 691; Sept. 2, 1958, Pub. L. 85-866, title I, § 89(b), 72 Stat. 1665.)

REFERENCES IN TEXT

Date of the enactment of this paragraph and of this sentence, referred to in the text, is Aug. 11, 1955.

AMENDMENTS

1958—Subsec. (b). Pub. L. 85-866 inserted "certified mail or" preceding "registered mail".

1955—Subsec. (b). Act Aug. 11, 1955, § 5, added second sentence relating to notice of deficiency to which subsec. (e) (2) applies.

Subsec. (e). Act. Aug. 11, 1955, § 4, permitted, in certain instances, application of this section to cases involving taxable years to which prior revenue laws apply.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (b) by Pub. L. 85-866 applicable only if mailing occurred after Sept. 2, 1958, see section 89(d) of Pub. L. 85-866, set out as a note under section 7502 of this title.

§ 535. Accumulated taxable income.

(a) Definition.

For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

(b) Adjustments to taxable income.

For purposes of subsection (a), taxable income shall be adjusted as follows:

(1) Taxes.

There shall be allowed as a deduction Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war profits, and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4), accrued during the taxable year or deemed to be paid by a domestic corporation under section 902(a)(1) or 960(a)(1)(C) for the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law.

(2) Charitable contributions.

The deduction for charitable contributions provided under section 170 shall be allowed without regard to section 170 (b) (2).

(3) Special deductions disallowed.

The special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) Net operating loss.

The net operating loss deduction provided in section 172 shall not be allowed.

(5) Capital losses.

There shall be allowed as deductions losses from sales or exchanges of capital assets during the taxable year which are disallowed as deductions under section 1211 (a).

(6) Long-term capital gains.

There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (determined without regard to the capital loss carryback or carryover provided in section 1212) minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) such taxes computed for such year without including in taxable income the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (determined with regard to the capital loss carryback and carryover provided in section 1212).

(7) Capital loss.

No allowance shall be made for the capital loss carryback or carryover provided in section 1212.

(8) Bank affiliates.

There shall be allowed the deduction described in section 601 (relating to bank affillates).

(9) Distributions of divested stock.

There shall be allowed as a deduction the amount of any dividend distribution received of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(10) Special adjustment on disposition of antitrust stock received as a dividend.

If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(C) paragraph (9) did not apply in respect of such distribution,

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

(c) Accumulated earnings credit.

(1) General rule.

For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b) (6). For purposes of this paragraph, the amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

(2) Minimum credit.

The credit allowable under paragraph (1) shall in no case be less than the amount by which $100,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

(3) Holding and investment companies.

In the case of a corporation which is a mere holding or investment company, the accumulated earnings credit is the amount (if any) by which $100,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

(4) Accumulated earnings and profits.

For purposes of paragraphs (2) and (3), the accumulated earnings and profits at the close of the preceding taxable year shall be reduced by the dividends which under section 563 (a) (relating to dividends paid after the close of the taxable year) are considered as paid during such taxable year.

(5) Cross reference.

For denial of credit provided in paragraph (2) or (3) where multiple corporations are formed to avoid tax, see section 1551, and for limitation on such credit in the case of certain controlled corporations, see sections 1561 and 1564.

(Aug. 16, 1954, ch. 736, 68A Stat. 180; Sept. 2, 1958, Pub. L. 85–866, title I, § 31, title II, § 205(a), 72 Stat. 1631, 1680; Feb. 2, 1962, Pub. L. 87–403, § 3(b), 76 Stat. 6; Oct. 16, 1962, Pub. L. 87–834, § 9(d)(2), 76 Stat. 1001; Feb. 26, 1964, Pub. L. 88–272, title II, § 207(b)(4), 78 Stat. 42; Dec. 30, 1969, Pub. L. 91–172, title IV, § 401(b)(2)(C), title V, § 512(f)(5), (6), 83 Stat. 602, 641.)

AMENDMENTS

1969—Subsec. (b)(6). Pub. L. 91–172, § 512(f)(5), substituted "capital loss carryback or carryover" for "capital loss carryover" and "capital loss carryback and carryover" for "capital loss carryover" in subpar. (B).

Subsec. (b)(7). Pub. L. 91–172, § 512(f)(6), substituted "Capital loss" for "Capital loss carryover" in par. catchline and "capital loss carryback or carryover" for "capital loss carryover" in text.

Subsec. (c)(5). Pub. L. 91–172, § 401(b)(2)(C), substituted "section 1551, and for limitation on such credit in the case of certain controlled corporations, see sections 1561 and 1564" for "section 1551".

1964—Subsec. (b)(1). Pub. L. 88–272 substituted "section 275(a)(4)" for "section 164(b)(6)."

1962—Subsec. (b)(1). Pub. L. 87–834 substituted "accrued during the taxable year or deemed to be paid by a domestic corporation under section 902(a)(1) or 960(a)(1)(C) for the taxable year" for "accrued during the taxable year."

Subsec. (b)(9), (10). Pub. L. 87–403 added subsec. (b)(9), (10).

1958—Subsec. (b)(2). Pub. L. 85–866, § 31(a), deleted following "without regard to" the words "the limitation in".

Subsec. (b)(6)(B). Pub. L. 85–866, § 31(a), substituted "in taxable income the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (determined without regard to the capital loss carryover provided in section 1212)" for "such excess in taxable income".

Subsec. (c). Pub. L. 85–866, § 205(a), substituted "$100,000" for "$60,000" in pars. (2) and (3).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (b)(6), (7) by section 512(f)(5), (6) of Pub. L. 91–172 applicable with respect to net capital losses sustained in taxable years beginning after Dec. 31, 1969, see section 512(g) of Pub. L. 91–172, set out as a note under section 1212 of this title.

Amendment of subsec. (c)(5) by section 401(b)(2)(C) of Pub. L. 91–172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 401(h)(2) of Pub. L. 91–172, set out as a note under section 1561 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 207(c) of Pub. L. 88–272, set out as a note under section 164 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of subsec. (b)(1) by Pub. L. 87–834 applicable in respect of any distribution received by a domestic corporation after Dec. 31, 1964, and in respect of any distribution received by a domestic corporation before Jan. 1, 1965, in a taxable year of such corporation beginning after Dec. 31, 1962, but only to the extent that such distribution is made out of the accumulated profits of a foreign corporation for a taxable year (of such foreign corporation) beginning after Dec. 31, 1962, see section 9(e) of Pub. L. 87–834, set out as a note under section 902 of this title.

Amendment of this section by Pub. L. 87–403 applicable only with respect to distributions made after Feb. 2, 1962, see section 3(g) of Pub. L. 87–403, set out as a note under section 312 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsecs. (b)(2) and (b)(6)(B) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 205(b) of Pub. L. 85–866 provided that: "The amendments made by subsection (a) [to subsec. (c)(2), (3) of this section and section 1551 of this title] shall apply with respect to taxable years beginning after December 31, 1957."

CROSS REFERENCES

Provisions respecting disposal of coal with retained economic interest as inapplicable in determining amount of deduction under subsection (b)(6) of this section, see section 631 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 243, 531, 601, 631, 1551, 1564 of this title.

§ 536. Income not placed on annual basis.

Section 443(b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the accumulated earnings tax imposed by section 531. (Aug. 16, 1954, ch. 736, 68A Stat. 182.)

CROSS REFERENCES

Personal holding company tax computation as not subject to section 443(b), see section 546 of this title.

Regulated investment company taxable income computation as not subject to section 443(b), see section 852 of this title.

Undistributed foreign personal holding company income computation as not subject to section 443(b), see section 557 of this title.

§ 537. Reasonable needs of the business.

(a) General rule.

For purposes of this part, the term "reasonable needs of the business" includes—

(1) the reasonably anticipated needs of the business,

(2) the section 303 redemption needs of the business, and

(3) the excess business holdings redemption needs of the business.

(b) Special rules.

For purposes of subsection (a)—

(1) Section 303 redemption needs.

The term "section 303 redemption needs" means, with respect to the taxable year of the corporation in which a shareholder of the corporation died or any taxable year thereafter, the amount needed (or reasonably anticipated to be needed) to make a redemption of stock included in the gross estate of the decedent (but not in excess of the maximum amount of stock to which section 303(a) may apply).

(2) Excess business holdings redemption needs.

The term "excess business holdings redemption needs" means, with respect to taxable years of the corporation ending after May 26, 1969, the amount needed (or reasonably anticipated to be needed) to redeem from a private foundation stock which—

(A) such foundation held on May 26, 1969 (or which was received by such foundation pursuant to a will or irrevocable trust to which section 4943(c)(5) applies), and

(B) constituted excess business holdings on May 26, 1969, or would have constituted excess business holdings as of such date if there were taken into account (i) stock received pursuant to a will or trust described in subparagraph (A), and (ii) the reduction in the total outstanding stock of the corporation which would have resulted solely from the redemption of stock held by the private foundation.

(3) Obligations incurred to make redemptions.

In applying paragraphs (1) and (2), the discharge of any obligation incurred to make a redemption described in such paragraphs shall be treated as the making of such redemption.

(4) No inference as to prior taxable years.

The application of this part to any taxable year before the first taxable year specified in paragraph (1) or (2) shall be made without regard to the fact that distributions in redemption coming within the terms of such paragraphs were subsequently made.

(Aug. 16, 1954, ch. 736, 68A Stat. 182; Dec. 30, 1969, Pub. L. 91–172, title IX, § 906(a), 83 Stat. 714.)

AMENDMENTS

1969—Pub. L. 91–172 designated existing provisions as subsec. (a)(1), and added subsecs. (a)(2), (3) and (b).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 906(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding subsecs. (a)(2), (3) and (b) of this section] shall apply to the tax imposed under section 531 of the Internal Revenue Code of 1954 [section 531 of this title] with respect to taxable years ending after May 26, 1969."

CROSS REFERENCES

Unreasonable accumulation determinative of purpose to avoid income tax, see section 533 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 311 of this title.

PART II.—PERSONAL HOLDING COMPANIES

Sec.
541. Imposition of personal holding company tax.
542. Definition of personal holding company.
543. Personal holding company income.
544. Rules for determining stock ownership.
545. Undistributed personal holding company income.
546. Income not placed on annual basis.
547. Deduction for deficiency dividends.

§ 541. Imposition of personal holding company tax.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the undistributed personal holding company income (as defined in section 545) of every personal holding company (as defined in section 542) a personal holding company tax equal to 70 percent of the undistributed personal holding company income. (Aug. 16, 1954, ch. 736, 68A Stat. 182; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(a), 78 Stat. 79.)

AMENDMENTS

1964—Pub. L. 88–272 reduced the tax from 75 percent of undistributed income not in excess of $2,000, and 85 percent when in excess of $2,000, to 70 percent.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(1) of Pub. L. 88–272 set out as a note under section 316 of this title.

CROSS REFERENCES

Adjustments for—
Accumulated taxable income as excluding deduction for tax imposed by this section, see section 535 of this title.
Undistributed foreign personal holding company income as excluding deduction for tax imposed by this section, see section 556 of this title.
Undistributed personal holding company income as excluding deduction for tax imposed by this section, see section 545 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 56, 111, 535, 545, 546, 547, 556, 563, 882, 901, 6682, 6683 of this title.

§ 542. Definition of personal holding company.

(a) General rule.

For purposes of this subtitle, the term "personal holding company" means any corporation (other than a corporation described in subsection (c)) if—

(1) Adjusted ordinary gross income requirement.

At least 60 percent of its adjusted ordinary gross income (as defined in section 543(b)(2)) for the taxable year is personal holding company income (as defined in section 543(a)), and

(2) Stock ownership requirement.

At any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals. For purposes of this paragraph, an organization described in section 401(a), 501(c)(17), or 509(a) or a portion of a trust permanently set aside or to be used exclusively for the purposes described in section 642(c) or a corresponding provision of a prior income tax law shall be considered an individual. The preceding sentence shall not apply in the case of an organization or trust organized or created before July 1, 1950, if at all times on or after July 1, 1950, and before the close of the taxable year such organization or trust has owned all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(b) Corporations filing consolidated returns.

(1) General rule.

In the case of an affiliated group of corporations filing or required to file a consolidated return under section 1501 for any taxable year, the adjusted ordinary gross income requirement of subsection (a)(1) of this section shall, except as provided in paragraphs (2) and (3), be applied for such year with respect to the consolidated adjusted ordinary gross income and the consolidated personal holding company income of the affiliated group. No member of such an affiliated group shall be considered to meet such adjusted ordinary gross income requirement unless the affiliated group meets such requirement.

(2) Ineligible affiliated group.

Paragraph (1) shall not apply to an affiliated group of corporations, other than an affiliated group of railroad corporations the common parent of which would be eligible to file a consolidated

return under section 141 of the Internal Revenue Code of 1939 prior to its amendment by the Revenue Act of 1942, if—

(A) any member of the affiliated group of corporations (including the common parent corporation) derived 10 percent or more of its adjusted ordinary gross income for the taxable year from sources outside the affiliated group, and

(B) 80 percent or more of the amount described in subparagraph (A) consists of personal holding company income (as defined in section 543).

For purposes of this paragraph, section 543 shall be applied as if the amount described in subparagraph (A) were the adjusted ordinary gross income of the corporation.

(3) Excluded corporations.

Paragraph (1) shall not apply to an affiliated group of corporations if any member of the affiliated group (including the common parent corporation) is a corporation excluded from the definition of personal holding company under subsection (c).

(4) Certain dividend income received by a common parent.

In applying paragraph (2) (A) and (B), personal holding company income and adjusted ordinary gross income shall not include dividends received by a common parent corporation from another corporation if—

(A) the common parent corporation owns, directly or indirectly, more than 50 percent of the outstanding voting stock of such other corporation, and

(B) such other corporation is not a personal holding company for the taxable year in which the dividends are paid.

(c) Exceptions.

The term "personal holding company" as defined in subsection (a) does not include—

(1) a corporation exempt from tax under subchapter F (sec. 501 and following);

(2) a bank as defined in section 581, or a domestic building and loan association within the meaning of section 7701(a)(19) without regard to subparagraphs (D) and (E) thereof;

(3) a life insurance company;

(4) a surety company;

(5) a foreign personal holding company as defined in section 552;

(6) a lending or finance company if—

(A) 60 percent or more of its ordinary gross income (as defined in section 543(b)(1)) is derived directly from the active and regular conduct of a lending or finance business;

(B) the personal holding company income for the taxable year (computed without regard to income described in subsection (d)(3) and income derived directly from the active and regular conduct of a lending or finance business, and computed by including as personal holding company income the entire amount of the gross income from rents, royalties, produced film rents, and compensation for use of corporate property by shareholders) is not more than 20 percent of the ordinary gross income;

(C) the sum of the deductions which are directly allocable to the active and regular conduct of its lending or finance business equals or exceeds the sum of—

(i) 15 percent of so much of the ordinary gross income derived therefrom as does not exceed $500,000, plus

(ii) 5 percent of so much of the ordinary gross income derived therefrom as exceeds $500,000 but not $1,000,000; and

(D) the loans to a person who is a shareholder in such company during the taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by members of his family as defined in section 544(a)(2)), outstanding at any time during such year do not exceed $5,000 in principal amount;

(7) a foreign corporation (other than a corporation which has income to which section 543(a)(7) applies for the taxable year), if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;

(8) A small business investment company which is licensed by the Small Business Administration and operating under the Small Business Investment Act of 1958 and which is actively engaged in the business of providing funds to small business concerns under that Act. This paragraph shall not apply if any shareholder of the small business investment company owns at any time during the taxable year directly or indirectly (including, in the case of an individual, ownership by the members of his family as defined in section 544(a)(2)) a 5 per centum or more proprietary interest in a small business concern to which funds are provided by the investment company or 5 per centum or more in value of the outstanding stock of such concern.

(d) Special rules for applying subsection (c)(6).

(1) Lending or finance business defined.

(A) In general.

Except as provided in subparagraph (B), for purposes of subsection (c)(6), the term "lending or finance business" means a business of—

(i) making loans,

(ii) purchasing or discounting accounts receivable, notes, or installment obligations,

(iii) rendering services or making facilities available in connection with activities described in clauses (i) and (ii) carried on by the corporation rendering services or making facilities available, or

(iv) rendering services or making facilities available to another corporation which is engaged in the lending or finance business (within the meaning of this paragraph), if such services or facilities are related to the lending or finance business (within such meaning)

of such other corporation and such other corporation and the corporation rendering services or making facilities available are members of the same affiliated group (as defined in section 1504).

(B) Exceptions.

For purposes of subparagraph (A), the term "lending or finance business" does not include the business of—

(i) making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, if (at the time of the loan, purchase, or discount) the remaining maturity exceeds 60 months, unless the loans, notes, or installment obligations are evidenced or secured by contracts of conditional sale, chattel mortgages, or chattel lease agreements arising out of the sale of goods or services in the course of the borrower's or transferor's trade or business, or

(ii) making loans evidenced by, or purchasing, certificates of indebtedness issued in a series, under a trust indenture, and in registered form or with interest coupons attached.

For purposes of clause (i), the remaining maturity shall be treated as including any period for which there may be a renewal or extension under the terms of an option exercisable by the borrower.

(2) Business deductions.

For purposes of subsection (c)(6)(C), the deductions which may be taken into account shall include only—

(A) deductions which are allowable only by reason of section 162 or section 404, except there shall not be included any such deduction in respect of compensation for personal services rendered by shareholders (including members of the shareholder's family as described in section 544(a)(2)), and

(B) deductions allowable under section 167, and deductions allowable under section 164 for real property taxes, but in either case only to the extent that the property with respect to which such deductions are allowable is used directly in the active and regular conduct of the lending or finance business.

(3) Income received from certain affiliated corporations.

For purposes of subsection (c)(6)(B), in the case of a lending or finance company which meets the requirements of subsection (c)(6)(A), there shall not be treated as personal holding company income the lawful income received from a corporation which meets the requirements of subsection (c)(6) and which is a member of the same affiliated group (as defined in section 1504) of which such company is a member.

(Aug. 16, 1954, ch. 736, 68A Stat. 182; Aug. 12, 1955, ch. 871, § 3, 69 Stat. 718; Sept. 23, 1959, Pub. L. 86–376, § 3(a), 73 Stat. 700; Oct. 9, 1962, Pub. L. 87–768, § 1, 76 Stat. 766; Feb. 26, 1964, Pub. L. 88–272, title II, § 225 (b), (c), (k)(1), 78 Stat. 79, 80, 93; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(h)(1), 80 Stat. 1559; Dec. 30, 1969, Pub. L. 91–172, title I, § 101(j)(16), 83 Stat. 528.)

REFERENCES IN TEXT

The Small Business Investment Act of 1958, referred to in subsec. (c)(8), is principally classified to chapter 14B of Title 15, Commerce and Trade. For distribution of the Act in the Code, see Short Title note under section 661 of Title 15.

That Act, referred to in subsec. (c)(8), refers to the Small Business Investment Act of 1958.

AMENDMENTS

1969—Subsec. (a)(2). Pub. L. 91–172 substituted "section 401(a), 501(c)(17), or 509(a)" for "section 503(b)" in the list of sections that contain the description of organizations that may be considered as individuals for the purpose of establishing stock ownership, and struck out provisions which would have kept an organization or trust created before July 1, 1950, from being so designated if it had been denied exemption under section 504 or an unlimited charitable deduction under section 681(c) of this title.

1966—Subsec. (c)(7). Pub. L. 89–809 substituted requirement that the foreign corporation be other than a corporation which has income to which section 543(a)(7) applies for the taxable year for requirement that the foreign corporation's gross income from sources within the United States for the period specified in section 861(a)(2)(B) be less than 50 percent of its total gross income from all sources, and expanded the devices included in methods of indirect ownership to encompass foreign estates, foreign trusts, and foreign partnerships.

1964—Subsec. (a)(1). Pub. L. 88–272, § 225(b), substituted "60 percent of its adjusted ordinary gross income (as defined in section 543(b)(2)) for the taxable year is personal holding company income (as defined in section 543(a))" for "80 percent of its gross income for the taxable year is personal holding company income as defined in section 543."

Subsec. (b). Pub. L. 88–272, § 225(k)(1), substituted "adjusted ordinary gross income" for "gross income", wherever appearing.

Subsec. (c)(2), (6)—(11). Pub. L. 88–272, § 225(c)(1), (2), inserted among the exceptions, domestic building and loan associations within section 7701(a)(19) without regard to subpars. (D) and (E) thereof, added par. (6), redesignated former pars. (10) and (11) as (7) and (8), respectively, and omitted former pars. (6)—(9) which related to licensed personal finance companies, lending companies, loan or investment corporations, and finance companies, respectively.

Subsec. (d). Pub. L. 88–272, § 225(c)(3), added subsec. (d).

1962—Subsec. (c)(7). Pub. L. 87–768 substituted "authorized to engage in and actively and regularly engaged in the small loan business (consumer finance business)" for "authorized to engage in the small loan business", inserted provisions excepting from the definition of "personal holding company" a lending company that received 80 percent or more of its gross income from lawful income from domestic subsidiary corporations (of which stock possessing at least 80 percent of the voting power of all classes of stock and of which at least 80 percent of each class of the nonvoting stock is owned directly by such lending company), which are themselves excepted under pars. (6), (7), (8), or (9) of this subsection, increased the maximum amount of the loan where no limit is prescribed from $500 to $1,500, and eliminated provisions which required loans to mature in not more than 36 months, and which limited interest, discount and other charges to not more than an amount equal to simple interest at 3 per cent per month payable in advance and computed only on unpaid balances.

1959—Subsec. (c)(11). Pub. L. 86–376 added subsec. (c)(11).

1955—Subsec. (a)(2). Act Aug. 12, 1955, § 3, added sentence at the end to except from consideration as "individuals" certain charitable foundations created before July 1, 1950.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 101(j)(16) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 101(k)(2)(B) of Pub. L. 91–172, set out as a note under section 4940 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-809 with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsecs. (a)(1), (b), (c) (6)—(8), and (d), by Pub. L. 88-272 applicable to taxable years beginning after Dec. 31, 1963, and amendment of subsec. (c)(2) by Pub. L. 88-272 applicable to taxable years beginning after Oct. 16, 1962, see section 225(1) of Pub. L. 88-272, set out as a note under section 316 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Section 2 of Pub. L. 87-768 provided that: "The amendment made by the first section of this Act [to subsec. (c)(7) of this section] shall apply with respect to taxable years beginning after December 31, 1961."

EFFECTIVE DATE OF 1959 AMENDMENT

Section 3(b) of Pub. L. 86-376 provided that: "The amendment made by this section [adding subsec. (c)(11) of this section] shall apply to taxable years beginning after December 31, 1958."

EFFECTIVE DATE OF 1955 AMENDMENT

Section 4 of act Aug. 12, 1955, provided that: "The amendment made by section 3 of this Act [to subsection (a) (2) of this section] shall apply only with respect to taxable years beginning after December 31, 1954."

CROSS REFERENCES

Accumulated earnings tax as inapplicable to personal holding company defined in this section, see section 532 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88-272, set out as a note under section 333 of this title.

Personal holding company dividend defined, see section 316 of this title.

Regulated investment company as meaning any domestic corporation other than a personal holding company as defined in this section, see section 851 of this title.

Rules for determining stock ownership, see section 544 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 316, 333, 532, 541, 544, 545, 562, 851, 856, 864, 4920 of this title.

§ 543. Personal holding company income.

(a) General rule.

For purposes of this subtitle, the term "personal holding company income" means the portion of the adjusted ordinary gross income which consists of:

(1) Dividends, etc.

Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. This paragraph shall not apply to—

(A) interest constituting rent (as defined in subsection (b)(3)),

(B) interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act, 1936, and

(C) a dividend distribution of divested stock (as defined in subsection (e) of section 1111), but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(2) Rents.

The adjusted income from rents; except that such adjusted income shall not be included if—

(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income, and

(B) the sum of—

(i) the dividends paid during the taxable year (determined under section 562),

(ii) the dividends considered as paid on the last day of the taxable year under section 563(c) (as limited by the second sentence of section 563(b)), and

(iii) the consent dividends for the taxable year (determined under section 565),

equals or exceeds the amount, if any, by which the personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (6), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) exceeds 10 percent of the ordinary gross income.

(3) Mineral, oil, and gas royalties.

The adjusted income from mineral, oil, and gas royalties; except that such adjusted income shall not be included if—

(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income,

(B) the personal holding company income for the taxable year (computed without regard to this paragraph, and computed by including as personal holding company income copyright royalties and the adjusted income from rents) is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are allowable under section 162 (relating to trade or business expenses) other than—

(i) deductions for compensation for personal services rendered by the shareholders, and

(ii) deductions which are specifically allowable under sections other than section 162, equals or exceeds 15 percent of the adjusted ordinary gross income.

(4) Copyright royalties.

Copyright royalties; except that copyright royalties shall not be included if—

(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

(B) the personal holding company income for the taxable year computed—

(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 porcent of all classes of stock entitled

to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and

(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,

is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under section 162, other than—

(i) deductions for compensation for personal services rendered by the shareholders,

(ii) deductions for royalties paid or accrued, and

(iii) deductions which are specifically allowable under sections other than section 162,

equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under section 167 (relating to depreciation) with respect to copyright royalties.

For purposes of this subsection, the term "copyright royalties" means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code (other than by reason of section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5)(B)) received for the use of, or right to use, films. For purposes of this paragraph, the term "shareholder" shall include any person who owns stock within the meaning of section 544.

(5) Produced film rents.

(A) Produced film rents; except that such rents shall not be included if such rents constitute 50 percent or more of the ordinary gross income.

(B) For purposes of this section, the term "produced film rents" means payments received with respect to an interest in a film for the use of, or right to use, such film, but only to the extent that such interest was acquired before substantial completion of production of such film.

(6) Use of corporation property by shareholder.

Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (2), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) in excess of 10 percent of its ordinary gross income.

(7) Personal service contracts.

(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(8) Estates and trusts.

Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries).

(b) Definitions.

For purposes of this part—

(1) Ordinary gross income.

The term "ordinary gross income" means the gross income determined by excluding—

(A) all gains from the sale or other disposition of capital assets,

(B) all gains (other than those referred to in subpargraph (A)) from the sale or other disposition of property described in section 1231(b), and

(C) in the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), all items of income which would, but for this subparagraph, constitute personal holding company income under any paragraph of subsection (a) other than paragraph (7) thereof:

(2) Adjusted ordinary gross income.

The term "adjusted ordinary gross income" means the ordinary gross income adjusted as follows:

(A) Rents.

From the gross income from rents (as defined in the second sentence of paragraph (3) of this subsection) subtract the amount allowable as deductions for—

(i) exhaustion, wear and tear, obsolescence, and amortization of property other than tangible personal property which is not customarily retained by any one lessee for more than three years,

(ii) property taxes,

(iii) interest, and

(iv) rent,

to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income from rents. The amount subtracted under this subparagraph shall not exceed such gross income from rents.

(B) Mineral, royalties, etc.

From the gross income from mineral, oil, and gas royalties described in paragraph (4), and from the gross income from working interests in an oil or gas well, subtract the amount allowable as deductions for—

(i) exhaustion, wear and tear, obsolescence, amortization, and depletion,

(ii) property and severance taxes,

(iii) interest, and

(iv) rent,

to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income from royalties or such gross income from working interests in oil or gas wells. The amount subtracted under this subparagraph with respect to royalties shall not exceed the gross income from such royalties, and the amount subtracted under this subparagraph with respect to working interests shall not exceed the gross income from such working interests.

(C) Interests.

There shall be excluded—

(i) interest received on a direct obligation of the United States held for sale to customers in the ordinary course of trade or business by a regular dealer who is making a primary market in such obligations, and

(ii) interest on a condemnation award, a judgment, and a tax refund.

(D) Certain excluded rents.

From the gross income consisting of compensation described in subparagraph (D) of paragraph (3) subtract the amount allowable as deductions for the items described in clauses (i), (ii), (iii), and (iv) of subparagraph (A) to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income. The amount subtracted under this subparagraph shall not exceed such gross income.

(3) Adjusted income from rents.

The term "adjusted income from rents" means the gross income from rents, reduced by the amount subtracted under paragraph (2)(A) of this subsection. For purposes of the preceding sentence, the term "rents" means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but such term does not include—

(A) amounts constituting personal holding company income under subsection (a)(6),

(B) copyright royalties (as defined in subsection (a)(4)),

(C) produced film rents (as defined in subsection (a)(5)(B)), or

(D) compensation, however designated, for the use of, or the right to use, any tangible personal property manufactured or produced by the taxpayer, if during the taxable year the taxpayer is engaged in substantial manufacturing or production of tangible personal property of the same type.

(4) Adjusted income from mineral, oil, and gas royalties.

The term "adjusted income from mineral, oil, and gas royalties" means the gross income from mineral, oil, and gas royalties (including production payments and overriding royalties), reduced by the amount subtracted under paragraph (2)(B) of this subsection in respect of such royalties.

(c) Gross income of insurance companies other than life or mutual.

In the case of an insurance company other than life or mutual, the term "gross income" as used in this part means the gross income, as defined in section 832 (b) (1), increased by the amount of losses incurred, as defined in section 832 (b) (5), and the amount of expenses incurred, as defined in section 832 (b) (6), and decreased by the amount deductible under section 832 (c) (7) (relating to tax-free interest). (Aug. 16, 1954, ch. 736, 68A Stat. 186; Apr. 22, 1960, Pub. L. 86-435, § 1(a), (b), 74 Stat. 77; Feb. 2, 1962, Pub. L. 87-403, § 3(c), 76 Stat. 6; Feb. 26, 1964, Pub. L. 88-272, title II, § 225 (d), (k)(2), 78 Stat. 81, 93; Aug. 22, 1964, Pub. L. 86-484, § 3(a), 78 Stat. 598; Nov. 13, 1966, Pub L. 89-809, title I, § 104(h)(2), title II, § 206(a)(b), 80 Stat. 1559, 1578, 1579.)

AMENDMENTS

1966—Subsec. (a)(2). Pub. L. 89-809, § 206(b)(1), struck out provision that royalties received for the use of, or for the privilege of using, a patent, invention, model, or design, secret formula, process, or other similar property right be treated as rent if such property right is also used by the corporation receiving such royalties in the manufacture or production of tanglble personal property held for lease to customers and if the amount constituting rent from such leases to customers meets the requirement of subparagraph (A).

Subsec. (b)(1). Pub. L. 89-809, § 104(h)(2), added subpar. (C).

Subsec. (b)(2). Pub. L. 89-809, § 206(b)(2), added subpar. (D).

Subsec. (b)(3). Pub. L. 89-809, § 206(a), struck out "amounts constituting personal holding company income under subsection (a)(6), nor copyright royalties (as defined in subsection (a)(4)), nor produced film rents (as defined in subsection (a)(5)(B))." following "but does not include", and added subpars. (A)—(D).

1964—Subsec. (a). Pub. L. 88-272, § 225(d), amended subsec. (a) generally, and among other changes, substituted "adjusted ordinary gross income" for "gross income", provided, relative to rental income, that in addition to the 50-percent test of par. (2)(A), now applied on the basis of adjusted income from rents and adjusted ordinary gross income, a second test for exclusion shall be whether the sum on the dividends paid during the

taxable year, the dividends paid on the last day of the year, and the consent dividends for the taxable year, equals or exceeds the amount by which the personal holding company income for the year exceeds 10 percent of the ordinary gross income, relative to mineral, oil, and gas royalties, that in addition to the 50-percent test of par. (3)(A), now applied on the basis of adjusted ordinary gross income, and the 15-percent test of par. (3)(C), from which test have been excluded deductions "specifically allowable under sections other than section 162" and is also now applied on the basis of adjusted gross income, the royalties shall be excluded if the personal holding company income for the taxable year is not more than 10 percent of the ordinary gross income, relative to copyright royalties, retained the 50-percent test as in par. (4)(A), making it applicable to ordinary gross income, included in the computation of the income for the taxable year the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties, excluded from the sum of deductions allocable to royalties, deductions specifically allowable under sections other than 162, and changed the requirement that deductions constitute 50 percent or more of gross income to provide that they must equal 25 percent of ordinary gross income reduced by royalties paid and by depreciation deductions with respect to copyrights, relative to produced film rents, that they be treated on their own basis and not as rentals, and defined "produced film rents", relative to use of corporation property by shareholders, that personal holding company income includes copyright royalties and the adjusted income from mineral, oil, and gas royalties, eliminated gains from the sale or other disposition of any interest in an estate or trust, from the sale or exchange of stock or securities, and from futures transactions in any commodity, and also the definition of "rents" which can now be found in subsec. (b)(3).

Subsec. (a)(2). Pub. L. 88–484 inserted sentence requiring royalties received for the use of, or for the privilege of using, a patent, invention, model, or design (whether or not patented), secret formula or process, or any other similar property right to be treated as rent, if such property right is also used by the corporation receiving such royalties in the manufacture or production of tangible personal property held for lease to customers, and if the amount (computed without regard to this sentence) constituting rent from such leases to customers meets the requirements of subparagraph (A).

Subsec. (b). Pub. L. 88–272, § 225(d), added subsec. (b), and omitted a prior subsec. (b) which provided that gross income and personal holding company income determined with respect to transactions relating to gains from stock and security transactions, and with respect to transactions relating to gains from commodity transactions, should include only the excess of gains over losses from such transactions.

Subsec. (d). Pub. L. 88–272, § 225(k)(2), eliminated subsec. (d) which related to special adjustment on disposition of antitrust stock received as a dividend.

1962—Subsec. (a)(1). Pub. L. 87–403 prescribed the conditions making inapplicable the provisions of the paragraph to dividend distribution of divested stock.

Subsec. (d). Pub. L. 87–403 added subsec. (d).

1960—Subsec. (a)(1). Pub. L. 86–485, § 1(b)(1), excluded copyright royalties.

Subsec. (a)(6). Pub. L. 86–435, § 1(b)(2), added sentence providing that copyright royalties constitute personal holding company income.

Subsec. (a)(9). Pub. L. 86–435, § 1(a), added subsec. (a)(9).

EFFECTIVE DATE OF 1966 AMENDMENT

Section 206(c) of Pub. L. 89–809 provided that: "The amendments made by subsections (a) and (b) [amending subsec. (a) and (b) of this section] shall apply to taxable years beginning after the date of the enactment of this Act [November 13, 1966]. Such amendments shall also apply, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate may prescribe), to taxable years beginning on or before such date and ending after December 31, 1965."

Amendment of subsec. (b)(1) by section 104(h)(2) of Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Section 3(b) of Pub. L. 88–484 provided that: "The amendment made by subsection (a) [to subsec. (a)(2) of this section] shall apply to taxable years beginning after December 31, 1963."

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272 set out as a note under section 316 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–403 applicable only with respect to distributions made after Feb. 2, 1962, see section 3(g) of Pub. L. 87–403, set out as a note under section 312 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Section 2 of Pub. L. 86–435 provided that: "The amendments made by the first section of this Act [to subsec. (a) of this section and sections 544 (a), (b), and 553 of this title] shall apply only with respect to taxable years beginning after December 31, 1959."

CROSS REFERENCES

Foreign personal holding company income, see section 553 of this title.

Limitations on assessment and collection, see section 6501 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

Personal holding company—

Definition as dependent upon personal holding company income, see section 542 of this title.

Dividend defined, see section 316 of this title.

Rules for determining stock ownership, see section 544 of this title.

Unincorporated business enterprises electing to be taxed as domestic corporations and treatment of personal holding company income, see section 1361 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 542, 544, 545, 856, 864, 6035, 6501 of this title.

§ 544. Rules for determining stock ownership.

(a) Constructive ownership.

For purposes of determining whether a corporation is a personal holding company, insofar as such determination is based on stock ownership under section 542(a)(2), section 543(a)(7), section 543(a)(6), or section 543(a)(4)—

(1) Stock not owned by individual.

Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) Family and partnership ownership.

An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For purposes of this paragraph, the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) Options.

If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) Application of family-partnership and option rules.

Paragraphs (2) and (3) shall be applied—

(A) for purposes of the stock ownership requirement provided in section 542 (a) (2), if, but only if, the effect is to make the corporation a personal holding company;

(B) for purposes of section 543(a)(7) (relating to personal service contracts), of section 543(a)(6) (relating to use of property by shareholders), or of section 543(a)(4) (relating to copyright royalties), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as personal holding company income.

(5) Constructive ownership as actual ownership.

Stock constructively owned by a person by reason of the application of paragraph (1) or (3), shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

(6) Option rule in lieu of family and partnership rule.

If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

(b) Convertible securities.

Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

(1) for purposes of the stock ownership requirement provided in section 542 (a) (2), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company;

(2) for purposes of section 543(a)(7) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income;

(3) for purposes of section 543 (a) (6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income; and

(4) for purposes of section 543(a)(4) (relating to copyright royalties), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income.

The requirement in paragraphs (1), (2), (3), and (4) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included. (Aug. 16, 1954, ch. 736, 68A Stat. 188; Apr. 22, 1960, Pub. L. 86–435, § 1 (c), (d), 74 Stat. 78; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(k)(3), 78 Stat. 93.)

AMENDMENTS

1964—Pub. L. 88–272 substituted "section 543(a)(7)" for "section 543(a)(5)", and "section 543(a)(4)" for "section 543(a)(9)," wherever appearing.

1960—Subsec. (a). Pub. L. 86–435, § 1(c)(1), inserted a reference to section 543(a)(9) in the opening provisions.

Subsec. (a)(4)(B). Pub. L. 86–435, § 1(c)(2), included section 543(a)(9).

Subsec. (b). Pub. L. 86–435, § 1(d), added par. (4), and inserted a reference to par. (4) in the last sentence.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(1) of Pub. L. 88–272 set out as a note under section 316 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of subsecs. (a) and (b) of this section by Pub. L. 86–435 applicable only with respect to taxable years beginning after Dec. 31, 1959, see section 2 of Pub. L. 86–435, set out as a note under section 543 of this title.

CROSS REFERENCES

Collapsible corporations, see section 341 of this title.

Limitations on assessment and collection, see section 6501 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

Returns of officers, directors, and shareholders of foreign personal holding companies, see section 6035 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 841, 542, 543, 6501 of this title.

§ 545. Undistributed personal holding company income.

(a) Definition.

For purposes of this part, the term "undistributed personal holding company income" means the taxable income of a personal holding company adjusted in the manner provided in subsections (b), (c), and (d), minus the dividends paid deduction as defined in section 561. In the case of a personal holding company which is a foreign corporation, not more than 10 percent in value of the outstanding stock of which is owned (within the meaning of section 958 (a)) during the last half of the taxable year by United States persons, the term "undistributed personal holding company income" means the amount determined by multiplying the undistributed personal holding company income (determined without regard to this sentence) by the percentage in value of its outstanding stock which is the greatest percentage in value of its outstanding stock so owned by United States persons on any one day during such period.

(b) Adjustments to taxable income.

For the purposes of subsection (a), the taxable income shall be adjusted as follows:

(1) Taxes.

There shall be allowed as a deduction Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31,

1940) and income, war profits and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4)), accrued during the taxable year or deemed to be paid by a domestic corporation under section 902(a)(1) or 960(a)(1)(C) for the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law. A taxpayer which, for each taxable year in which it was subject to the tax imposed by section 500 of the Internal Revenue Code of 1939, deducted Federal income and excess profits taxes when paid for the purpose of computing subchapter A net income under such Code, shall deduct taxes under this paragraph when paid, unless the taxpayer elects, in its return for a taxable year ending after June 30, 1954, to deduct the taxes described in this paragraph when accrued. Such an election shall be irrevocable and shall apply to the taxable year for which the election is made and to all subsequent taxable years.

(2) Charitable contributions.

The deduction for charitable contributions provided under section 170 shall be allowed, but in computing such deduction the limitations in section 170(b)(1)(A), (B), and (D) shall apply, and section 170(b)(2) and (d)(1) shall not apply. For purposes of this paragraph, the term "contribution base" when used in section 170(b)(1) means the taxable income computed with the adjustments (other than the 5-percent limitation) provided in section 170(b)(2) and (d)(1) and without deduction of the amount disallowed under paragraph (8) of this subsection.

(3) Special deductions disallowed.

The special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) Net operating loss.

The net operating loss deduction provided in section 172 shall not be allowed, but there shall be allowed as a deduction the amount of the net operating loss (as defined in section 172 (c)) for the preceding taxable year computed without the deductions provided in part VIII (except section 248) of subchapter B.

(5) Long-term capital gains.

There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) such taxes computed for such year without including such excess in taxable income.

(6) Bank affiliates.

There shall be allowed the deduction described in section 601 (relating to bank affiliates).

(7) Payment of indebtedness incurred prior to January 1, 1934.

There shall be allowed as a deduction amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred before January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness.

(8) Expenses and depreciation applicable to property of the taxpayer.

The aggregate of the deductions allowed under section 162 (relating to trade or business expenses) and section 167 (relating to depreciation), which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Secretary or his delegate) to the satisfaction of the Secretary or his delegate—

(A) that the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(B) that the property was held in the course of a business carried on bona fide for profit; and

(C) either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(9) Amount of a lien in favor of the United States.

There shall be allowed as a deduction the amount, not to exceed the taxable income of the taxpayer, of any lien in favor of the United States (notice of which has been filed as provided in section 6323 (f)) to which the taxpayer is subject at the close of the taxable year. The sum of the amounts deducted under this paragraph with respect to any lien shall, for the purposes of this section, be added to the taxable income of the taxpayer for the taxable year in which such lien is satisfied or released. Where an amount is added to the taxable income of a corporation by reason of the preceding sentence of this paragraph, the shareholders of the corporation may, pursuant to regulations prescribed by the Secretary or his delegate, elect to compute the income tax with respect to such dividends as are attributable to such amount as though they were received ratably over the period the lien was in effect.

(10) Distributions of divested stock.

There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(11) Special adjustment on disposition of antitrust stock received as a dividend.

If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(C) Paragraph (10) did not apply in respect of such distribution,

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

(c) Special adjustment to taxable income.

(1) In general.

Except as otherwise provided in this subsection, for purposes of subsection (a) there shall be allowed as a deduction amounts used, or amounts irrevocably set aside (to the extent reasonable with reference to the size and terms of the indebtedness), to pay or retire qualified indebtedness.

(2) Corporations to which applicable.

This subsection shall apply only with respect to a corporation—

(A) which for at least one of the two most recent taxable years ending before the date of the enactment of this subsection was not a personal holding company under section 542, but would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such taxable year, or

(B) to the extent that it succeeds to the deduction referred to in paragraph (1) by reason of section 381(c)(15).

(3) Qualified indebtedness.

(A) In general.

Except as otherwise provided in this paragraph, for purposes of this subsection the term "qualified indebtedness" means—

(i) the outstanding indebtedness incurred by the taxpayer after December 31, 1933, and before January 1, 1964, and

(ii) the outstanding indebtedness incurred after December 31, 1963, for the purpose of making a payment or set-aside referred to in paragraph (1) in the same taxable year, but, in the case of such a payment or set-aside which is made on or after the first day of the first taxable year beginning after December 31, 1963, only to the extent the deduction otherwise allowed in paragraph (1) with respect to such payment or set-aside is treated as nondeductible by reason of the election provided in paragraph (4).

(B) Exception.

For purposes of subparagraph (A), qualified indebtedness does not include any amounts which were, at any time after December 31, 1963, and before the payment or set-aside, owed to a person who at such time owned (or was considered as owning within the meaning of section 318(a)) more than 10 percent in value of the taxpayer's outstanding stock.

(C) Reduction for amounts irrevocably set aside.

For purposes of subparagraph (A), the qualified indebtedness with respect to a contract shall be reduced by amounts irrevocably set aside before the taxable year to pay or retire such indebtedness; and no deduction shall be allowed under paragraph (1) for payments out of amounts so set aside.

(4) Election not to deduct.

A taxpayer may elect, under regulations prescribed by the Secretary or his delegate, to treat as nondeductible an amount otherwise deductible under paragraph (1); but only if the taxpayer files such election on or before the 15th day of the third month following the close of the taxable year with respect to which such election applies, designating therein the amounts which are to be treated as nondeductible and specifying the indebtedness (referred to in paragraph (3)(A)(ii)) incurred for the purpose of making the payment or set-aside.

(5) Limitations.

The deduction otherwise allowed by this subsection for the taxable year shall be reduced by the sum of—

(A) the amount, if any, by which—

(i) the deductions allowed for the taxable year and all preceding taxable years beginning after December 31, 1963, for exhaustion, wear and tear, obsolescence, amortization, or depletion (other than such deductions which are disallowed in computing undistributed personal holding company income under subsection (b)(8)), exceed

(ii) any reduction, by reason of this subparagraph, of the deductions otherwise allowed by this subsection for such preceding taxable years, and

(B) the amount, if any, by which—

(i) the deductions allowed under subsection (b)(5) in computing undistributed personal holding company income for the taxable year and all preceding taxable years beginning after December 31, 1963, exceed

(ii) any reduction, by reason of this subparagraph, of the deductions otherwise allowed by this subsection for such preceding taxable years.

(6) Pro-rata reduction in certain cases.

For purposes of paragraph (3)(A), if property (of a character which is subject to an allowance for exhaustion, wear and tear, obsolescence, amortization, or depletion) is disposed of after December 31, 1963, the total amounts of qualified indebtedness of the taxpayer shall be reduced pro-rata in the taxable year of such disposition by the amount, if any, by which—

(A) the adjusted basis of such property at the time of such disposition, exceeds

(B) the amount of qualified indebtedness which ceased to be qualified indebtedness with respect to the taxpayer by reason of the assumption of the indebtedness by the transferee.

(d) Certain foreign corporations.

In the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), the taxable income for purposes of subsection (a) shall be the income which constitutes personal holding company income under section 543(a)(7), reduced by the deductions attributable to such income, and adjusted, with respect to such income, in the manner provided in subsection (b). (Aug. 16, 1954, ch. 736, 68A Stat. 189; Sept. 2, 1958, Pub. L. 85–866, title I, § 32 (a), (b), 72 Stat. 1631; Feb. 2, 1962, Pub. L. 87–403, § 3(d), 76 Stat. 7; Oct. 16, 1962, Pub. L. 87–834, § 9(d)(2), 76 Stat. 1001; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 207(b)(5), 209(c)(2), 225(i)(1), (2), 78 Stat. 42, 46, 90; Nov. 2, 1966, Pub. L. 89–719, title I, § 101(b)(2), 80 Stat. 1132; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(h)(3), 80 Stat. 1560; Dec. 30, 1969, Pub. L. 91–172, title II, § 201(a)(2)(B), 83 Stat. 558.)

AMENDMENTS

1969—Subsec. (b)(2). Pub. L. 91–172 substituted "section 170(b)(1)(A), (B), and (D)", "section 170(b)(2) and (d)(1)" for "section 170(b)(1)(A) and (B)" and "section 170(b)(2) and (5)", respectively, in the provisions of the first sentence setting out the sections appropriate to the computation of the deduction, and in the provisions of the second sentence describing applicability of terms for purposes of this paragraph, substituted "contribution base" and "section 170(b)(2) and (d)(1)" for "adjusted gross income" and "the first sentence of section 170(b)(2) and (5)," respectively.

1966—Subsec. (a). Pub. L. 89–809, § 104(h)(3)(A), substituted "in the manner provided in subsections (b), (c), and (d)" for "in the manner provided in subsection (b) and (c)" and added provisions governing the case of a personal holding company which is a foreign corporation, not more than 10 percent in value of the outstanding stock of which is owned (within the meaning of section 958(a)) during the last half of the taxable year by United States persons.

Subsec. (b)(9). Pub. L. 89–719 substituted "section 6323(f)" for "section 6323(a)(1), (2), or (3)."

Subsec. (d). Pub. L. 89–809, § 104(h)(3)(B), added subsec. (d).

1964—Subsec. (a). Pub. L. 88–272, § 225(i)(1), inserted the reference to subsection (c).

Subsec. (b)(1), (2). Pub. L. 88–272, §§ 207(b)(5), 209(c)(2), substituted "section 275(a)(4)" for "section 164(b)(6)" in par. (1), and inserted the reference to section 170(b)(5) in par. (2).

Subsec. (c). Pub. L. 88–272, § 225(i)(2), added subsec. (c).

1962—Subsec. (b)(1). Pub. L. 87–834 substituted "accrued during the taxable year or deemed to be paid by a domestic corporation under section 902(a)(1) or 960(a)(1)(C) for the taxable year" for "accrued during the taxable year."

Subsec. (b)(10), (11). Pub. L. 87–403 added subsec. (b)(10), (11).

1958—Subsec. (b)(2). Pub. L. 85–866, § 32(a), substituted in the first sentence ", but in computing such deduction the limitations in section 170 (b)(1)(A) and (B) shall apply, and section 170 (b) shall not apply " for "but with the limitations in section 170 (b)(1)(A) and (B) (in lieu of the limitation in section 170 (b)(2)", and inserted in the second sentence "(other than the 5-percent limitation)" and "the first sentence" following "with the adjustments" and "provided in ", respectively.

Subsec. (b)(4). Pub. L. 85–866, § 32(b), inserted "computed without the deductions provided in part VIII (except section 248) of subchapter B".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 201(g) of Pub. L. 91–172, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1966 AMENDMENTS

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

Amendment of section by Pub. L. 89–719 applicable after Nov. 2, 1966, regardless of when the title or lien of the United States arose or when the lien or interest of another person was acquired, except in a case in which a lien or title derived from enforcement of a lien held by the United States has been enforced by a civil action or suit which has become final by judgment, sale, or agreement before Nov. 2, 1966, or in a case in which the amendment would impair a priority held by any person other than the United States holding a lien or interest prior to Nov. 2, 1966, operate to increase the liability of such person, or shorten the time for bringing suit with respect to transactions occurring before Nov. 2, 1966, see section 114(a)—(e) of Pub. L. 89–719, set out as a note under section 6323 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (a) by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272 set out as a note under section 316 of this title.

Amendment of subsec. (b)(1) by Pub. L. 88–272, § 207(b)(5), applicable to taxable years beginning after Dec. 31, 1963, see section 207(c) of Pub. L. 88–272, set out as a note under section 164 of this title.

Amendment of subsec. (b)(2) by Pub. L. 88–272, § 209(c)(2), applicable to contributions paid in taxable years beginning after Dec. 31, 1963, see section 209(f)(1) of Pub. L. 88–272, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of subsec (b)(1) by Pub. L. 87–834 applicable in respect of any distribution received by a domestic corporation after Dec. 31, 1964, and in respect of any distribution received by a domestic corporation before Jan. 1, 1965, in a taxable year of such corporation beginning after Dec. 31, 1962, but only to the extent that such distribution is made out of the accumulated profits of a foreign corporation for a taxable year (of such foreign corporation) beginning after Dec. 31, 1962, see section 9(e) of Pub. L. 87–834, set out as a note under section 902 of this title.

Amendment of section by Pub. L. 87–403 applicable only with respect to distributions made after Feb. 2, 1962, see section 3(g) of Pub. L. 87–403, set out as a note under section 312 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (b) (2) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 32(c) of Pub. L. 85–866 provided that: "The amendment made by subsection (b) of this section [to subsec. (b) (4) of this section] shall apply with respect to adjustments under section 545 (b) (4) of the Internal Revenue Code of 1954 for taxable years beginning after December 31, 1957."

CROSS REFERENCES

Acquiring corporation as distributor or transferor corporation for purpose of determining applicability of subsection (b) (7) of this section, see section 381 of this title.

Charitable contributions deduction disallowed under certain circumstances when—
Made in trust, see section 681 of this title.
Made to exempt organization, see section 503 of this title.
Dividend carryover determined by making adjustments provided in this section to taxable income, see section 564 of this title.
Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.
Personal holding company dividend defined, see section 316 of this title.
Provisions respecting disposal of coal with retained economic interest as inapplicable in determining amount of deduction under subsection (b) (5) of this section, see section 631 of this title.
Rules relating to deduction for dividends paid after close of taxable year, see section 568 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 316, 333, 381, 508, 541, 564, 601, 631, 4947, 4948 of this title.

§ 546. Income not placed on annual basis.

Section 443 (b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the personal holding company tax imposed by section 541. (Aug. 16, 1954, ch. 736, 68A Stat. 191.)

CROSS REFERENCES

Accumulated earnings tax computation as not subject to section 443 (b), see section 536 of this title.
Regulated investment company taxable income computation as not subject to section 443 (b), see section 852 of this title.
Undistributed foreign personal holding company computation as not subject to section 443 (b), see section 557 of this title.

§ 547. Deduction for deficiency dividends.

(a) General rule.

If a determination (as defined in subsection (c)) with respect to a taxpayer establishes liability for personal holding company tax imposed by section 541 (or by a corresponding provision of a prior income tax law) for any taxable year, a deduction shall be allowed to the taxpayer for the amount of deficiency dividends (as defined in subsection (d)) for the purpose of determining the personal holding company tax for such year, but not for the purpose of determining interest, additional amounts, or assessable penalties computed with respect to such personal holding company tax.

(b) Rules for application of section.

(1) Allowance of deduction.

The deficiency dividend deduction shall be allowed as of the date the claim for the deficiency dividend deduction is filed.

(2) Credit or refund.

If the allowance of a deficiency dividend deduction results in an overpayment of personal holding company tax for any taxable year, credit or refund with respect to such overpayment shall be made as if on the date of the determination 2 years remained before the expiration of the period of limitation on the filing of claim for refund for the taxable year to which the overpayment relates. No interest shall be allowed on a credit or refund arising from the application of this seetion.

(c) Determination.

For purposes of this seetion, the term "determination" means—

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement made under section 7121; or

(3) under regulations prescribed by the Secretary or his delegate, an agreement signed by the Secretary or his delegate and by, or on behalf of, the taxpayer relating to the liability of such taxpayer for personal holding company tax.

(d) Deficiency dividends.

(1) Definition.

For purposes of this section, the term "deficiency dividends" means the amount of the dividends paid by the corporation on or after the date of the determination and before filing claim under subsection (e), which would have been includible in the computation of the deduction for dividends paid under section 561 for the taxable year with respect to which the liability for personal holding company tax exists, if distributed during such taxable year. No dividends shall be considered as deficiency dividends for purposes of subsection (a) unless distributed within 90 days after the determination.

(2) Effect on dividends paid deduction.

(A) For taxable year in which paid.

Deficiency dividends paid in any taxable year (to the extent of the portion thereof taken into account under subsection (a) in determining personal holding company tax) shall not be included in the amount of dividends paid for such year for purposes of computing the dividends paid deduction for such year and succeeding years.

(B) For prior taxable year.

Deficiency dividends paid in any taxable year (to the extent of the portion thereof taken into account under subsection (a) in determining personal holding company tax) shall not be allowed for purposes of section 563 (b) in the computation of the dividends paid deduction for the taxable year preceding the taxable year in which paid.

(e) Claim required.

No deficiency dividend deduction shall be allowed under subsection (a) unless (under regulations prescribed by the Secretary or his delegate) claim therefor is filed within 120 days after the determination.

(f) Suspension of statute of limitations and stay of collection.

(1) Suspension of running of statute.

If the corporation files a claim, as provided in subsection (e), the running of the statute of limitations provided in section 6501 on the making of assessments, and the bringing of distraint or a proceeding in court for collection, in respect of the deficiency and all interest, additional amounts, or assessable ponalties, shall be suspended for a poriod of 2 years after the date of the determination.

(2) Stay of collection.

In the case of any deficiency with respect to the tax imposed by section 541 established by a determination under this section—

(A) the collection of the deficiency and all interest, additional amounts, and assessable penalties shall, except in cases of jeopardy, be stayed until the expiration of 120 days after the date of the determination, and

(B) if claim for deficiency dividend deduction is filed under subsection (e), the collection of such part of the deficiency as is not reduced by the deduction for deficiency dividends provided in subsection (a) shall be stayed until the date the claim is disallowed (in whole or in part) and if disallowed in part collection shall be made only with respect to the part disallowed.

No distraint or proceeding in court shall be begun for the collection of an amount the collection of which is stayed under subparagraph (A) or (B) during the period for which the collection of such amount is stayed.

(g) Deduction denied in case of fraud, etc.

No deficiency dividend deduction shall be allowed under subsection (a) if the determination contains a finding that any part of the deficiency is due to fraud with intent to evade tax, or to wiiful failure to file an income tax return within the time prescribed by law or prescribed by the Secretary or his delegate in pursuance of law.

(h) Effective date.

Subsections (a) through (f), inclusive, shall apply only with respect to determinations made more than 90 days after the date of enactment of this title. If the taxable year with respect to which the deficiency is asserted began before January 1, 1954, the term "deficiency dividend" includes only amounts which would have been includible in the computation under the Internal Revenue Code of 1939 of the basic surtax credit for such taxable year. Subsection (g) shall apply only if the taxable year with respect to which the deficiency is asserted begins after December 31, 1953. (Aug. 16, 1954, ch. 736, 68A Stat. 191.)

CROSS REFERENCES

Distributor or transfer corporation in carryover situations as entitled to deficiency dividend deduction, see section 381 of this title.

Personal holding company dividend defined, see section 316 of this title.

Suspension of running of period of limitation, see section 6503 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 316, 381 of this title.

PART III.—FOREIGN PERSONAL HOLDING COMPANIES

Sec.
551. Foreign personal holding company income taxed to United States shareholders.
552. Definition of foreign personal holding company.
553. Foreign personal holding company income.
554. Stock ownership.
555. Gross income of foreign personal holding companies.
556. Undistributed foreign personal holding company income.
557. Income not placed on annual basis.
558. Returns of officers, directors, and shareholders of foreign personal holding companies.

AMENDMENTS

1958—Pub. L. 85–866, title I, § 33(d)(2), Sept. 2, 1958, 72 Stat. 1632, added item 558.

§ 551. Foreign personal holding company income taxed to United States shareholders.

(a) General rule.

The undistributed foreign personal holding company income of a foreign personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporations, domestic partnerships, and estates or trusts (other than estates or trusts the gross income of which under this subtitle includes only income from sources within the United States), who are shareholders in such foreign personal holding company (hereinafter called "United States shareholders") in the manner and to the extent set forth in this part.

(b) Amount included in gross income.

Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States group (as defined in section 552 (a) (2)) existed with respect to the company, shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend (determined as if any distribution in liquidation actually made in such taxable year had not been made) if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) Deduction for obligations of United States and its instrumentalities.

Each United States shareholder shall take into account in determining his income tax his proportionate share of partially tax-exempt interest on obligations described in section 35 or 242 which is included in the gross income of the company otherwise than by the application of the provisions of section 555 (b) (relating to the inclusion in the gross income of a foreign personal holding company of its distributive share of the undistributed foreign personal holding company income of another foreign personal holding company in which it is a shareholder). If the foreign personal holding company elects under section 171 to amortize the premiums on such obligations, for purposes of the preceding sentence each United States shareholder's proportionate share of such interest received by the foreign personal holding company shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 171 as is attributable to such share.

(d) Information in return.

Every United States shareholder who is required under subsection (b) to include in his gross income any amount with respect to the undistributed foreign

personal holding company income of a foreign personal holding company and who, on the last day on which a United States group existed with respect to the company, owned 5 percent or more in value of the outstanding stock of such company, shall set forth in his return in complete detail the gross income, deductions and credits, taxable income, foreign personal holding company, and undistributed foreign personal holding company income of such company.

(e) Effect on capital account of foreign personal holding company.

An amount which bears the same ratio to the undistributed foreign personal holding company income of the foreign personal holding company for its taxable year as the portion of such taxable year up to and including the last day on which a United States group existed with respect to the company bears to the entire taxable year, shall, for the purpose of determining the effect of distributions in subsequent taxable years by the corporation, be considered as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend, directly or indirectly, in the gross income of United States shareholders.

(f) Basis of stock in hands of shareholders.

The amount required to be included in the gross income of a United States shareholder under subsection (b) shall, for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of 6 years after the date prescribed by law for filing the return.

(g) Cross references.

(1) For basis of stock or securities in a foreign personal holding company acquired from a decedent, see section 1014 (b) (5).

(2) For period of limitation on assessment and collection without assessment, in case of failure to include in gross income the amount properly includible therein under subsection (b), see section 6501.

(3) For treatment of gain on liquidation of certain foreign personal holding companies, see section 342.

(Aug. 16, 1954, ch. 736, 68A Stat. 193; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(f)(4), 78 Stat. 88.)

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–272 inserted "(determined as if any distribution in liquidation actually made in such taxable year had not been made)."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section Pub. L. 88–272 applicable to distributions made in any taxable year of the distributing corporation beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272, set out as a note under section 316 of this title.

CROSS REFERENCES

Adjustments to basis, see section 1016 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 951, 1016, 6501 of this title.

§ 552. Definition of foreign personal holding company.

(a) General rule.

For purposes of this subtitle, the term "foreign personal holding company" means any foreign corporation if—

(1) Gross income requirement.

At least 60 percent of its gross income (as defined in section 555 (a)) for the taxable year is foreign personal holding company income as defined in section 553; but if the corporation is a foreign personal holding company with respect to any taxable year ending after August 26, 1937, then, for each subsequent taxable year, the minimum percentage shall be 50 percent in lieu of 60 percent, until a taxable year during the whole of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 50 percent of the gross income is foreign personal holding company income. For purposes of this paragraph, there shall be included in the gross income the amount includible therein as a dividend by reason of the application of section 555 (c) (2); and

(2) Stock ownership requirement.

At any time during the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States, hereinafter called "United States group".

(b) Exceptions.

The term "foreign personal holding company" does not include—

(1) a corporation exempt from tax under subchapter F (sec. 501 and following); and

(2) a corporation organized and doing business under the banking and credit laws of a foreign country if it is established (annually or at other periodic intervals) to the satisfaction of the Secretary or his delegate that such corporation is not formed or availed of for the purpose of evading or avoiding United States income taxes which would otherwise be imposed upon its shareholders. If the Secretary or his delegate is satisfied that such corporation is not so formed or availed of, he shall issue to such corporation annually or at other periodic intervals a certification that the corporation is not a foreign personal holding company.

Each United States shareholder of a foreign corporation which would, except for the provisions of paragraph (2), be a foreign personal holding company, shall attach to and file with his income tax return for the taxable year a copy of the certification by the Secretary or his delegate made pursuant to paragraph (2). Such copy shall be filed with the taxpayer's return for the taxable year if he has been a shareholder of such corporation for any part of such year. (Aug. 16, 1954, ch. 736, 68A Stat. 195.)

CROSS REFERENCES

Accumulated earnings tax as inapplicable to foreign personal holding company defined in this section, see section 532 of this title.

Election as to taxable and partially taxable bonds under provisions respecting amortizable bond premium in case of bonds held by foreign personal holding company as defined in this section, see section 171 of this title.

Liquidation of certain foreign personal holding companies, see section 342 of this title.

Personal holding company as excluding foreign personal holding company, see section 542 of this title.

Returns of officers, directors, and shareholders of foreign personal holding companies, see section 6035 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 171, 342, 532, 542, 551, 553, 554, 555, 562, 1212 of this title.

§ 553. Foreign personal holding company income.

(a) Foreign personal holding company income.

For purposes of this subtitle, the term "foreign personal holding company income" means that portion of the gross income, determined for purposes of section 552, which consists of:

(1) Dividends, etc.

Dividends, interest, royalties, and annuities. This paragraph shall not apply to a dividend distribution of divested stock (as defined in subsection (e) of section 1111) but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(2) Stock and securities transactions.

Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

(3) Commodities transactions.

Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This paragraph shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

(4) Estates and trusts.

Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries); and gains from the sale or other disposition of any interest in an estate or trust.

(5) Personal service contracts.

(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(6) Use of corporation property by shareholder.

Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has foreign personal holding company income for the taxable year, computed without regard to this paragraph and paragraph (7), in excess of 10 percent of its gross income.

(7) Rents.

Rents, unless constituting 50 percent or more of the gross income. For purposes of this paragraph, the term "rents" means compensation, however designated, for the use of, or right to use, property, but does not include amounts constituting foreign personal holding company income under paragraph (6).

(b) Limitation on gross income in certain transactions.

For purposes of this part—

(1) gross income and foreign personal holding company income determined wih respect to transactions described in subsection (a) (2) (relating to gains from stock and security transactions) shall include only the excess of gains over losses from such transactions, and

(2) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a) (3) (relating to gains from commodity transactions) shall include only the excess of gains over losses from such transactions.

(Aug. 16, 1954, ch. 736, 68A Stat. 195; Apr. 22, 1960, Pub. L. 86–435, § 1(e), 74 Stat. 78; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(e), 78 Stat. 85.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272 designated existing provisions as subsec. (a), and substituted pars. (1)—(7) for "personal holding company income, as defined in section 543, except that all interest, whether or not treated as rent, and all royalties, whether or not mineral, oil, or gas royalties or copyright royalties, shall constitute "foreign personal holding company income."

Subsec. (b). Pub. L. 88–272 added subsec. (b).

1960—Pub. L. 86–435 included copyright royalties within foreign personal holding company income.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272 set out as a note under section 316 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–435 applicable only with respect to taxable years beginning after Dec. 31, 1959, see section 2 of Pub. L. 86–435, set out as a note under section 543 of this title.

CROSS REFERENCES

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 552, 554, 954 of this title.

§ 554. Stock ownership.

(a) Constructive ownership.

For purposes of determining whether a corporation is a foreign personal holding company, insofar as such determination is based on stock ownership under section 552(a)(2), section 553(a)(5), or section 553(a)(6)—

(1) Stock not owned by individual.

Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) Family and partnership ownership.

An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For purposes of this paragraph, the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) Options.

If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) Application of family-partnership and option rules.

Paragraphs (2) and (3) shall be applied—

(A) for purposes of the stock ownership requirement provided in section 552(a)(2), if, but only if, the effect is to make the corporation a foreign personal holding company;

(B) for purposes of section 553(a)(5) (relating to personal service contracts) or of section 553(a)(6) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

(5) Constructive ownership as actual ownership.

Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

(6) Option rule in lieu of family and partnership rule.

If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

(b) Convertible securities.

Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

(1) for purposes of the stock ownership requirement provided in section 552(a)(2), but only if the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company;

(2) for purposes of section 553(a)(5) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income; and

(3) for purposes of section 553(a)(6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included. (Aug. 16, 1954, ch. 736, 68A Stat. 196; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(e), 78 Stat. 86.)

AMENDMENTS

1964—Pub. L. 88–272 amended section generally by designating existing provisions as subsec. (a), and substituting pars. (1)—(6) therein and subsec. (b), for provisions which incorporated by reference substantially the same provisions as in such pars. (1)—(6) and subsec. (b).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272 set out as a note under section 316 of this title.

CROSS REFERENCES

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

§ 555. Gross income of foreign personal holding companies.

(a) General rule.

For purposes of this part, the term "gross income" means, with respect to a foreign corporation, gross income computed (without regard to the provisions of subchapter N (sec. 861 and following)) as if the foreign corporation were a domestic corporation which is a personal holding company.

(h) Additions to gross income.

In the case of a foreign personal holding company (whether or not a United States group, as defined in section 552 (a) (2), existed with respect to such company on the last day of its taxable year) which was a shareholder in another foreign personal holding company on the day in the taxable year of the second company which was the last day on which a United States group existed with respect to the

second company, there shall be included, as a dividend, in the gross income of the first company, for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend if on such last day there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) Application of subsection (b).

The rule provided in subsection (b)—

(1) shall be applied in the case of a foreign personal holding company for the purpose of determining its undistributed foreign personal holding company income which, or a part of which, is to be included in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies;

(2) shall be applied in the case of every foreign corporation with respect to which a United States group exists on some day of its taxable year, for the purpose of determining whether such corporation meets the gross income requirements of section 552 (a) (1).

(Aug. 16, 1954, ch. 736, 68A Stat. 196.)

CROSS REFERENCES

Charitable contributions adjustment to taxable income, see section 556 of this title.

Deduction for obligations of United States and its instrumentalities, see section 551 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 551, 552, 556, 6035 of this title.

§ 556. Undistributed foreign personal holding company income.

(a) Definition.

For purposes of this part, the term "undistributed foreign personal holding company income" means the taxable income of a foreign personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561).

(b) Adjustments to taxable income.

For the purposes of subsection (a), the taxable income shall be adjusted as follows:

(1) Taxes.

There shall be allowed as a deduction Federal income and excess profits taxes (other than the excess profits tax imposed by subehapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war profits, and excess-profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4)), accrued during the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law. A taxpayer which, for each taxable year in which it was subject to the provisions of supplement P of the Internal Revenue Code of 1939, deducted Federal income and excess profits taxes when paid for the purpose of computing undistributed supplement P net income under such code, shall deduct taxes under this paragraph when paid, unless the corporation elects, under regulations prescribed by the Secretary or his delegate, after the date of enactment of this title to deduct the taxes described in this paragraph when accrued. Such election shall be irrevocable and shall apply to the taxable year for which the election is made and to all subsequent taxable years.

(2) Charitable contributions.

The deduction for charitable contributions provided under section 170 shall be allowed, but in computing such deduction the limitations in section 170(b)(1)(A), (B), and (D) shall apply, and section 170(b)(2) and (d)(1) shall not apply. For purposes of this paragraph, the term "contribution base" when used in section 170(b)(1) means the taxable income computed with the adjustments (other than the 5-percent limitation) provided in section 170(b)(2) and (d)(1) and without the deduction of the amounts disallowed under paragraphs (5) and (6) of this subsection or the inclusion in gross income of the amounts includible therein as dividends by reason of the application of the provisions of section 555(b) (relating to the inclusion in gross income of a foreign personal holding company of its distributive share of the undistributed foreign personal holding company income of another company in which it is a shareholder).

(3) Special deductions disallowed.

The special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) Net operating loss.

The net operating loss deduction provided in section 172 shall not be allowed, but there shall be allowed as a deduction the amount of the net operating loss (as defined in section 172 (c)) for the preceding taxable year computed without the deductions provided in part VIII (except section 248) of subchapter B.

(5) Expenses and depreciation applicable to property of the taxpayer.

The aggregate of the deductions allowed under section 162 (relating to trade or business expenses) and section 167 (relating to depreciation) which are allocable to the operation and maintenance of property owned or operated by the company, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Secretary or his delegate) to the satisfaction of the Secretary or his delegate—

(A) that the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(B) that the property was held in the course of a business carried on bona fide for profit; and

(C) either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(6) Taxes and contributions to pension trusts.

The deductions provided in section 164 (e) (relating to taxes of a shareholder paid by the corporation) and in section 404 (relating to pension, etc., trusts) shall not be allowed.

(7) Distributions of divested stock.

There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(8) Special adjustment on disposition of antitrust stock received as a dividend.

If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(C) paragraph (7) did not apply in respect of such distribution,

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegato, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

(Aug. 16, 1954, ch. 736, 68A Stat. 196; Sept. 2, 1958, Pub. L. 85–866, title I, § 33(a), (b) (1), (c) (1), 72 Stat. 1632; Feb. 2, 1962, Pub. L. 87–403, § 3(e), 76 Stat. 7; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 207 (b)(6), 209(c)(2), 78 Stat. 42, 46; Dec. 30, 1969, Pub. L. 91–172, title II, § 201(a)(2)(B), 83 Stat. 558.)

AMENDMENTS

1969—Subsec. (b)(2). Pub. L. 91–172 substituted "section 170(b)(1) (A), (B), and (D)" and "section 170(b)(2) and (d)(1)" for "section 170(b)(1) (A) and (B)" and "section 170(b)(2) and (5)" respectively in the provisions of the first sentence setting out the sections appropriate to the computation of the deduction, and in the provisions of the second sentence describing applicability of terms for purposes of this paragraph, substituted "contribution base" and "section 170(b)(2) and (d)(1)" for "adjusted gross income" and "the first sentence of section 170(b)(2) and (5)", respectively.

1964—Subsec. (b) (1), (2). Pub. L. 88–272 substituted "section 275(a)(4)" for section 164(b)(6)" in par. (1), and inserted the reference to section 170(b)(5) in par. (2).

1962—Subsec. (b)(7), (8). Pub. L. 87–403 added subsec. (b)(7), (8).

1958—Subsec. (b)(2). Pub. L. 85–866, § 33(a) (1) (2), substituted in the first sentence "but in computing such deduction the limitations in section 170 (b) (1) (A) and (B) shall apply, and section 170 (b) (2) shall not apply" for "but with the limitation in section 170 (b) (1) (A) and (B) (in lieu of the limitation in section 170 (b) (2))" and in the second sentence "the taxable income computed with the adjustments (other than the 5-percent limitation) provided in the first sentence of section 170 (b) (2) for "the taxable income computed with the adjustments provided in section 170 (b) (2)".

Subsec. (b)(3). Pub. L. 85–866, § 33 (b)(1), substituted "section 248" for "sections 242 and 248."

Subsec. (b)(4). Pub. L. 85–866, § 33 (c)(1), inserted "computed without the deductions provided in part VIII (except section 248) of subchapter B".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 201(g) of Pub. L. 91–172, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (b)(1) by Pub. L. 88–272, § 207 (b)(6), applicable to taxable years beginning after Dec. 31, 1963, see section 207(c) of Pub. L. 88–272, set out as a note under section 164 of this title.

Amendment of subsec. (b)(2) by Pub. L. 88–227, § 209 (c)(2), applicable to contributions paid in taxable years beginning after Dec. 31, 1963, see section 209(f)(1) of Pub. L. 88–272, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of this section by Pub. L. 87–403 applicable only with respect to distribution made after Feb. 2, 1962, see section 3(g) of Pub. L. 87–403, set out as a note under section 312 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (b) (2) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 33 (b) (2) of Pub. L. 85–866 provided that: "The amendment made by paragraph (1) [to subsec (b) (3) of this section] shall apply only with respect to taxable years ending after December 31, 1957."

Section 33 (c) (2) of Pub. L. 85–866 provided that: "The amendment made by paragraph (1) [to subsec. (b) (4) of this section] shall apply with respect to adjustments under section 556 (b) (4) of the Internal Revenue Code of 1954 for taxable years ending after December 31, 1957."

CROSS REFERENCES

Provisions for computation of tax on change of annual accounting period upon making returns for period less than 12 months as inapplicable in computation of tax imposed by this section, see section 557 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 508, 557, 4947, 4948 of this title.

§ 557. Income not placed on annual basis.

Section 443 (b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the undistributed foreign personal holding company income under section 556. (Aug. 16, 1954, ch. 736, 68A Stat. 198.)

CROSS REFERENCES

Accumulated earnings tax computation as not subject to section 443 (b), see section 536 of this title.

Personal holding company tax computation as not subject to section 443 (b), see section 546 of this title.

Regulated investment company taxable income computation as not subject to section 443 (b), see section 852 of this title.

§ 558. Retnrns of officers, directors, and shareholders of foreign personal holding companies.

For provisions relating to returns of officers, directors, and shareholders of foreign personal holding companies, see section 6035.

(Added Pub. L. 85–866, title I, § 33 (d) (1), Sept. 2, 1958, 72 Stat. 1632.)

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

PART IV.—DEDUCTION FOR DIVIDENDS PAID

Sec.
561. Definition of deduction for dividends paid.
562. Rules applicable in determining dividends eligible for dividends paid deduction.
563. Rules relating to dividends paid after close of taxable year.
564. Dividend carryover.
565. Consent dividends.

§ 561. Definition of deduction for dividends paid.

(a) General rule.

The deduction for dividends paid shall be the sum of—

(1) the dividends paid during the taxable year,

(2) the consent dividends for the taxable year (determined under section 565), and

(3) in the case of a personal holding company, the dividend carryover described in section 564.

(b) Special rules applicable.

(1) In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.

(2) If a corporation received antitrust stock (as defined in section 301(f) in a distribution to which section 301 applied and such corporation distributes such stock (or other property the basis of which is determined by reference to the basis of such stock) to its shareholders, proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the amount of the deduction provided for in subsection (a).

(Aug. 16, 1954, ch. 736, 68A Stat. 198; Feb. 2, 1962, Pub. L. 87–403, § 3(f), 76 Stat. 8.)

AMENDMENTS

1962—Subsec. (b). Pub. L. 87–403 designated existing provisions as par. (1) and added par. (2).

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of this section by Pub. L. 87–403 applicable only with respect to distributions made after Feb. 2, 1962, see section 3(g) of Pub. L. 37–403, set out as a note under section 312 of this title.

CROSS REFERENCES

Accumulated taxable income as taxable income minus, among others, dividends paid deduction, and accumulated earnings credit as related to dividends paid deduction, see section 535 of this title.

Deductions of dividends paid on certain preferred stock as reducing deduction for dividends paid under this section, see section 583 of this title.

Deficiency dividend deduction of personal holding companies, see section 547 of this title.

Taxation of regulated investment companies and their shareholders, see section 852 of this title.

Undistributed foreign personal holding company income as taxable income minus, among others, dividends paid deduction, see section 556 of this title.

Undistributed personal holding company income as taxable income minus, among others, dividends paid deduction, see section 545 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 535, 545, 547, 564, 565, 583, 852, 857 of this title.

§ 562. Rules applicable in determining dividends eligible for dividends paid deduction.

(a) General rule.

For purposes of this part, the term "dividend" shall, except as otherwise provided in this section, include only dividends described in section 316 (relating to definition of dividends for purposes of corporate distributions).

(b) Distributions in liquidation.

(1) Except in the case of a personal holding company described in section 542 or a foreign personal holding company described in section 552—

(A) in the case of amounts distributed in liquidation, the part of such distribution which is properly chargeable to earnings and profits accumulated after February 28, 1913, shall be treated as a dividend for purposes of computing the dividends paid deduction, and

(B) in the case of a complete liquidation occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction.

(2) In the case of a complete liquidation of a personal holding company, occurring within 24 months after the adoption of a plan of liquidation, the amount of any distribution within such period pursuant to such plan shall be treated as a dividend for purposes of computing the dividends paid deduction, to the extent that such amount is distributed to corporate distributees and represents such corporate distributees' allocable share of the undistributed personal holding company income for the taxable year of such distribution computed without regard to this paragraph and without regard to subparagraph (B) of section 316(b)(2).

(c) Preferential dividends.

The amount of any distribution shall not be considered as a dividend for purposes of computing the dividends paid deduction, unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

(d) Distributions by a member of an affiliated group.

In the case where a corporation which is a member of an affiliated group of corporations filing or required to file a consolidated return for a taxable year is required to file a separate personal holding company schedule for such taxable year, a distribution by such corporation to another member of the affiliated group shall be considered as a dividend for purposes of computing the dividends paid deduction if such distribution would constitute a dividend under the other provisions of this section to a re-

cipient which is not a member of an affiliated group. (Aug. 16, 1954, ch. 736, 68A Stat. 198; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(f)(3), 78 Stat. 88.)

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–272 designated existing provisions as subpars. (A) and (B) of par. (1), excepted personal holding companies in section 542, and foreign personal holding companies in section 552 therefrom, and added par. (2).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section Pub. L. 88–272 applicable to distributions made in any taxable year of the distributing corporation beginning after Dec. 31, 1963, see section 225(1) of Pub. L. 88–272, set out as a note under section 316 of this title.

CROSS REFERENCES

Limitations on consent dividends, see section 565 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

Partial liquidation defined, see section 346 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 316, 346, 543, 561, 563, 565, 852 of this title.

§ 563. Rules relating to dividends paid after close of taxable year.

(a) Accumulated earnings tax.

In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall be considered as paid during such taxable year.

(b) Personal holding company tax.

In the determination of the dividends paid deduction for purposes of the personal holding company tax imposed by section 541, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the taxpayer elects in its return for the taxable year, be considered as paid during such taxable year. The amount allowed as a dividend by reason of the application of this subsection with respect to any taxable year shall not exceed either—

(1) The undistributed personal holding company income of the corporation for the taxable year, computed without regard to this subsection, or

(2) 20 percent of the sum of the dividends paid during the taxable year, computed without regard to this subsection.

(c) Dividends considered as paid on last day of taxable year.

For the purpose of applying section 562 (a), with respect to distributions under subsection (a) or (b) of this section, a distribution made after the close of a taxable year and on or before the 15th day of the third month following the close of the taxable year shall be considered as made on the last day of such taxable year. (Aug. 16, 1954, ch. 736, 68A Stat. 199; Dec. 30, 1969, Pub. L. 91–172, title IX, § 914(a), 83 Stat. 823.)

AMENDMENTS

1969—Subsec. (b)(2). Pub. L. 91–172 substituted "20 percent" for "10 percent".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 914(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 1969."

CROSS REFERENCES

Accumulated earnings credit reduced under certain circumstances by dividends paid after close of taxable year but considered as paid during taxable year, see section 535 of this title.

Deficiency dividend deduction of personal holding companies, see section 547 of this title.

Personal holding company dividend defined, see section 316 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 316, 535, 543, 547, 561 of this title.

§ 564. Dividend carryover.

(a) General rule.

For purposes of computing the dividends paid deduction under section 561, in the case of a personal holding company the dividend carryover for any taxable year shall be the dividend carryover to such taxable year, computed as provided in subsection (b), from the two preceding taxable years.

(b) Computation of dividend carryover.

The dividend carryover to the taxable year shall be determined as follows:

(1) For each of the 2 preceding taxable years there shall be determined the taxable income computed with the adjustments provided in section 545 (whether or not the taxpayer was a personal holding company for either of such preceding taxable years), and there shall also be determined for each such year the deduction for dividends paid during such year as provided in section 561 (but determined without regard to the dividend carryover to such year).

(2) There shall be determined for each such taxable year whether there is an excess of such taxable income over such deduction for dividends paid or an excess of such deduction for dividends paid over such taxable income, and the amount of each such excess.

(3) If there is an excess of such deductions for dividends paid over such taxable income for the first preceding taxable year, such excess shall be allowed as a dividend carryover to the taxable year.

(4) If there is an excess of such deduction for dividends paid over such taxable income for the second preceding taxable year, such excess shall be reduced by the amount determined in paragraph (5), and the remainder of such excess shall be allowed as a dividend carryover to the taxable year.

(5) The amount of the reduction specified in paragraph (4) shall be the amount of the excess of the taxable income, if any, for the first preceding taxable year over such deduction for dividends paid, if any, for the first preceding taxable year.

(c) Determination of dividend carryover from taxable years to which this subtitle does not apply.

In a case where the first or second preceding taxable year began before the taxpayer's first taxable year under this subtitle, the amount of the dividend carryover to taxable years to which this

subtitle applies shall be determined under the provisions of the Internal Revenue Code of 1939.
(Aug. 16, 1954, ch. 736, 63A Stat. 200.)

CROSS REFERENCES

Items of distributor or transferor corporation in carryover situations as including dividend carryover described in this section, see section 381 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 381, 561 of this title.

§ 565. Consent dividends.

(a) General rule.

If any person owns consent stock (as defined in subsection (f) (1)) in a corporation on the last day of the taxable year of such corporation, and such person agrees, in a consent filed with the return of such corporation in accordance with regulations prescribed by the Secretary or his delegate, to treat as a dividend the amount specified in such consent, the amount so specified shall, except as provided in subsection (b), constitute a consent dividend for purposes of section 561 (relating to the deduction for dividends paid).

(b) Limitations.

A consent dividend shall not include—

(1) an amount specified in a consent which, if distributed in money, would constitute, or be part of, a distribution which would be disqualified for purposes of the dividends paid deduction under section 562 (c) (relating to preferential dividends), or

(2) an amount specified in a consent which would not constitute a dividend (as defined in section 316) if the total amounts specified in consents filed by the corporation had been distributed in money to shareholders on the last day of the taxable year of such corporation.

(c) Effect of consent.

The amount of a consent dividend shall be considered, for purposes of this title—

(1) as distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation, and

(2) as contributed to the capital of the corporation by the shareholder on such day.

(d) Consent dividends and other distributions.

If a distribution by a corporation consists in part of consent dividends and in part of money or other property, the entire amount specified in the consents and the amount of such money or other property shall be considered together for purposes of applying this title.

(e) Nonresident aliens and foreign corporations.

In the case of a consent dividend which, if paid in money would be subject to the provisions of section 1441 (relating to withholding of tax on nonresident aliens) or section 1442 (relating to withholding of tax on foreign corporations), this section shall not apply unless the consent is accompanied by money, or such other medium of payment as the Secretary or his delegate may by regulations authorize, in an amount equal to the amount that would be required to be deducted and withheld under sections 1441 or 1442 if the consent dividend had been, on the last day of the taxable year of the corporation, paid to the shareholder in money as a dividend. The amount accompanying the consent shall be credited against the tax imposed by this subtitle on the shareholder.

(f) Definitions.

(1) Consent stock.

Consent stock, for purposes of this section, means the class or classes of stock entitled, after the payment of preferred dividends, to a share in the distribution (other than in complete or partial liquidation) within the taxable year of all the remaining earnings and profits, which share constitutes the same proportion of such distribution regardless of the amount of such distribution.

(2) Preferred dividends.

Preferred dividends, for purposes of this section, means a distribution (other than in complete or partial liquidation), limited in amount, which must be made on any class of stock before a further distribution (other than in complete or partial liquidation) of earnings and profits may be made within the taxable year.

(Aug. 16, 1954, ch. 736, 68A Stat. 200.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 543, 561 of this title.

Subchapter H.—Banking Institutions

Part
I. Rules of general application to banking institutions.
II. Mutual savings banks, etc.
III. Bank affiliates.

PART I.—RULES OF GENERAL APPLICATION TO BANKING INSTITUTIONS

Sec.
581. Definition of bank.
582. Bad debts, losses, and gains with respect to securities held by financial institutions.
583. Deductions of dividends paid on certain preferred stock.
584. Common trust funds.
585. Reserves for losses on loans of banks.
586. Reserves for losses on loans of small business investment companies, etc.

AMENDMENTS

1969—Pub. L. 91-172, title IV, § 431(c)(2), Dec. 30, 1969, 83 Stat. 620, substituted "Bad debts, losses, and gains with respect to securities held by financial institutions", for "Bad debt and loss deduction with respect to securities held by banks" in item 582, and added items 585 and 586.

§ 581. Definition of bank.

For purposes of sections 582 and 584, the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the Currency, and which is subject by law to supervision and examination by State, Territorial, or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

(Aug. 16, 1954, ch. 736, 68A Stat. 202; Sept. 28, 1962, Pub. L. 87-722, § 5, 76 Stat. 670.)

AMENDMENTS

1962—Pub. L. 87-722 substituted "authority of the Comptroller of the Currency" for "section 11(k) of the Federal Reserve Act (38 Stat. 262; 12 U.S.C. 248(k)."

CROSS REFERENCES

Debts owed by political parties, etc., deduction of, see section 271 of this title.

Personal holding company as excluding bank as defined in this section, see section 542 of this title.

Returns of banks with respect to common trust funds, see section 6032 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 271, 279, 542, 585, 586, 593, 4912, 4914, 6032, 6223, 6323, 7512 of this title.

§ 582. Bad debts, losses, and gains with respect to securities held by financial institutions.

(a) Securities.

Notwithstanding sections 165 (g) (1) and 166 (e), subsections (a), (b), and (c) of section 166 (relating to allowance of deduction for bad debts) shall apply in the case of a bank to a debt which is evidenced by a security as defined in section 165 (g) (2) (C).

(b) Worthless stock in affiliated bank.

For purposes of section 165 (g) (1), where the taxpayer is a bank and owns directly at least 80 percent of each class of stock of another bank, stock in such other bank shall not be treated as a capital asset.

(c) Bond, etc., losses and gains of financial institutions.

(1) General rule.

For purposes of this subtitle, in the case of a financial institution to which section 585, 586, or 593 applies, the sale or exchange of a bond, debenture, note, or certificate or other evidence of indebtedness shall not be considered a sale or exchange of a capital asset.

(2) Transitional rule for banks.

In the case of a bank, if the net long-term capital gains of the taxable year from sales or exchanges of qualifying securities exceed the net short-term capital losses of the taxable year from such sales or exchanges, such excess shall be considered as gain from the sale of a capital asset held for more than 6 months to the extent it does not exceed the net gain on sales and exchanges described in paragraph (1).

(3) Special rules.

For purposes of this subsection—

(A) The term "qualifying security" means a bond, debenture, note, or certificate or other evidence of indebtedness held by a bank on July 11, 1969.

(B) The amount treated as capital gain or loss from the sale or exchange of a qualifying security shall be determined by multiplying the amount of capital gain or loss from the sale or exchange of such security (determined without regard to this subsection) by a fraction, the numerator of which is the number of days before July 12, 1969, that such security was held by the bank, and the denominator of which is the number of days the security was held by the bank.

(Aug. 16, 1954, ch. 736, 68A Stat. 202; Sept. 2, 1958, Pub. L. 85-866, title I, § 34, 72 Stat. 1632; Dec. 30, 1969, Pub. L. 91-172, title IV, § 433(a), (c), 83 Stat. 623, 624.)

AMENDMENTS

1969—Pub. L. 91-172, § 433(c), substituted "Bad debts, losses, and gains with respect to securities held by financial institutions" for "Bad debt and loss deduction with respect to securities held by banks" in the section catchline.

Subsec. (c). Pub. L. 91-172, § 433(a), redesignated existing provisions as par. (1), expanded the provisions by reference to sections 585, 586 and 593 in par. (1) as redesignated, and added pars. (2) and (3).

1958—Subsec. (c). Pub. L. 85-866 deleted "with interest coupons or in registered form," preceding "exceed the gains".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 433(d) of Pub. L. 91-172 provided that:

"(1) In general.—The amendments made by this section [amending subsec. (c) of this section and section 1243(1) of this title] shall apply to taxable years beginning after July 11, 1969.

"(2) Election for small business investment companies and business development corporations.—Notwithstanding paragraph (1), in the case of a financial institution described in section 586(a) of the Internal Revenue Code of 1954 [section 586(a) of this title], the amendments made by this section [amending subsec. (c) of this section and section 1243(1) of this title] shall not apply for its taxable years beginning after July 11, 1969, and before July 11, 1974, unless the taxpayer so elects at such time and in such manner as shall be prescribed by the Secretary of the Treasury or his delegate. Such election shall be irrevocable and shall apply to all such taxable years."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (c) of this section by Pub. L. 85-866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85-866, set out as a note under section 165 of this title.

CROSS REFERENCES

Bonds and other evidences of indebtedness, sale or exchange, see section 1232 of this title.

Capital asset defined, see section 1221 of this title.

Dealers in securities, see section 1236 of this title.

Definition of bank, see section 581 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 581, 1236 of this title.

§ 583. Deductions of dividends paid on certain preferred stock.

In computing the taxable income of any national banking association, or of any bank or trust company organized under the laws of any State, Territory, possession of the United States, or the Canal Zone, or of any other banking corporation engaged in the business of industrial banking and under the supervision of a State banking department or of the Comptroller of the Currency, or of any incorporated domestic insurance company, there shall be allowed as a deduction from gross income, in addition to deductions otherwise provided for in this subtitle, any dividend (not including any distribution in liquidation) paid, within the taxable year, to the United States or to any instrumentality thereof exempt from Federal income taxes, on the preferred stock of the corporation owned by the United States or such instrumentality. The amount allowable as a deduction under this section shall reduce the deduction for dividends paid otherwise computed under section 561. (Aug. 16, 1954, ch. 736, 68A Stat. 202.)

§ 584. Common trust funds.

(a) Definitions.

For purposes of this subtitle, the term "common trust fund" means a fund maintained by a bank—

(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executer, administrator, or guardian; and

(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

(b) Taxation of common trust funds.

A common trust fund shall not be subject to taxation under this chapter and for purposes of this chapter shall not be considered a corporation.

(c) Income of participants in fund.

(1) Inclusions in taxable income.

Each participant in the common trust fund in computing its taxable income shall include, whether or not distributed and whether or not distributable—

(A) as part of its gains and losses from sales or exchanges of capital assets held for not more than 6 months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for not more than 6 months;

(B) as part of its gains and losses from sales or exchanges of capital assets held for more than 6 months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for more than 6 months;

(C) its proportionate share of the ordinary taxable income or the ordinary net loss of the common trust fund, computed as provided in subsection (d).

(2) Dividends and partially tax exempt interest.

The proportionate share of each participant in the amount of dividends to which section 116 applies, and in the amount of partially tax exempt interest on obligations described in section 35 or section 242, received by the common trust fund shall be considered for purposes of such sections as having been received by such participant. If the common trust fund elects under section 171 (relating to amortizable bond premium) to amortize the premium on such obligations, for purposes of the preceding sentence the proportionate share of the participant of such interest received by the common trust fund shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 171 as is attributable to such share.

(d) Computation of common trust fund income.

The taxable income of a common trust fund shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(1) there shall be segregated the gains and losses from sales or exchanges of capital assets;

(2) after excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) an ordinary taxable income which shall consist of the excess of the gross income over deductions; or

(B) an ordinary net loss which shall consist of the excess of the deductions over the gross income;

(3) the deduction provided by section 170 (relating to charitable, etc., contributions and gifts) shall not be allowed; and

(4) the standard deduction provided in section 141 shall not be allowed.

(e) Admission and witbdrawal.

No gain or loss shall be realized by the common trust fund by the admission or withdrawal of a participant. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by the participant.

(f) Different taxable years of common trust fund and participant.

If the taxable year of the common trust fund is different from that of a participant, the inclusions with respect to the taxable income of the common trust fund, in computing the taxable income of the participant for its taxable year, shall be based upon the taxable income of the common trust fund for any taxable year of the common trust fund ending within or with the taxable year of the participant.

(g) Net operating loss deduction.

The benefit of the deduction for net operating losses provided by section 172 shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Secretary or his delegate. (Aug. 16, 1954, ch. 736, 68A Stat. 203; Sept. 28, 1962, Pub. L. 87–722, § 4, 76 Stat. 670; Feb. 26, 1964, Pub. L. 88–272, title II, § 201(d)(5), 78 Stat. 32.)

AMENDMENTS

1964—Subsec. (c)(2). Pub. L. 88–272 deleted "section 34 or" preceding "section 116 applies."

1962—Subsec. (a)(2). Pub. L. 87–722 inserted "or the Comptroller of the Currency" after "the Board of Governors of the Federal Reserve System."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable with respect to dlvidends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 171, 581, 851, 4920 of this title.

§ 585. Reserves for losses on loans of banks.

(a) Institutions to which section applies.

This section shall apply to the following financial institutions:

(1) any bank (as defined in section 581) other than an organization to which section 593 applies, and

(2) any corporation to which paragraph (1) would apply except for the fact that it is a foreign corporation, and in the case of any such foreign corporation this section shall apply only with respect to loans outstanding the interest on which is

effectively connected with the conduct of a banking business within the United States.

(b) Addition to reserves for bad debts.

(1) General rule.

For purposes of section 166(c), the reasonable addition to the reserve for bad debts of any financial institution to which this section applies shall be an amount determined by the taxpayer which shall not exceed the greater of—

(A) for taxable years beginning before 1988 the addition to the reserve for losses on loans determined under the percentage method as provided in paragraph (2), or

(B) the addition to the reserve for losses on loans determined under the experience method as provided in paragraph (3).

(2) Percentage method.

The amount determined under this paragraph for a taxable year shall be the amount necessary to increase the balance of the reserve for losses on loans (at the close of the taxable year) to the allowable percentage of eligible loans outstanding at such time, except that—

(A) If the reserve for losses on loans at the close of the base year is less than the allowable percentage of eligible loans outstanding at such time, the amount determined under this paragraph with respect to the difference shall not exceed one-fifth of such difference.

(B) If the reserve for losses on loans at the close of the base year is not less than the allowable percentage of eligible loans outstanding at such time, the amount determined under this paragraph shall be the amount necessary to increase the balance of the reserve at the close of the taxable year to (i) the allowable percentage of eligible loans outstanding at such time, or (ii) the balance of the reserve at the close of the base year, whichever is greater, but if the amount of eligible loans outstanding at the close of the taxable year is less than the amount of such loans outstanding at the close of the base year, the amount determined under clause (ii) shall be the amount necessary to increase the balance of the reserve at the close of the taxable year to the amount which bears the same ratio to eligible loans outstanding at the close of the taxable year as the balance of the reserve at the close of the base year bears to the amount of eligible loans outstanding at the close of the base year.

For purposes of this paragraph, the term "allowable percentage" means 1.8 percent for taxable years beginning before 1976; 1.2 percent for taxable years beginning after 1975 but before 1982; and 0.6 percent for taxable years beginning after 1981. The amount determined under this paragraph shall not exceed 0.6 percent of eligible loans outstanding at the close of the taxable year or an amount sufficient to increase the reserve for losses on loans to 0.6 percent of eligible loans outstanding at the close of the taxable year, whichever is greater. For purposes of this paragraph, the term "base year" means: for taxable years beginning before 1976, the last taxable year beginning on or before July 11, 1969, for taxable years beginning after 1975 but before 1982, the last taxable year beginning before 1976, and for taxable years beginning after 1981, the last taxable year beginning before 1982; except that for purposes of subparagraph (A) such term means the last taxable year before the most recent adoption of the percentage method, if later.

(3) Experience method.

The amount determined under this paragraph for a taxable year shall be the amount necessary to increase the balance of the reserve for losses on loans (at the close of the taxable year) to the greater of—

(A) the amount which bears the same ratio to loans outstanding at the close of the taxable year as (i) the total bad debts sustained during the taxable year and the 5 preceding taxable years (or, with the approval of the Secretary or his delegate, a shorter period), adjusted for recoveries of bad debts during such period, bears to (ii) the sum of the loans outstanding at the close of such 6 or fewer taxable years, or

(B) the lower of—

(i) the balance of the reserve at the close of the base year, or

(ii) if the amount of loans outstanding at the close of the taxable year isi ess than the amount of loans outstanding at the close of the base year, the amount which bears the same ratio to loans outstanding at the close of the taxable year as the balance of the reserve at the close of the base year bears to the amount of loans outstanding at the close of the base year.

For purposes of this paragraph, the base year shall be the last taxable year before the most recent adoption of the experience method, except that for taxable years beginning after 1987 the base year shall be the last taxable year beginning before 1988.

(4) Regulations; definition of eligible loan, etc.

The Secretary or his delegate shall define the terms "loan" and "eligible loan" and prescribe such regulations as may be necessary to carry out the purposes of this section; except that the term "eligible loan" shall not include—

(A) a loan to a bank (as defined in section 581),

(B) a loan to a domestic branch of a foreign corporation to which subsection (a)(2) applies,

(C) a loan secured by a deposit (i) in the lending bank, or (ii) in an institution described in subparagraph (A) or (B) if the lending bank has control over withdrawal of such deposit,

(D) a loan to or guaranteed by the United States, a possession or instrumentality thereof, or a State or a political subdivision thereof,

(E) a loan evidenced by a seeurity as defined in section 165(g)(2)(C),

(F) a loan of Federal funds, and

(G) commercial paper, including short-term promissory notes which may be purchased on the open market.

(Added Pub. L. 91–172, title IV, § 431(a), Dec. 30, 1969, 83 Stat. 616.)

EFFECTIVE DATE

Section 431(d) of Pub. L. 91–172 provided that: "The amendments made by subsections (a) [enacting this section and section 586 of this title] and (c) [adding par. (4) to section 166(h) of this title] shall apply to taxable years beginning after July 11, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 172, 582, 593 of this title.

§ 586. Reserves for losses on loans of small business investment companies, etc.

(a) Institutions to which section applies.

This section shall apply to the following financial institutions:

(1) any small business investment company operating under the Small Business Investment Act of 1958, and

(2) any business development corporation.

For purposes of this section, the term "business development corporation" means a corporation which was created by or pursuant to an act of a State legislature for purposes of promoting, maintaining, and assisting the economy and industry within such State on a regional or statewide basis by making loans to be used in trades and businesses which would generally not be made by banks (as defined in section 581) within such region or State in the ordinary course of their business (except on the basis of a partial participation), and which is operated primarily for such purposes.

(b) Addition to reserves for bad debts.

(1) General rule.

For purposes of section 166(c), except as provided in paragraph (2) the reasonable addition to the reserve for bad debts of any financial institution to which this section applies shall be an amount determined by the taxpayer which shall not exceed the amount necessary to increase the balance of the reserve for bad debts (at the close of the taxable year) to the greater of—

(A) the amount which bears the same ratio to loans outstanding at the close of the taxable year as (i) the total bad debts sustained during the taxable year and the 5 preceding taxable years (or, with the approval of the Secretary or his delegate, a shorter period), adjusted for recoveries of bad debts during such period, bears to (ii) the sum of the loans outstanding at the close of such 6 or fewer taxable years, or

(B) the lower of—

(i) the balance of the reserve at the close of the base year, or

(ii) if the amount of loans outstanding at the close of the taxable year is less than the amount of loans outstanding at the close of the base year, the amount which bears the same ratio to loans outstanding at the close of the taxable year as the balance of the reserve at the close of the base year bears to the amount of loans outstanding at the close of the base year.

For purposes of this subparagraph, the term "base year" means the last taxable year beginning on or before July 11, 1969.

(2) New financial institutions.

In the case of any taxable year beginning not more than 10 years after the day before the first day on which a financial institution (or any predecessor) was authorized to do business as a financial institution described in subsection (a), the reasonable addition to the reserve for bad debts of such financial institution shall not exceed the larger of the amount determined under paragraph (1) or the amount necessary to increase the balance of the reserve for bad debts at the close of the taxable year to the amount which bears the same ratio (as determined by the Secretary or his delegate) to loans outstanding at the close of the taxable year as (i) the total bad debts sustained by all institutions described in the applicable paragraph of subsection (a) during the 6 preceding taxable years (adjusted for recoveries of bad debts during such period), bears to (ii) the sum of the loans by all such institutions outstanding at the close of such taxable years.

(Added Pub. L. 91–172, title IV, § 431(a), Dec. 30, 1969, 83 Stat. 618.)

EFFECTIVE DATE

Section applicable to taxable years beginning after July 11, 1969, see section 431(d) of Pub. L. 91–172, set out as a note under section 585 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 172, 582 of this title.

PART II.—MUTUAL SAVINGS BANKS, ETC.

Sec.
591. Deduction for dividends paid on deposits.
592. Deduction for repayment of certain loans.
593. Reserves for losses on loans.
594. Alternative tax for mutual savings banks conducting life insurance business.
595. Foreclosure on property securing loans.
596. Limitation on dividends received deduction.

AMENDMENTS

1969—Pub. L. 91–172, title IV, § 434(b)(2), Dec. 30, 1969, 83 Stat. 625, added item 596.

1962—Pub. L. 87–834, § 6(d), Oct. 16, 1962, 76 Stat. 984, substituted "Reserves for losses on loans" for "Additions to reserve for bad debts" in item 593, and added item 595.

§ 591. Deduction for dividends paid on deposits.

In the case of mutual savings banks, cooperative banks, and domestic building and loan associations and other savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, there shall be allowed as deductions in computing taxable income amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw. (Aug. 16, 1954, ch. 736, 68A Stat. 204; Oct. 16, 1962, Pub. L. 87–834, § 6(f), 76 Stat. 984.)

AMENDMENTS

1962—Pub. L. 87–834 included other savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, and authorized amounts paid as interest as a deduction.

CROSS REFERENCES

Partial exclusion of dividends received by individuals, see section 116 of this title.

Special deduction for dividends received by corporation, see section 243 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 116, 243, 593, 861, 6223, 6323 of this title.

§ 592. Deduction for repayment of certain loans.

In the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank without capital stock organized and operated for mutual purposes and without profit, there shall be allowed as deductions in computing taxable income amounts paid by the taxpayer during the taxable year in repayment of loans made before September 1, 1951, by (1) the United States or any agency or instrumentality thereof which is wholly owned by the United States, or (2) any mutual fund established under the authority of the laws of any State (Aug. 16, 1954, ch. 736, 68A Stat. 205.)

§ 593. Reserves for losses on loans.

(a) Organizations to which section applies.

This section shall apply to any mutual savings bank not having capital stock represented by shares, domestic building and loan association, or cooperative bank without capital stock organized and operated for mutual purposes and without profit.

(b) Addition to reserves for bad debts.

(1) In general.

For purposes of section 166(c), the reasonable addition for the taxable year to the reserve for bad debts of any taxpayer described in subsection (a) shall be an amount equal to the sum of—

(A) the amount determined to be a reasonable addition to the reserve for losses on nonqualifying loans, computed in the same manner as is provided with respect to additions to the reserves for losses on loans of banks under section 585(b)(3), plus

(B) the amount determined by the taxpayer to be a reasonable addition to the reserve for losses on qualifying real property loans, but such amount shall not exceed the amount determined under paragraph (2), (3), or (4), whichever amount is the largest, but the amount determined under this subparagraph shall in no case be greater than the larger of—

(i) the amount determined under paragraph (4), or

(ii) the amount which, when added to the amount determined under subparagraph (A), equals the amount by which 12 percent of the total deposits or withdrawable accounts of depositors of the taxpayer at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of such year (taking into account any portion thereof attributable to the period before the first taxable year beginning after December 31, 1951).

(2) Percentage of taxable income method.

(A) In general.

Subject to subparagraphs (B), (C), and (D), the amount determined under this paragraph for the taxable year shall be an amount equal to the applicable percentage of the taxable income for such year (determined under the following table):

For a taxable year beginning in—	The applicable percentage under this paragraph shall be—
1969	60 percent.
1970	57 percent.
1971	54 percent.
1972	51 percent.
1973	49 percent.
1974	47 percent.
1975	45 percent.
1976	43 percent.
1977	42 percent.
1978	41 percent.
1979 or thereafter	40 percent.

(B) Reduction of applicable percentage in certain cases.

If, for the taxable year, the percentage of the assets of a taxpayer described in subsection (a), which are assets described in section 7701(a)(19)(C), is less than—

(i) 82 percent of the total assets in the case of a taxpayer other than a mutual savings bank, the applicable percentage for such year provided by subparagraph (A) shall be reduced by ¾ of 1 percentage point for each 1 percentage point of such difference, or

(ii) 72 percent of the total assets in the case of a mutual savings bank, the applicable percentage for such year provided by subparagraph (A) shall be reduced by 1½ percentage points for each 1 percentage point of such difference.

If, for the taxable year, the percentage of the assets of such taxpayer which are assets described in section 7701(a)(19)(C) is less than 60 percent (50 percent for a taxable year beginning before 1973 in the case of a mutual savings bank), this paragraph shall not apply.

(C) Reduction for amounts referred to in paragraph (1)(A).

The amount determined under subparagraph (A) shall be reduced by that portion of the amount referred to in paragraph (1)(A) for the taxable year (not in excess of 100 percent) which bears the same ratio to such amount as (i) 18 percent (28 percent in the case of mutual savings banks) bears to (ii) the percentage of the assets of the taxpayer for such year which are not assets described in section 7701(a)(19)(C).

(D) Overall limitation on paragraph.

The amount determined under this paragraph shall not exceed the amount necessary to increase the balance at the close of the taxable year of the reserve for losses on qualifying real property loans to 6 percent of such loans outstanding at such time.

(E) Computation of taxable income.

For purposes of this paragraph, taxable income shall be computed—

(i) by excluding from gross income any amount included therein by reason of subsection (f),

(ii) without regard to any deduction allowable for any addition to the reserve for bad debts,

(iii) by excluding from gross income an amount equal to the net gain for the taxable year arising from the sale or exchange of stock of a corporation or of obligations the interest on which is excludable from gross income under section 103,

(iv) by excluding from gross income an amount equal to the lesser of ⅜ of the net long-term capital gain for the taxable year or ⅜ of the net long-term capital gain for the taxable year from the sale or exchange of property other than property described in clause (iii), and

(v) by excluding from gross income dividends with respect to which a deduction is allowable by part VIII of subchapter B, reduced by an amount equal to the applicable percentage (determined under subparagraphs (A) and (B)) of the dividends received deduction (determined without regard to section 596) for the taxable year.

(3) Percentage method.

The amount determined under this paragraph to be a reasonable addition to the reserve for losses on qualifying real property loans shall be computed in the same manner as is provided with respect to additions to the reserves for losses on loans of banks under section 585(b)(2), reduced by the amount referred to in paragraph (1)(A) for the taxable year.

(4) Experience method.

The amount determined under this paragraph for the taxable year shall be computed in the same manner as is provided with respect to additions to the reserves for losses on loans of banks under section 585(b)(3).

(5) Determination of reserve for percentage method.

For purposes of paragraph (3), the amount deemed to be the balance of the reserve for losses on loans at the beginning of the taxable year shall be the total of the balances at such time of the reserve for losses on nonqualifying loans, the reserve for losses on qualifying real property loans, and the supplemental reserve for losses on loans.

(c) Treatment of reserve for bad debts.

(1) Establishment of reserves.

Each taxpayer described in subsection (a) which uses the reserve method of accounting for bad debts shall establish and maintain a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, and a supplemental reserve for losses on loans. For purposes of this title, such reserves shall be treated as reserves for bad debts, but no deduction shall be allowed for any addition to the supplemental reserve for losses on loans.

(2) Allocation of pre-1963 reserves.

For purposes of this section, the pre-1963 reserves shall, as of the close of December 31, 1962, be allocated to, and constitute the opening balance of—

(A) the reserve for losses on nonqualifying loans,

(B) the reserve for losses on qualifying real property loans, and

(C) the supplemental reserve for losses on loans.

(3) Method of allocation.

The allocation provided by paragraph (2) shall be made—

(A) first, to the reserve described in paragraph (2)(A), to the extent such reserve is not increased above the amount which would be a resonable addition under section 166(c) for a period in which the nonqualifying loans increased from zero to the amount thereof outstanding at the close of December 31, 1962;

(B) second, to the reserve described in paragraph (2)(B), to the extent such reserve is not increased above the amount which would be determined under paragraph (3)(A) or (4) of subsection (b) (whichever such amount is the larger) for a period in which the qualifying real property loans increased from zero to the amount thereof outstanding at the close of December 31, 1962; and

(C) then to the supplemental reserve for losses on loans.

(4) Pre-1963 reserves defined.

For purposes of this subsection, the term "pre-1963 reserves" means the net amount, determined as of the close of December 31, 1962 (after applying subsection (d)(1)), accumulated in the reserve for bad debts pursuant to section 166(c) (or the corresponding provisions of prior revenue laws) for taxable years beginning after December 31, 1951.

(5) Certain pre-1952 surplus.

If after the application of paragraph (3), the opening balance of the reserve described in paragraph (2)(B) is less than the amount described in paragraph (3)(B), then, for purposes of this subsection, the term "pre-1963 reserves" includes so much of the surplus, undivided profits, and bad debt reserves (determined as of December 31, 1962) attributable to the period before the first taxable year beginning after December 31, 1951, as does not exceed the amount by which such opening balance is less than the amount described in paragraph (3)(B). For purposes of the preceding sentence, the surplus, undivided profits, and bad debt reserves attributable to the period before the first taxable year beginning after December 31, 1951, shall be reduced by the amount thereof which is attributable to interest which would have been excludable from gross income under section 22(b)(4) of the Internal Revenue Code of 1939 (relating to interest on governmental obligations) or the corresponding provisions of prior laws. Notwithstanding the second sentence of paragraph (1), any amount which, by reason of the application of the first sentence of this paragraph, is allocated to the reserve described in paragraph (2)(B) shall not be treated as a reserve for bad debts for any purpose other than determining the amount referred to in subsection (b)(1)(B), and for such purpose such amount shall be treated as remaining in such reserve.

(6) Charging of bad debts to reserves.

Any debt becoming worthless or partially worthless in respect of a qualifying real property loan shall be charged to the reserve for losses on such

loans, and any debt becoming worthless or partially worthless in respect of a nonqualifying loan shall be charged to the reserve for losses on nonqualifying loans; except that any such debt may, at the election of the taxpayer, be charged in whole or in part to the supplemental reserve for losses on loans.

(d) Taxable years beginning in 1962 and ending in 1963.

In the case of a taxable year beginning before January 1, 1963, and ending after December 31, 1962, of a taxpayer described in subsection (a) which uses the reserve method of accounting for bad debts, the taxable income shall be the sum of—

(1) that portion of the taxable income allocable to the part of the taxable year occurring before January 1, 1963, reduced by the amount of the deduction for an addition to a reserve for bad debts which would be allowable under section 166(c) (without regard to the amendments made by section 6 of the Revenue Act of 1962) if such part year constituted a taxable year, plus

(2) that portion of the taxable income allocable to the part of the taxable year occurring after December 31, 1962, reduced by the amount of the deduction for an addition to a reserve for bad debts which would be allowed under section 166(c) (taking into account the amendments made by section 6 of the Revenue Act of 1962) if such part year constituted a taxable year.

For purposes of the preceding sentence, the taxable income shall be determined without regard to any deduction under section 166(c), and the portion thereof allocable to each part year shall be determined on the basis of the ratio which the number of days in such part year bears to the number of days in the entire taxable year.

(e) Loans defined.

For purposes of this section—

(1) Qualifying real property loans.

The term "qualifying real property loan" means any loan secured by an interest in improved real property or secured by an interest in real property which is to be improved out of the proceeds of the loan, but such term does not include—

(A) any loan evidenced by a security (as defined in section 165(g)(2)(C));

(B) any loan, whether or not evidenced by a security (as defined in section 165(g)(2)(C)), the primary obligor on which is—

(i) a government or political subdivision or instrumentality thereof;

(ii) a bank (as defined in section 581); or

(iii) another member of the same affiliated group;

(C) any loan, to the extent secured by a deposit in or share of the taxpayer; or

(D) any loan which, within a 60-day period beginning in one taxable year of the creditor and ending in its next taxable year, is made or acquired and then repaid or disposed of, unless the transactions by which such loan was made or acquired and then repaid or disposed of are established to be for bona fide business purposes.

For purposes of subparagraph (B)(iii), the term "affiliated group" has the meaning assigned to such term by section 1504(a); except that (i) the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1504(a), and (ii) all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

(2) Nonqualifying loans.

The term "nonqualifying loan" means any loan which is not a qualifying real property loan.

(3) Loan.

The term "loan" means debt, as the term "debt" is used in section 166.

(f) Distributions to shareholders.

(1) In general.

For purposes of this chapter, any distribution of property (as defined in section 317(a)) by a domestic building and loan association to a shareholder with respect to its stock, if such distribution is not allowable as a deduction under section 591, shall be treated as made—

(A) first out of its earnings and profits accumulated in taxable years beginning after December 31, 1951, to the extent thereof,

(B) then out of the reserve for losses on qualifying real property loans, to the extent additions to such reserve exceed the additions which would have been allowed under subsection (b)(4),

(C) then out of the supplemental reserve for losses on loans, to the extent thereof,

(D) then out of such other accounts as may be proper.

This paragraph shall apply in the case of any distribution in redemption of stock or in partial or complete liquidation of the association, except that any such distribution shall be treated as made first out of the amount referred to in subparagraph (B), second out of the amount referred to in subparagraph (C), third out of the amount referred to in subparagraph (A), and then out of such other accounts as may be proper. This paragraph shall not apply to any transaction to which section 381 (relating to carryovers in certain corporate acquisitions) applies.

(2) Amounts charged to reserve accounts and included in gross income.

If any distribution is treated under paragraph (1) as having been made out of the reserves described in subparagraphs (B) and (C) of such paragraph, the amount charged against such reserve shall be the amount which, when reduced by the amount of tax imposed under this chapter and attributable to the inclusion of such amount in gross income, is equal to the amount of such distribution; and the amount so charged against such reserve shall be included in gross income of the taxpayer.

(3) Special rules.

(A) For purposes of paragraph (1)(B), additions to the reserve for losses on qualifying real property loans for the taxable year in which the distribution occurs shall be taken into account.

(B) For purposes of computing under this section the amount of a reasonable addition to the reserve for losses on qualifying real property loans for any taxable year, any amount charged during any year to such reserve pursuant to the provisions of paragraph (2) shall not be taken into account.

(Aug. 16, 1954, ch. 736, 68A Stat. 205; Oct. 16, 1962, Pub. L. 87–834, § 6(a), 76 Stat. 977; Dec. 30, 1969, Pub. L. 91–172, title IV, § 432(a), (b), 83 Stat. 620, 622.)

REFERENCES IN TEXT

The amendments made by section 6 of the Revenue Aot of 1962, referred to in subsec. (d) (1), (2), means the amendments made by section 6 of Pub. L. 87–834, which amended this section in its entirety. The text of this section prior to this amendment is set forth in the 1962 amendment note hereunder.

AMENDMENTS

1969—Subsec. (b) (1) (A). Pub. L. 91–172, § 432(a) (1), added provisions for the method of computing the amount of the reasonable addition to the reserve for losses on nonqualifying loans.

Subsec. (b) (2). Pub. L. 91–172, § 432(a) (2), substituted a table of applicable percentages of the taxable income for each year up to 1979 and thereafter for the amount in excess of 60 percent over the amount referred to in former subsec. (b) (1) (A), transferred the remaining provisions of former subsec. (b) (2) to subpar. (D), and added subpars. (B) to (E).

Subsec. (b) (3). Pub. L. 91–172, § 432(a) (2), substantially changed the method of computation of the amount by conforming it to the method of determining the additions to the reserves for losses on loans of banks under section 585(b) (2).

Subsec. (b) (4). Pub. L. 91–172, § 432(a) (2), changed the method of computation of the amount by conforming it to the method of determining the additions to the reserves for losses on loans of banks under section 585(b) (8).

Subsec. (b) (5). Pub. L. 91–172, § 432(a) (2), substituted provisions relating to the determination of reserve for percentage method for provisions relating to the limitation in case of certain domestic building and loan associations.

Subsec. (f). Pub. L. 91–172, § 432(b), excepted the application of par. (1) to any transaction to which section 381 of this title applied.

1962—Pub. L. 87–834 amended section generally to read as above set forth. Prior to such amendment, section read as follows:

"§ 593. Additions to reserve for bad debts.

"In the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit, the reasonable addition to a reserve for bad debts under section 166(c) shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserves existing at the close of December 31, 1951. In the case of a taxpayer described in the preceding sentence, the reasonable addition to a reserve for bad debts for any taxable year shall in no case be less than the amount determined by the taxpayer as the reasonable addition for such year; except that the amount determined by the taxpayer under this sentence shall not be greater than the lesser of—

"(1) the amount of its taxable income for the taxable year, computed without regard to this section, or

"(2) the amount by which 12 percent of the total deposits or withdrawable accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year."

EFFECTIVE DATE OF 1969 AMENDMENT

Section 432(e) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and section 7701(a) (19), (32) of this title] shall be effective for taxable years beginning after July 11, 1969."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 6(g) (1) of Pub. L. 87–834 provided that: "The amendment made by subsection (a) [amending this section] shall apply to taxable years ending after December 31, 1962, except that section 593(f) of the Internal Revenue Code of 1954 shall apply to distributions after December 31, 1962, in taxable years ending after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 57, 172, 582, 585, 595, 596, 1038 of this title.

§ 594. Alternative tax for mutual savings banks conducting life insurance business.

(a) Alternative tax.

In the case of a mutual savings bank not having capital stock represented by shares, authorized under State law to engage in the business of issuing life insurance contracts, and which conducts a life insurance business in a separate department the accounts of which are maintained separately from the other accounts of the mutual savings bank, there shall be imposed in lieu of the taxes imposed by section 11 or section 1201 (a), a tax consisting of the sum of the partial taxes determined under paragraphs (1) and (2):

(1) A partial tax computed on the taxable income determined without regard to any items of gross income or deductions properly allocable to the business of the life insurance department, at the rates and in the manner as if this section had not been enacted; and

(2) a partial tax computed on the income of the life insurance department determined without regard to any items of gross income or deductions not properly allocable to such department, at the rates and in the manner provided in subchapter L (sec. 801 and following) with respect to life insurance companies.

(b) Limitations of section.

Subsection (a) shall apply only if the life insurance department would, if it were treated as a separate corporation, qualify as a life insurance company under section 801. (Aug. 16, 1954, ch. 736, 68A Stat. 205; Mar. 13, 1956, ch. 83, § 5 (3), 70 Stat. 49.)

AMENDMENTS

1956—Subsec. (a) (2). Act Mar. 13, 1956, substituted "the income" for "the taxable income (as defined in section 803)".

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956 applicable only to taxable years beginning after Dec. 31, 1954, see not set out under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 11, 811 of this title.

§ 595. Foreclosure on property securing loans.

(a) Nonrecognition of gain or loss as a result of foreclosure.

In the case of a creditor which is an organization described in section 593(a), no gain or loss shall be recognized, and no debt shall be considered as becoming worthless or partially worthless, as the result of such organization having bid in at foreclosure, or having otherwise reduced to ownership or possession by agreement or process of law, any property which was security for the payment of any indebtedness.

(b) Character of property.

For purposes of sections 166 and 1221, any property acquired in a transaction with respect to which gain or loss to an organization was not recognized by reason of subsection (a) shall be considered as property having the same characteristics as the indebtedness for which such property was security. Any amount realized by such organization with respect to such property shall be treated for purposes of this chapter as a payment on account of such indebtedness, and any loss with respect thereto shall be treated as a bad debt to which the provisions of section 166 (relating to allowance of a deduction for bad debts) apply.

(c) Basis.

The basis of any property to which subsection (a) applies shall be the basis of the indebtedness for which such property was security (determined as of the date of the acquisition of such property), properly increased for costs of acquisition.

(d) Regulatory authority.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section. (Added Pub. L. 87–834, § 6(b), Oct. 16, 1962, 76 Stat. 982.)

EFFECTIVE DATE

Section 6(g)(2) of Pub L. 87–834 provided that: "The amendment made by subsection (b) [adding this section] shall apply to transactions described in section 595(a) of the Internal Revenue Code of 1954 occurring after December 31, 1962, in taxable years ending after such date."

§ 596. Limitation on dividends received deduction.

In the case of an organization to which section 593 applies and which computes additions to the reserve for losses on loans for the taxable year under section 593(b)(2), the total amount allowed under sections 243, 244, and 245 (determined without regard to this section) for the taxable year as a deduction with respect to dividends received shall be reduced by an amount equal to the applicable percentage for such year (determined under subparagraphs (A) and (B) of section 593(b)(2)) of such total amount. (Added Pub. L. 91–172, title IV, § 434(a), Dec. 30, 1969, 83 Stat. 624.)

EFFECTIVE DATE

Section 434(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section and adding subsec. (d) to section 246 of this title] shall apply to taxable years beginning after July 11, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 593 of this title.

PART III.—BANK AFFILIATES

Sec.
601. Special deduction for bank affiliates.

§ 601. Special deduction for bank affiliates.

In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933; 12 U. S. C. 221a (c)), there shall be allowed as a deduction, for purposes of section 535 (b) (8) (relating to the computation of accumulated taxable income) and section 545 (b) (6) (relating to the computation of undistributed personal holding company income), the amount of the earnings and profits which the Board of Governors of the Federal Reserve System certifies to the Secretary or to his delegate has been devoted by such affiliate during the taxable year to the acquisition of readily marketable assets other than bank stock in compliance with section 5144 of the Revised Statutes (12 U. S. C. 61). The amount of the deduction under this section for any taxable year shall not exceed the taxable income for such year computed without regard to the special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.). The aggregate of the deductions allowable under this section and the credits allowable under the corresponding provision of any prior income tax law for all taxable years shall not exceed the amount required to be devoted under such section 5144 to such purposes. (Aug. 16, 1954, ch. 736, 68A Stat. 206.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 535, 545 of this title.

Subchapter I.—Natural Resources

Part
I. Deductions.
II. Exclusions from gross income.
III. Sales and exchanges.
IV. Mineral production payments.
V. Continental shelf areas.

PART I.—DEDUCTIONS

Sec.
611. Allowance of deduction for depletion.
612. Basis for cost depletion.
613. Percentage depletion.
614. Definition of property.
615. Pre-1970 exploration expenditures.
616. Development expenditures.
617. Deduction and recapture of certain mining exploration expenditures.

AMENDMENTS

1969—Pub. L. 91–172, title V, §§ 503(b), 505(c), Dec. 30, 1969, 83 Stat. 631, 634, added "Part IV. Mineral production payments" and "Part V. Continental shelf areas."

Pub. L. 91–172, title V, § 504(c)(5), Dec. 30, 1969, 83 Stat. 633, substituted "Pre-1970 exploration expenditures" for "Exploration expenditures" in item 615 and substituted "Deduction and recapture of certain mining exploration expenditures" for "Additional exploration expenditures in the case of domestic mining" in item 617.

1966—Pub. L. 89–570, § 1(d), Sept. 12, 1966, 80 Stat. 762, added item 617.

§ 611. Allowance of deduction for depletion.

(a) General rule.

In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613 (c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

(b) Special rules.

(1) Leases.

In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.

(2) Life tenant and remainderman.

In the case of property held by one person for life with remainder to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.

(3) Property held in trust.

In the case of property held in trust, the deduction under this section shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(4) Property held by estate.

In the case of an estate, the deduction under this section shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each.

(c) Cross reference.

For other rules applicable to depreciation of improvements, see section 167.

(Aug. 16, 1954, ch. 736, 68A Stat. 207; Sept. 2, 1958, Pub. L. 85–866, title I, § 35, 72 Stat. 1632.)

AMENDMENTS

1958—Subsec. (d) (4). Pub. L. 85–866 substituted "devisees" for "devises".

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (b) (4) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 62, 163, 174, 613, 615, 616, 617, 642, 691, 804, 822, 1082, 4940 of this title.

§ 612. Basis for cost depletion.

Except as otherwise provided in this subchapter, the basis on which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain upon the sale or other disposition of such property. (Aug. 16, 1954, ch. 736, 68A Stat. 208.)

CROSS REFERENCES

Adjusted basis of mine or deposit, see sections 615 (d) and 616 (c) of this title.

Adjustments to basis in respect of depletion, see section 1016 (a) of this title.

Basis for depreciation, see section 167 (f) of this title.

Basis of property as cost, see section 1012 of this title.

§ 613. Percentage depletion.

(a) General rule.

In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). For purposes of the preceding sentence, the allowable deductions taken into account with respect to expenses of mining in computing the taxable income from the property shall be decreased by an amount equal to so much of any gain which (1) is treated under section 1245 (relating to gain from disposition of certain depreciable property) as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231, and (2) is properly allocable to the property. In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) Percentage depletion rates.

The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

(1) 22 percent.

(A) oil and gas wells;

(B) sulphur and uranium; and

(C) if from deposits in the United States—anorthosite, clay, laterite, and nephelite syenite (to the extent that alumina and aluminum compounds are extracted therefrom), asbestos, bauxite, celestite, chromite, corundum, fluorspar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grade), rutile, block steatite talc, and zircon, and ores of the following metals: antimony, beryllium, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, molybdenum, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

(2) 15 percent.

If from deposits in the United States—

(A) gold, silver, copper, and iron ore, and

(B) oil shale (except shale described in paragraph (5)).

(3) 14 percent.

(A) metal mines (if paragraph (1)(C) or (2)(A) does not apply), rock asphalt, and vermiculite; and

(B) if paragraph (1)(C), (5), or (6)(B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties.

(4) 10 percent.

Asbestos (if paragraph (1)(C) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

(5) 7½ percent.

Clay and shale used or sold for use in the manufacture of sewer pipe or brick, and clay, shale, and slate used or sold for use as sintered or burned lightweight aggregates.

(6) 5 percent.

(A) gravel, peat, pumice, sand, scoria, shale (except shale described in paragraph (2)(B) or (5)), and stone (except stone described in paragraph (7));

(B) clay used, or sold for use, in the manufacture of drainage and roofing tile, flower pots, and kindred products; and

(C) if from brine wells—bromine, calcium chloride, and magnesium chloride.

(7) 14 percent.

All other minerals, including, but not limited to, aplite, barite, borax, calcium carbonates, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, mollusk shells (including clam shells and oyster shells), phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (1) (C) does not apply) bauxite, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc (including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral (other than slate to which paragraph (5) applies) when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

For the purposes of this subsection, minerals (other than sodium chloride) extracted from brines pumped from a saline perennial lake within the United States shall not be considered minerals from an inexhaustible source.

(c) Definition of gross income from property.

For purposes of this section—

(1) Gross income from the property.

The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) Mining.

The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) Extraction of the ores or minerals from the ground.

The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) Treatment processes considered as mining.

The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—cleaning, pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and ores or minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, sintering, and substantially equivalent processes to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, uranium, or fluorspar ores, potash, and ores or minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore or the mineral or minerals from other material from the mine or other natural deposit;

(E) the pulverization of talc, the burning of magnesite, the sintering and nodulizing of phosphate rock, and the furnacing of quicksilver ores;

(F) in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln food into the kiln, but not including any subsequent process;

(G) in the case of clay to which paragraph (5) or (6) (B) of subsection (b) applies—crushing, grinding, and separating the mineral from waste, but not including any subsequent process;

(H) in the case of oil shale—extraction from the ground, crushing, loading into the retort, and retorting, but not hydrogenation, refining, or any other process subsequent to retorting; and

(I) any other treatment process provided for by regulations prescribed by the Secretary or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of this paragraph.

(5) Treatment processes not considered as mining.

Unless such processes are otherwise provided for in paragraph (4) (or are necessary or incidental to processes so provided for), the following treatment processes shall not be considered as "mining": electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping.

(d) Application of percentage depletion rates to certain taxable years ending in 1954.

(1) General rule.

At the election of the taxpayer in respect of any property (within the meaning of the Internal Revenue Code of 1939), the percentage specified in subsection (b) in the case of any mine, well, or other natural deposit listed in such subsection shall apply to a taxable year ending after December 31, 1953, to which the Internal Revenue Code of 1939 applies.

(2) Method of compntation.

The allowance for depletion, in respect of any property for which an election is made under paragraph (1) for any taxable year, shall be an amount equal to the sum of—

(A) that portion of a tentative allowance, computed under the Internal Revenue Code of 1939 without regard to paragraph (1) of this subsection, which the number of days in such taxable year before January 1, 1954, bears to the total number of days in such taxable year; plus

(B) that portion of a tentative allowance, computed under the Internal Revenue Code of 1939 (as modified solely by the application of paragraph (1) of this subsection), which the number of days in such taxable year after December 31, 1953, bears to the total number of days in such taxable year.

(Aug. 16, 1954, ch. 736, 68A Stat. 208; Sept. 2, 1958, Pub. L. 85–866, title 1, § 36 (a), 72 Stat. 1633; June 30, 1960, Pub. L. 86–564, title III, § 302 (a), (b), 74 Stat. 291; Oct. 16, 1962, Pub. L. 87–834, § 13(e), 76 Stat. 1034; Sept. 2, 1964, Pub. L. 88–571, § 6(a), 78 Stat. 860; Nov. 13, 1966, Pub. L. 89–809, title II, §§ 207(a), 208(a), 209 (a), (b), 80 Stat. 1579, 1580; Dec. 30, 1969, Pub. L. 91–172, title V, §§ 501(a), 502 (a), 83 Stat. 629, 630.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91–172, § 501(a), reduced the percentage depletion rate on oil and gas wells from 27½ percent to 22 percent, reduced to 22 percent other minerals formerly receiving percentage depletion at a rate of 23 percent, added molybdenum in the category of minerals subject to the 22 percent depletion rate, reduced to 14 percent the rate on minerals formerly receiving depletion at a 15 percent rate except in the case of domestic gold, silver, oil shale, copper, and iron ore, and added provision that for percentage depletion purposes, minerals other than sodium chloride, extracted from brine pumped from a saline perennial lake within the United States are not to be considered minerals from an inexhaustible source.

Subsec. (c)(4). Pub. L. 91–172, § 502(a), added subpar. (H). Former subpar. (H) was redesignated as subpar. (I).

1966—Subsec. (b)(2)(B). Pub. L. 89–809, § 207(a)(1), inserted "clay, laterite, and nephelite syenite" following "anorthosite".

Subsec. (b)(3)(B). Pub. L. 89–809, §§ 207(a)(2), 209(a)(2), substituted "if neither paragraph (2)(B), (5), or (6)(B) applies" for "if paragraph (5)(B) does not apply".

Subsec. (b)(5). Pub. L. 89–809, § 209(a)(1), added par. (5). Former par. (5) redesignated as par. (6).

Subsec. (b)(6). Pub. L. 89–809, §§ 208(a)(1), 209 (a)(1), (3), (4), redesignated former par. (5) as par. (6) and, in par. (6) as so redesignated, struck out "mollusk shells (including clam shells and oyster shells)," and substituted "shale (except shale described in paragraph (5)), and stone (except stone described in paragraph (7))" for "shale, and stone, except stone described in paragraph (6)" in subpar. (A), and struck out "building or paving brick," and "sewer pipe," in subpar. (B). Former par. (6) redesignated as par. (7).

Subsec. (b)(7). Pub. L. 89–809, §§ 208(a)(2), 209(a)(1), (5), redesignated former par. (6) as par. (7), and, in par. (7) as so redesignated, inserted "mollusk shells (including clam shells and oyster shells)," after "marble," and "(other than slate to which paragraph (5) applies" following "any other such mineral".

Subsec. (c)(4)(G). Pub. L. 89–809, § 209(b), substituted "paragraph (5) or (6)(B)" for "paragraph (5)(B)".

1964—Subsec. (b)(2)(B), (6). Pub. L. 88–571 inserted "beryllium" following "antimony" in subpar. (2)(B), and deleted "beryl" following "bauxite" in both subpars. (2)(B) and (6).

1962—Subsec. (a). Pub. L. 87–834 inserted provisions requiring the allowable deductions taken into account with respect to expenses of mining in computing the taxable income from the property to be decreased by an amount equal to so much of any gain which is treated under section 1245 as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231, and is properly allocable to the property.

1960—Subsec. (b)(3). Pub. L. 86–564, § 302(a)(1), limited the 15 percent allowance for ball clay, bentonite, china clay, and sagger clay to cases where paragraph (5)(B) does not apply, and authorized a 15 percent allowance, if paragraph (5)(B) does not apply, for clay used or sold for use for purposes dependent on its refractory properties.

Subsec. (b)(5). Pub. L. 86–564, § 302(a)(2), substituted provisions authorizing a 5 percent allowance for clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products for provisions which authorized a 5 percent allowance for brick and tile clay.

Subsec. (b)(6). Pub. L. 86–564, § 302(a)(3), eliminated provisions which authorized a 15 percent allowance for refractory and fire clay. See subsec. (b)(3) of this section.

Subsec. (c)(2). Pub. L. 86–564, § 302(b)(1), substituted "the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto)" for "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products", and "such treatment processes" for "the ordinary treatment processes."

Subsec. (c)(4). Pub. L. 86–564, § 302(b)(2), substituted "The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611" for "The term 'ordinary treatment processes' includes the following" in the opening provisions, included cleaning in cl. (B), substituted "ores or minerals which" for "minerals which" and included substantially equivalent processes in cl. (C), included uranium and minerals which are not customarily sold in the form of the crude mineral product and substituted "from the ore or the mineral or minerals from other material from the mine or other natural deposit" for "from the ore, including the furnacing of quicksilver ores" in cl. (D), included the furnacing of quicksilver ores in cl. (E), and added cls. (F)—(H).

Subsec. (c)(5). Pub. L. 86–564, § 302(b)(2), added subsec. (c)(5).

1958—Subsec. (d). Pub. L. 85–866 added subsec. (d).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 501(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [amending subsec. (b) of this section] shall apply to taxable years beginning after October 9, 1969."

Section 502(b) of Pub. L. 91–172 provided that: "The amendments made by subsection (a) [amending subsec. (c)(4)(G)–(I) of this section] shall apply to taxable years beginning after the date of the enactment of this Act [Dec. 30, 1969]."

EFFECTIVE DATE OF 1966 AMENDMENT

Section 207(b) of Pub. L. 89–809 provided that: "The amendments made by subsection (a) [amending subsecs. (b)(2) and (b)(3) of this section] shall apply to taxable years beginning after the date of the enactment of this Act [Nov. 13, 1966]."

Section 208(b) of Pub. L. 89–809 provided that: "The amendments made by subsection (a) [amending subsecs. (b)(6)(A) and (b)(7) of this section] shall apply to taxable years beginning after the date of the enactment of this Act [Nov. 13, 1966]."

Section 209(c) of Pub. L. 89–809 provided that: "The amendments made by subsections (a) and (b) [adding subsec. (b)(5) and amending subsecs. (b)(3)(B), (b)(6), (b)(7), and (c)(4)(G) of this section] shall apply to taxable years beginning after the date of the enactment of this Act [Nov. 13, 1966]."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 6(b) of Pub. L. 88–571 provided that: "The amendments made by subsection (a) [to this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (a) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Section 302(c) of Pub. L. 86–564, as amended by Pub. L. 86–781, § 4, Sept. 14, 1960, 74 Stat. 1018, provided that:

"(1) In general.—Except as provided in paragraph (2), the amendments made by subsections (a) and (b) [to subsecs. (b), (3), (5), (6), (c), (2), (4), (5) of this section] shall be applicable only with respect to taxable years beginning after December 31, 1960.

"(2) Calcium carbonates, etc.—

"(A) Election for past years.—In the case of calcium carbonates or other minerals when used in making cement, if an election is made by the taxpayer under subparagraph (C)—

"(i) the amendments made by subsection (b) [to subsecs. (b), (3), (5), (6), (c), (2), (4), (5) of this section] shall apply to taxable years with respect to which such election is effective and

"(ii) provisions having the same effect as the amendments made by subsection (b) [to subsecs.. (b), (3), (5), (6), (c), (2), (4), (5) of this section] shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply to taxable years with respect to which such election is effective in lieu of the corresponding provisions of such Code.

"(B) Years to which applicable.—An election made under subparagraph (C) to have the provisions of this paragraph apply shall be effective for all taxable years beginning before January 1, 1961, in respect of which—

"(i) the assessment of a deficiency,

"(ii) the refund or credit of an overpayment, or

"(iii) the commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on the date of the enactment of this paragraph [Sept. 14, 1960] by the operation of any law or rule of law. Such election shall also be effective for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this paragraph.

"(C) Time and manner of election.—An election to have the provisions of this paragraph apply shall be made by the taxpayer on or before the 60th day after the date of publication in the Federal Register of final regulations issued under authority of subparagraph (F), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

"(D) Statutes of limitation.—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the application of the amendments made by subsection (b) [to subsecs. (c), (2), (4), (5) of this section] may be made with respect to any taxable year to which such amendments apply under an election made under subparagraph (C), and the period within which a claim for refund or credit of an overpayment attributable to the application of such amendments may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subparagraph (C). An election by a taxpayer under subparagraph (C) shall be considered as a consent to the application of the provisions of this subparagraph.

"(E) Terms; applicability of other laws.—Except where otherwise distinctly expressed or manifestly intended, terms used in this paragraph shall have the same meaning as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this paragraph as if this paragraph were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

"(F) Regulations.—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this paragraph."

EFFECTIVE DATE OF 1958 AMENDMENT

Subsec. (d) of this section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

REFUND OR CREDIT OF OVERPAYMENTS; LIMITATIONS; INTEREST

Section 36 (b) of Pub. L. 85–866 provided that: "If refund or credit of any overpayment resulting from the application of the amendment made by subsection (a) of this section [adding subsec. (d) of this section] is prevented on the date of the enactment of this Act [Sept. 2, 1958], or within 6 months from such date, by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954, relating to closing agreements, and other than section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within 6 months from such date. No interest shall be paid on any overpayment resulting from the application of the amendment made by subsection (a) of this section [adding subsec. (d) of this section]."

ELECTION FOR CLAY AND SHALE USED IN MANUFACTURE OF CLAY PRODUCTS

Pub. L. 87–312, Sept. 26, 1961, 75 Stat. 674, provided:

"That (a) *Election for past years.*—In the case of brick and tile clay, fire clay, or shale used by the mine-owner or operator in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products (without regard to the applicable rate of percentage depletion), if an election is made under subsection (c), for the purpose of applying section 613(c) of the Internal Revenue Code of 1954 [subsec. (c) of this section] (and corresponding provision of the Internal Revenue Code of 1939) for each of the taxable years with respect to which the election is effective—

"(1) gross income from the property shall be 50 per centum of the amount for which the manufactured products are sold during the taxable year except that with respect to such manufactured products, gross income from the property shall not exceed an amount

equal to $12.50 multiplied by the number of short tons used in the manufactured products sold during the taxable year, and

"(2) for purposes of computing the 50 per centum limitation under section 613(a) of the Internal Revenue Code of 1954 [subsec. (a) of this section] (or the corresponding provision of the Internal Revenue Code of 1939), the taxable income from the property (computed without allowance for depletion) shall be 50 per centum of the taxable income from the manufactured products sold during the taxable year (computed without allowance for depletion).

"(b) *Years to which applicable.*—An election made under subsection (c) to have the provisions of this section apply shall be effective for all taxable years beginning before January 1, 1961, in respect of which—

"(1) the assessment of a deficiency,

"(2) the refund or credit of an overpayment, or

"(3) the commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on the date of the enactment of this Act [Sept. 26, 1961] by the operation of any law or rule of law. Such election shall also be effective for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this Act [Sept. 26, 1961].

"(c) *Time and manner of election.*—An election to have the provisions of this section apply shall be made by the taxpayer on or before the sixtieth day after the date of publication in the Federal Register of final regulations issued under authority of subsection (f), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

"(d) *Statues of limitation.*—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the election under subsection (c) may be made with respect to any taxable year for which such election is effective, and the period within which a claim for refund or credit of an overpayment attributable to the election under such subsection may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subsection (c). An election by a taxpayer under subsection (c) shall be considered as a consent to the application of the provisions of this subsection.

"(e) *Terms; applicability of other laws.*—Except where otherwise distinctly expressed or manifestly intended, terms used in this section shall have the same meaning as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this section as if this section were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

"(f) *Regulations.*—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section."

ELECTION FOR QUARTZITE AND CLAY USED IN PRODUCTION OF REFRACTORY PRODUCTS

Pub. L. 87-321, § 2, Sept. 26, 1961, 75 Stat. 683, provided that:

"(a) *Election for past years.*—If an election is made under subsection (c), in the case of quartzite and clay used by the mine owner or operator in the production of refractory products, for the purpose of applying section 613 (c) of the Internal Revenue Code of 1954 [subsec. (c) of this section] (and corresponding provisions of the Internal Revenue Code of 1939) for each of the taxable years with respect to which the election is effective—

"(1) the term 'ordinary treatment processes' shall include crushing, grinding, and separating the mineral from waste, but shall not include any subsequent process; and

"(2) the gross income from mining for each short ton of such quartzite or clay used in the production of all refractory products sold during the taxable year shall be equal to 87½ percent of the lesser of—

"(A) the average lowest published or advertised price, or

"(B) the average lowest actual selling price,

at which, during the taxable year, the mine owner or operator offered to sell, or sold, such quartzite or clay (in the form and condition of such products after the application of only the processes described in paragraph (1) and before transportation from the plant in which such processes were applied). For purposes of this paragraph, exceptional, unusual, or nominal sales or selling prices shall be disregarded. If the mine owner or operator makes no sales of, or makes only exceptional, unusual, or nominal sales of, such quartzite or clay after application of only the processes described in paragraph (1), then in lieu of the price provided for in subparagraph (A) or (B) there shall be used the average lowest recognized selling price for the taxable year for such quartzite or clay in the marketing area of the mine owner or operator published in a trade journal or other industry publication.

"(b) *Years to which applicable.*—An election made under subsection (c) to have the provisions of this section apply shall be effective on and after January 1, 1951, for all taxable years beginning before January 1, 1961, in respect of which—

"(1) the assessment of a deficiency,

"(2) the refund or credit of an overpayment, or

"(3) the commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on the date of the enactment of this Act [Sept. 26, 1961] by the operation of any law or rule of law. Such election shall also be effective on and after January 1, 1951, for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this Act [Sept. 26, 1961].

"(c) *Time and manner of election.*—An election to have the provisions of this section apply shall be made by the taxpayer on or before the 60th day after the date of publication in the Federal Register of final regulations issued under authority of subsection (f), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

"(d) *Statutes of limitations.*—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the election under subsection (c) may be made with respect to any taxable year for which such election is effective, and the period within which a claim for refund or credit of an overpayment attributable to the election under such subsection may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subsection (c). An election by a taxpayer under subsection (c) shall be considered as a consent to the application of the provisions of this subsection.

"(e) *Terms; applicability of other laws.*—Except where otherwise distinctly expressed or manifestly intended, terms used in this section shall have the same meaning as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this section as if this section were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

"(f) *Regulations.*—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section."

CROSS REFERENCES

Allowance of deduction for depletion, see section 611 of this title.

Percentage depletion inapplicable to certain owners of coal or iron ore, see section 631 (c) of this title.

Sale of oil and gas properties, surtax on sale, see section 632 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 163, 381, 611, 614, 617, 631, 636, 1082, 4940 of this title.

§ 614. Definition of property.

(a) General rule.

For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

(b) Special rules as to operating mineral interests in oil and gas wells.

In the case of oil and gas wells—

(1) In general.

Except as otherwise provided in this subsection—

(A) all of the taxpayer's operating mineral interests in a separate tract or parcel of land shall be combined and treated as one property, and

(B) the taxpayer may not combine an operating mineral interest in one tract or parcel of land with an operating mineral interest in another tract or parcel of land.

(2) Election to treat operating mineral interests as separate properties.

If the taxpayer has more than one operating mineral interest in a single tract or parcel of land, he may elect to treat one or more of such operating mineral interests as separate properties. The taxpayer may not have more than one combination of operating mineral interests in a single tract or parcel of land. If the taxpayer makes the election provided in this paragraph with respect to any interest in a tract or parcel of land, each operating mineral interest which is discovered or acquired by the taxpayer in such tract or parcel of land after the taxable year for which the election is made shall be treated—

(A) if there is no combination of interests in such tract or parcel, as a separate property unless the taxpayer elects to combine it with another interest, or

(B) if there is a combination of interests in such tract or parcel, as part of such combination unless the taxpayer elects to treat it as a separate property.

(3) Certain unitization or pooling arrangements.

(A) In general.

Under regulations prescribed by the Secretary or his delegate, if one or more of the taxpayer's operating mineral interests participate, under a voluntary or compulsory unitization or pooling agreement, in a single cooperative or unit plan of operation, then for the period of such participation—

(i) they shall be treated for all purposes of this subtitle as one property, and

(ii) the application of paragraphs (1), (2), and (4) in respect of such interests shall be suspended.

(B) Limitation.

Subparagraph (A) shall apply to a voluntary agreement only if all the operating mineral interests covered by such agreement—

(i) are in the same deposit, or are in 2 or more deposits the joint development or production of which is logical from the standpoint of geology, convenience, economy, or conservation, and

(ii) are in tracts or parcels of land which are contiguous or in close proximity.

(C) Special rule in the case of arrangements entered into a taxable years beginning before January 1, 1964.

If—

(i) two or more of the taxpayer's operating mineral interests participate under a voluntary or compulsory unitization or pooling agreement entered into in any taxable year beginning before January 1, 1964, in a single cooperative or unit plan of operation,

(ii) the taxpayer, for the last taxable year beginning before January 1, 1964, treated such interests as two or more separate properties, and

(iii) it is determined that such treatment was proper under the law applicable to such taxable year,

such taxpayer may continue to treat such interests in a consistent manner for the period of such participation.

(4) Manner, time, and scope of election.

(A) Manner and time.

Any election provided in paragraph (2) shall be made for each operating mineral interest, in the manner prescribed by the Secretary or his delegate by regulations, not later than the time prescribed by law for filing the return (including extensions thereof) for whichever of the following taxable years is the later: The first taxable year beginning after December 31, 1963, or the first taxable year in which any expenditure for development or operation in respect of such operating mineral interest is made by the taxpayer after the acquisition of such interest.

(B) Scope.

Any election under paragraph (2) shall be for all purposes of this subtitle and shall be binding on the taxpayer for all subsequent taxable years.

(5) Treatment of certain properties.

If, on the day preceding the first day of the first taxable year beginning after December 31, 1963, the taxpayer has any operating mineral interests which he treats under subsection (d) of this section (as in effect before the amendments made by the Revenue Act of 1964), such treatment shall be continued and shall be deemed to have been adopted pursuant to paragraphs (1) and (2) of this subsection (as amended by such Act).

(c) Special rules as to operating mineral interests in mines.

(1) Election to aggregate separate interests.

Except in the case of oil and gas wells, if a taxpayer owns two or more separate operating mineral interests which constitute part or all of an

operating unit, he may elect (for all purposes of this subtitle)—

(A) to form an aggregation of, and to treat as one property, all such interests owned by him which comprise any one mine or any two or more mines; and

(B) to treat as a separate property each such interest which is not included within an aggregation referred to in subparagraph (A).

For purposes of this paragraph, separate operating mineral interests which constitute part or all of an operating unit may be aggregated whether or not they are included in a single tract or parcel of land and whether or not they are included in contiguous tracts or parcels. For purposes of this paragraph, a taxpayer may elect to form more than one aggregation of operating mineral interests within any one operating unit; but no aggregation may include any operating mineral interest which is a part of a mine without including all of the operating mineral interests which are a part of such mine in the first taxable year for which the election to aggregate is effective, and any operating mineral interest which thereafter becomes a part of such mine shall be included in such aggregation.

(2) Election to treat a single interest as more than one property.

Except in the case of oil and gas wells, if a single tract or parcel of land contains a mineral deposit which is being extracted, or will be extracted by means of two or more mines for which expenditures for development or operation have been made by the taxpayer, then the taxpayer may elect to allocate to such mines, under regulations prescribed by the Secretary or his delegate, all of the tract or parcel of land and of the mineral deposit contained therein, and to treat as a separate property that portion of the tract or parcel of land and of the mineral deposit so allocated to each mine. A separate property formed pursuant to an election under this paragraph shall be treated as a separate property for all purposes of this subtitle (including this paragraph). A separate property so formed may, under regulations prescribed by the Secretary or his delegate, be included as a part of an aggregation in accordance with paragraphs (1) and (3), but the provisions of paragraph (4) shall not apply with respect to such separate property. The election provided by this paragraph may not be made with respect to any property which is a part of an aggregation formed by the taxpayer under paragraph (1) except with the consent of the Secretary or his delegate.

(3) Manner and scope of election.

(A) In general.

Except as provided in subparagraph (D), the election provided by paragraph (1) shall be made for each operating mineral interest, in accordance with regulations prescribed by the Secretary or his delegate, not later than the time prescribed by law for filing the return (including extensions thereof) for whichever of the following taxable years is the later: The first taxable year beginning after December 31, 1957, or the first taxable year in which any expenditure for development or operation in respect of the separate operating mineral interest is made by the taxpayer after the acquisition of such interest. Except as provided in subparagraph (D), the election provided by paragraph (2) shall be made for any property, in accordance with regulations prescribed by the Secretary or his delegate, not later than the time prescribed by law for filing the return (including extensions thereof) for whichever of the following taxable years in the later: The first taxable year beginning after December 31, 1957, or the first taxable year in which expenditures for development or operation of more than one mine in respect of the property are made by the taxpayer after the acquisition of the property. No election may be made pursuant to this subparagraph for any operating mineral interest which constitutes part or all of an operating unit if the taxpayer makes an election pursuant to subparagraph (B) with respect to any operating mineral interest which constitutes part or all of such operating unit.

(B) Taxable years beginning before January 1, 1958.

The election provided by paragraph (1) may, at the election of the taxpayer, be made for each operating mineral interest, in accordance with regulations prescribed by the Secretary or his delegate, within the time provided in subparagraph (D), for whichever of the following taxable years is the later (not including any taxable year in respect of which an assessment of deficiency is prevented on the date of the enactment of the Technical Amendments Act of 1958 by the operation of any law or rule of law): The first taxable year of the taxpayer which begins after December 31, 1953, and ends after August 16, 1954, or the first taxable year in which any expenditure for development or operation in respect of the separate operating mineral interest is made by the taxpayer after the acquisition of such interest. The election provided by paragraph (2) may, at the election of the taxpayer, be made for any property, in accordance with regulations prescribed by the Secretary or his delegate, within the time prescribed in subparagraph (D), for whichever of the following taxable years is the later (not including any taxable year in respect of which an assessment of deficiency is prevented on the date of the enactment of the Technical Amendments Act of 1958 by the operation of any law or rule of law): The first taxable year beginning after December 31, 1953, and ending after August 16, 1954, or the first taxable year in which expenditures for development or operation of more than one mine in respect of the property are made by the taxpayer after the acquisition of the property.

(C) Effect.

An election made under paragraph (1) or (2) shall be binding upon the taxpayer for all subsequent taxable years, except that the Secretary

or his delegate may consent to a different treatment of any interest with respect to which an election has been made.

(D) Election after final regulations.

Notwithstanding any other provision of this paragraph the time for making an election under paragraph (1) or (2) shall not expire prior to the first day of the first month which begins more than 90 days after the date of publication in the Federal Register of final regulations issued under the authority of this subsection.

(E) Statute of limitations.

If the taxpayer makes an election pursuant to subparagraph (B) and if assessment of any deficiency for any taxable year resulting from such election is prevented on the first day of the first month which begins more than 90 days after the date of publication in the Federal Register of final regulations issued under authority of this subsection, or at any time within one year after such day, by the operation of any law or rule of law, such assessment may, nevertheless, be made if made within one year after such day. An election by a taxpayer pursuant to subparagraph (B) shall be considered as a consent to the assessment pursuant to this subparagraph of any such deficiency. If refund or credit of any overpayment of income tax resulting from an election made pursuant to subparagraph (B) is prevented on such day, or at any time within one year after such day, by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year after such day. This subparagraph shall not apply to any taxable year in respect of which an assessment of a deficiency, or a refund or credit of an overpayment, as the case may be, is prevented by the operation of any law or rule of law on the date of the enactment of the Technical Amendments Act of 1958.

(4) Special rule as to deductions under section 615 (a) prior to aggregation.

(A) In general.

If an aggregation of operating mineral interests formed under paragraph (1) includes any interest or interests in respect of which exploration expenditures, paid or incurred after the acquisition of such interest or interests, were deducted by the taxpayer under section 615 (a) for any taxable year all or any portion of which precedes the date on which such aggregation becomes effective, or the date on which such interest or interests become a part of such aggregation (as the case may be), then the tax imposed by this chapter for such taxable year shall be recomputed as provided in subparagraph (B). In the case of any taxable year beginning before January 1, 1958, this subparagraph shall apply to exploration expenditures deducted in respect of any interest or interests for such taxable year, only if such interest or interests constitute part or all of any operating unit with respect to which the taxpayer makes an election pursuant to paragraph (3) (B) which is applicable with respect to such taxable year.

(B) Recomputation of tax.

A recomputation of the tax imposed by this chapter shall be made for each taxable year described in subparagraph (A) for which exploration expenditures were deducted as though, for each such year, an election had been made to aggregate the separate operating mineral interest or interests with respect to which such exploration expenditures were deducted with those operating mineral interests included in the aggregation formed under paragraph (1) in respect of which any expenditure for exploration, development, or operation had been made by the taxpayer before or during the taxable year to which such election would apply. A recomputation of the tax imposed by this chapter (or by the corresponding provisions of the Internal Revenue Code of 1939) shall also be made for taxable years affected by the recomputation described in the preceding sentence. If the tax so recomputed for any taxable year or years, by reason of the application of this paragraph, exceeds the tax liability previously determined for such year or years, such excess shall be taken into account in the first taxable year to which the election to aggregate under paragraph (1) applies and succeeding taxable years as provided in subparagraph (C).

(C) Increase in tax.

The tax imposed by this chapter for the first taxable year to which the election to aggregate under paragraph (1) applies, and for each succeeding taxable year until the full amount of the excess described in subparagraph (B) has been taken into account, shall be increased by an amount equal to the quotient obtained by dividing such excess by the total number of taxable years described in subparagraph (A) in respect of which—

(i) exploration expenditures were deducted by the taxpayer under section 615 (a), and

(ii) the recomputation of tax described in the first sentence of subparagraph (B) results in an increase in tax or a reduction of a net operating loss.

If the taxpayer dies or ceases to exist, then so much of the excess described in subparagraph (B) as was not taken into account under the preceding sentence for taxable years preceding such death, or such cessation of existence, shall be taken into account for the taxable year in which such death, or such cessation of existence, occurs.

(D) Basis adjustment.

If the tax liability of a taxpayer is increased by reason of the application of this paragraph, proper adjustments shall be made with respect to the basis of the aggregated property owned by such taxpayer, in accordance with regulations prescribed by the Secretary or his delegate, as though the tax liability of the taxpayer for the prior taxable year or years had

been determined in accordance with the recomputation of tax described in subparagraph (B).

(d) Operating mineral interests defined.

For purposes of this section, the term 'operating mineral interest' includes only an interest in respect of which the costs of production of the mineral are required to be taken into account by the taxpayer for purposes of computing the 50 percent limitation provided for in section 613, or would be so required if the mine, well, or other natural deposit were in the production stage.

(e) Special rule as to nonoperating mineral interests.

(1) Aggregation of separate interests.

If a taxpayer owns two or more separate nonoperating mineral interests in a single tract or parcel of land or in two or more adjacent tracts or parcels of land, the Secretary or his delegate shall, on showing by the taxpayer that a principal purpose is not the avoidance of tax, permit the taxpayer to treat (for all purposes of this subtitle) all such mineral interests in each separate kind of mineral deposit as one property. If such permission is granted for any taxable year, the taxpayer shall treat such interests as one property for all subsequent taxable years unless the Secretary or his delegate consents to a different treatment.

(2) Nonoperating mineral interests defined.

For purposes of this subsection, the term "nonoperating mineral interests" includes only interests which are not operating mineral interests.

(Aug. 16, 1954, ch. 736, 68A Stat. 210; Sept. 2, 1958, Pub. L. 85–866, title I, § 37 (a—d), 72 Stat. 1633–1637; Feb. 26, 1964, Pub. L. 88–272, title II, § 226 (a), (b), 78 Stat. 94, 96.)

REFERENCES IN TEXT

The Revenue Act of 1964, referred to in subsec. (b), means Pub. L. 88–272. See short title note set out under section 1 of this title.

Date of the enactment of the Technical Amendments Act of 1958, referred to in subsec. (c) (3) (B), (E), was Sept. 2, 1958.

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–272, § 226(a), amended subsec. (b) generally, and among other changes, substituted provisions stating that except as otherwise provided, all of the taxpayer's operating mineral interests in a separate tract or parcel of land will be combined and treated as one property, that the taxpayer may not combine any operating mineral interest in one tract or parcel of land with an operating mineral interest in another tract or parcel of land, that if he has more than one operating mineral interest in a single tract of land he may elect to treat one or more of such interests as separate properties, limited, however, to one combination of interests in a single tract of land, and providing, in the event the election in par. (2) is made with respect to any tract of land, for the treatment of interests discovered or acquired by the taxpayer in such a tract after the taxable year for which the election is made, for provisions which permitted a taxpayer who owned two or more separate operating mineral interests which constituted all or a part of an operating unit, to elect to form one aggregation and treat as one property any two or more of these interests, treating as separate properties any interests which he did not include in the one aggregation, to aggregate separate interests whether or not in a single tract of land, or contiguous tracts of land, and which forbade him to form more than one aggregation within a single operating unit, inserted provisions in par. (3) relating to unitization or pooling arrangements, and in par (5), providing that if the taxpayer has operating mineral interests on the day preceding the first day of the first taxable year beginning after Dec. 31, 1963, which he treats under subsec. (d) of this section as in effect before amendment by Pub. L. 88–272, he shall continue such treatment and it shall be deemed adopted pursuant to pars. (1) and (2) of this subsection, and eliminated provisions defining "operating mineral interests", and providing for termination of election with respect to mines, excepting oil and gas wells. For definition of "operating mineral interests", see subsec. (d) of this section.

Subsec. (c). Pub. L. 88–272, § 226(b)(1),(2), eliminated par. (5) which defined operating mineral interests, and "1958" which preceded "Special rules" in the subsection catchline.

Subsec. (d). Pub. L. 88–272, § 226(b)(3), amended subsec. (d) generally by substituting the definition of operating mineral interests, for provisions relating to the 1939 Code treatment respecting operating mineral interest in case of oil and gas wells.

Subsec. (e)(2). Pub. L. 88–272, § 226(b)(4), deleted "within the meaning of subsection (b)(3)" from the end of the sentence.

1958—Subsec. (b)(4). Pub. L. 85–866, § 37(a), added subsec. (b)(4).

Subsec. (c). Pub. L. 85–866, § 37(b), added subsec. (c) and redesignated former subsec. (c) as (e).

Subsec. (d). Pub. L. 85–866, § 37(c), added subsec. (d).

Subsec. (e). Pub. L. 85–866, § 37 (b), (d), redesignated former subsec. (c) as (e) and substituted in first sentence of par. (1) "or in two or more adjacent tracts" for "or in two or more contiguous tracts" and "shall, on showing by the taxpayer that a principal purpose is not the avoidance of tax, permit the taxpayer to treat (for all purposes of this subtitle) all such mineral interests in each separate kind of mineral deposit as one property" for "may, on showing of undue hardship, permit the taxpayer to treat (for all purposes of this subtitle) all such mineral interests as one property".

EFFECTIVE DATE OF 1964 AMENDMENT

Section 226(d) of Pub. L. 88–272 provided that: "The amendments made by subsections (a) and (b) [to this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 37 (e) of Pub. L. 85–866 provided that: "The amendments made by subsections (a) and (c) [adding subsecs. (b) (4) and (d) of this section] shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. The amendments made by subsection (b) [to subsecs. (c) and (e) of this section] shall apply with respect to taxable years beginning after December 31, 1957, except that such amendments shall, at the election of the taxpayer made in conformity with such amendments, apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. The amendment made by subsection (d) [to subsecs. (e) (1) of this section] shall apply with respect to taxable years beginning after December 31, 1957, except that with respect to any taxpayer such amendment shall, at the election of the taxpayer, apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954."

ALLOCATION OF BASIS IN CERTAIN CASES

Section 226(c) of Pub. L. 88–272 provided that:

"For purposes of the Internal Revenue Code of 1954—

"(1) Fair market value rule.—Except as provided in paragraph (2), if a taxpayer has a section 614(b) aggregation, then the adjusted basis (as of the first day of the first taxable year beginning after December 31, 1963) of each property included in such aggregation shall be determined by multiplying the adjusted basis of the aggregation by a fraction—

"(A) the numerator of which is the fair market value of such property, and

"(B) the denominator of which is the fair market value of such aggregation.

For purposes of this paragraph, the adjusted basis and the fair market value of the aggregation, and the fair market value of each property included therein,

shall be determined as of the day preceding the first day of the first taxable year which begins after December 31, 1963.

"(2) Allocation of adjustments, etc.—If the taxpayer makes an election under this paragraph with respect to any section 614(b) aggregation, then the adjusted basis (as of the first day of the first taxable year beginning December 31, 1963) of each property included in such aggregation shall be the adjusted basis of such property at the time it was first included in the aggregation by the taxpayer, adjusted for that portion of those adjustments to the basis of the aggregation which are reasonably attributable to such property. If, under the preceding sentence, the total of the adjusted bases of the interests included in the aggregation exceeds the adjusted basis of the aggregation (as of the day preceding the first day of the first taxable year which begins after December 31, 1963), the adjusted bases of the properties which include such interests shall be adjusted, under regulations prescribed by the Secretary of the Treasury or his delegate, so that the total of the adjusted bases of such interests equals the adjusted basis of the aggregation. An election under this paragraph shall be made at such time and in such manner as the Secretary of the Treasury or his delegate shall by regulations prescribe.

"(3) Definitions. For purposes of this subsection—

"(A) Section 614(b) aggregation.—

"The term 'section 614(b) aggregation' means any aggregation to which section 614(b)(1)(A) of the Internal Revenue Code of 1954 (as in effect before the amendments made by subsection (a) of this section) applied for the day preceding the first day of the first taxable year beginning after December 31, 1963.

"(B) Property.

"The term 'property' has the same meaning as is applicable, under section 614 of the Internal Revenue Code of 1954, to the taxpayer for the first taxable year beginning after December 31, 1963."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 57, 617, 636 of this title.

§ 615. Pre-1970 exploration expenditures.

(a) In general.

In the case of expenditures paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, and paid or incurred before the beginning of the development stage of the mine or deposit, there shall be allowed as a deduction in computing taxable income so much of such expenditures as does not exceed $100,000. This section shall apply only with respect to the amount of such expenditures which, but for this section, would not be allowable as a deduction for the taxable year. This section shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 167, but allowances for depreciation shall be considered, for purposes of this section, as expenditures paid or incurred. In no case shall this section apply with respect to amounts paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil or gas.

(b) Election of taxpayer.

If the taxpayer elects, in accordance with regulations prescribed by the Secretary or his delegate, to treat as deferred expenses any portion of the amount deductible for the taxable year under subsection (a), such portion shall not be deductible in the manner provided in subsection (a) but shall be deductible on a ratable basis as the units of produced ores or minerals discovered or explored by reason of such expenditures are sold. An election made under this subsection for any taxable year shall be binding for such year.

(c) Limitation.

(1) In general.

This section shall not apply to any amount paid or incurred to the extent that it would, when added to the amounts which have been deducted under subsection (a) and the amounts which have been treated as deferred expenses under subsection (b), or the corresponding provisions of prior law, exceed $400,000.

(2) Amounts taken into account.

For purposes of paragraph (1), there shall be taken into account amounts deducted and amounts treated as deferred expenses by—

(A) the taxpayer, and

(B) any individual or corporation who has transferred to the taxpayer any mineral property.

(3) Application of paragraph (2)(B).

Paragraph (2)(B) shall apply with respect to all amounts deducted and all amounts treated as deferred expenses which were paid or incurred before the latest such transfer from the individual or corporation to the taxpayer. Paragraph (2)(B) shall apply only if—

(A) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make paragraph (7), (8), (11), (15), (17), (20), or (22) of section 113(a) of the Internal Revenue Code of 1939 apply to such transfer;

(B) the taxpayer would be entitled under section 381(c)(10) to deduct expenses deferred under this section had the distributor or transferor corporation elected to defer such expenses; or

(C) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make section 334(b), 362(a) and (b), 372(a), 373(b)(1), 1051, or 1082 apply to such transfer.

(d) Adjusted basis of mine or deposit.

The amount of expenditures which are treated under subsection (b) as deferred expenses shall be taken into account in computing the adjusted basis of the mine or deposit, but such amounts, and the adjustments to basis provided in section 1016(a)(10) shall be disregarded in determining the adjusted basis of the property for the purpose of computing a deduction for depletion under section 611.

(e) Election to have section apply.

This section (other than subsections (f) and (g)) shall apply only if the taxpayer so elects in such manner as the Secretary or his delegate may by regulations prescribe. Such election shall be made before the expiration of 3 years after the time prescribed by law (determined without any extension thereof) for filing the return for the first taxable year ending after the date of the enactment of this subsection in

which expenditures described in subsection (a) are paid or incurred after such date. Such election may not be revoked after the expiration of such 3 years.

(f) Section 615 and section 617 elections to be mutually exclusive.

A taxpayer who has made an election under subsection (e) (which he has not revoked) may not make an election under section 617(a). A taxpayer who has made an election under section 617(a) (which he has not revoked) may not make an election under subsection (e) of this section.

(g) Effect of transfer of mineral property.

(1) Transfer before election.

If—

(A) any person transfers any mineral property to another person in a transaction as a result of which the basis of such property in the hands of the transferee is determined by reference to the basis in the hands of the transferor, and

(B) the transferor has not, at the time of the transfer, made an election under either subsection (a) of section 617 or subsection (e) of this section,

then no election by the transferor under either such subsection shall apply with respect to expenditures which are made by the transferor after the date of the enactment of this subsection and before the date of the transfer and which are properly chargeable to such property. For purposes of the preceding sentence, a transferor of mineral property who made an election under subsection (a) of section 617 or subsection (e) of this section before the transfer but who revokes such election after the transfer shall be treated with respect to such property as not having made an election under either such subsection.

(2) Effect of election by transferee under section 617.

If—

(A) the taxpayer receives mineral property in a transaction described in paragraph (1)(A),

(B) an election made by the transferor under subsection (e) applies with respect to expenditures which are made by him after the date of the enactment of this subsection and before the date of the transfer and which are properly chargeable to such property, and

(C) the taxpayer has made or makes an election under section 617(a),

then in applying section 617 with respect to the transferee, the amounts allowed as deductions under this section to the transferor, which (but for the transferor's election) would be reflected in the adjusted basis of such property in the hands of the transferee, shall be treated as expenditures allowed as deductions under section 617(a) to the transferor. Notwithstanding subsections (b) and (d) of this section (and section 381(c)(10)), any deferred expenses described in subsection (b) which are not allowed as deductions to the transferor for a period before the transfer may not be deducted by the transferee and in his hands shall be charged to capital account.

(h) Termination.

The provisions of this section shall not apply with respect to expenditures paid or incurred after December 31, 1969. (Aug. 16, 1954, ch. 736, 68A Stat. 211; July 6, 1960, Pub. L. 86–594, § 1, 74 Stat. 333; Sept. 12, 1966, Pub. L. 89–570, § 2(a), 80 Stat. 763; Dec. 30, 1969, Pub. L. 91–172, title V, § 504(a), 83 Stat. 632.)

REFERENCES IN TEXT

The date of the enactment of this subsection, referred to in subsecs. (e) and (g)(1) following (B), (g)(2)(B), means Sept. 12, 1966, the date of enactment of Pub. L. 89–570 which added such subsecs.

AMENDMENTS

1969—Pub. L. 91–172 substituted "Pre-1970 exploration expenditures" for "Exploration expenditures" in the section catchline, and added subsec. (h).

1966—Subsecs. (e)—(g). Pub. L. 89–570 added subsecs. (e)—(g).

1960—Subsec. (c). Pub. L. 86–594 amended subsection generally, and among other changes, substituted provisions making section inapplicable to any amount paid or incurred to the extent that it would, when added to the amounts which have been deducted under subsec. (a) and the amounts which have been treated as deferred expenses under subsec. (b) or the corresponding provisions of prior law, exceed $400,000, for provisions which made section inapplicable to any amount paid or incurred in any taxable year if in any four preceding years a deduction or election has been allowed or exercised, and eliminated provisions which made par. (2)(B) applicable if the taxpayer acquired any mineral property under circumstances which made paragraph (13) of section 113(a) of the Internal Revenue Code of 1939 applicable to the transfer.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 504(d) of Pub. L. 91–172 provided that:

"(1) In general.—The amendments made by this section [amending this section and sections 243, 381, 617, 703 and 1016 of this title] shall apply with respect to exploration expenditures paid or incurred after December 31, 1969.

"(2) Presumption of election under section 617.—For purposes of section 617 of the Internal Revenue Code of 1954 [section 617 of this title], an election under section 615(e) of such Code [subsec. (e) of this section], which is effective with respect to exploration expenditures paid or incurred before January 1, 1970, shall be treated as an election under section 617(a) of such Code [section 617(a) of this title] with respect to exploration expenditures paid or incurred after December 31, 1969. The preceding sentence shall not apply to any taxpayer who notifies the Secretary of the Treasury or his delegate (at such time and in such manner as the Secretary or his delegate prescribes by regulations) that he does not desire his election under section 615(e) [subsec. (e) of this section] to be so treated."

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 89–570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Section 2 of Pub. L. 86–594 provided that: "The amendment made by the first section of this Act [to subsec. (c) of this section] shall apply only with respect to taxable years beginning after the date of the enactment of this Act [July 6, 1960]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 243, 381, 614, 617, 703, 1016, 1091 of this title.

§ 616. Development expenditures.

(a) In general.

Except as provided in subsection (b), there shall be allowed as a deduction in computing taxable in-

come all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed. This section shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 167, but allowances for depreciation shall be considered, for purposes of this section, as expenditures.

(b) Election of taxpayer.

At the election of the taxpayer, made in accordance with regulations prescribed by the Secretary or his delegate, expenditures described in subsection (a) paid or incurred during the taxable year shall be treated as deferred expenses and shall be deductible on a ratable basis as the units of produced ores or minerals benefited by such expenditures are sold. In the case of such expenditures paid or incurred during the development stage of the mine or deposit, the election shall apply only with respect to the excess of such expenditures during the taxable year over the net receipts during the taxable year from the ores or minerals produced from such mine or deposit. The election under this subsection, if made, must be for the total amount of such expenditures, or the total amount of such excess, as the case may be, with respect to the mine or deposit, and shall be binding for such taxable year.

(c) Adjusted basis of mine or deposit.

The amount of expenditures which are treated under subsection (b) as deferred expenses shall be taken into account in computing the adjusted basis of the mine or deposit, except that such amount, and the adjustments to basis provided in section 1016 (a) (9), shall be disregarded in determining the adjusted basis of the property for the purpose of computing a deduction for depletion under section 611. (Aug. 16, 1954, ch. 736, 68A Stat. 212.)

CROSS REFERENCES

Exception from denial of deduction for capital expenditures, see section 263 (a) (1) (A) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 263, 381, 1016 of this title.

§ 617. Deduction and recapture of certain mining exploration expenditures.

(a) Allowance of deduction.

(1) General rule.

At the election of the taxpayer, expenditures paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, and paid or incurred before the beginning of the development stage of the mine, shall be allowed as a deduction in computing taxable income. This subsection shall apply only with respect to the amount of such expenditures which, but for this subsection, would not be allowable as a deduction for the taxable year. This subsection shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 167, but allowances for depreciation shall be considered, for purposes of this subsection, as expenditures paid or incurred. In no case shall this subsection apply with respect to amounts paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil or gas or of any mineral with respect to which a deduction for percentage depletion is not allowable under section 613.

(2) Elections.

(A) Method.

Any election under this subsection shall be made in such manner as the Secretary or his delegate may by regulations prescribe.

(B) Time and scope.

The election provided by paragraph (1) for the taxable year may be made at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for the taxable year. Such an election for the taxable year shall apply to all expenditures described in paragraph (1) paid or incurred by the taxpayer during the taxable year or during any subsequent taxable year. Such an election may not be revoked after the last day of the third month following the month in which the final regulations issued under the authority of this subsection are published in the Federal Register, unless the Secretary or his delegate consents to such revocation.

(C) Deficiencies.

The statutory period for the assessment of any deficiency for any taxable year, to the extent such deficiency is attributable to an election or revocation of an election under this subsection, shall not expire before the last day of the 2-year period beginning on the day after the date on which such election or revocation of election is made; and such deficiency may be assessed at any time before the expiration of such 2-year period, notwithstanding any law or rule of law which would otherwise prevent such assessment.

(h) Recapture on reaching producing stage.

(1) Recapture.

If, in any taxable year, any mine with respect to which expenditures were deducted pursuant to subsection (a) reaches the producing stage, then—

(A) If the taxpayer so elects with respect to all such mines reaching the producing stage during the taxable year, he shall include in gross income for the taxable year an amount equal to the adjusted exploration expenditures with respect to such mines, and the amount so included in income shall be treated for purposes of this subtitle as expenditures which (i) are paid or incurred on the respective dates on which the mines reach the producing stage, and (ii) are properly chargeable to capital account.

(B) If subparagraph (A) does not apply with respect to any such mine, then the deduction for depletion under section 611 with respect to the property shall be disallowed until the amount of depletion which would be allowable but for

this subparagraph equals the amount of the adjusted exploration expenditures with respect to such mine.

(2) Elections.

(A) Method.

Any election under this subsection shall be made in such manner as the Secretary or his delegate may by regulations prescribe.

(B) Time and scope.

The election provided by paragraph (1) for any taxable year may be made or changed not later than the time prescribed by law for filing the return (including extensions thereof) for such taxable year.

(c) Recapture in case of bonus or royalty.

If an election has been made under subsection (a) with respect to expenditures relating to a mining property and the taxpayer receives or accrues a bonus or a royalty with respect to such property, then the deduction for depletion under section 611 with respect to the bonus or royalty shall be disallowed until the amount of depletion which would be allowable but for this subsection equals the amount of the adjusted exploration expenditures with respect to the property to which the bonus or royalty relates.

(d) Gain from dispositions of certain mining property.

(1) General rule.

Except as otherwise provided in this subsection, if mining property is disposed of the lower of—

(A) the adjusted exploration expenditures with respect to such property, or

(B) the excess of—

(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value (in the case of any other disposition), over

(ii) the adjusted basis of such property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Disposition of portion of property.

For purposes of paragraph (1)—

(A) In the case of the disposition of a portion of a mining property (other than an undivided interest), the entire amount of the adjusted exploration expenditures with respect to such property shall be treated as attributable to such portion to the extent of the amount of the gain to which paragraph (1) applies.

(B) In the case of the disposition of an undivided interest in a mining property (or a portion thereof), a proportionate part of the adjusted exploration expenditures with respect to such property shall be treated as attributable to such undivided interest to the extent of the amount of the gain to which paragraph (1) applies.

This paragraph shall not apply to any expenditure to the extent the taxpayer establishes to the satisfaction of the Secretary or his delegate that such expenditure relates neither to the portion (or interest therein) disposed of nor to any mine, in the property held by the taxpayer before the disposition, which has reached the producing stage.

(3) Exceptions and limitations.

Paragraphs (1), (2), and (3) of section 1245(b) (relating to exceptions and limitations with respect to gain from disposition of certain depreciable property) shall apply in respect of this subsection in the same manner and with the same effect as if references in section 1245(b) to section 1245 or any provision thereof were references to this subsection or the corresponding provisions of this subsection and as if references to section 1245 property were references to mining property.

(4) Application of subsection.

This subsection shall apply notwithstanding any other provision of this subtitle.

(e) Basis of property.

(1) Basis.

The basis of any property shall not be reduced by the amount of any depletion which would be allowable but for the application of this section.

(2) Adjustments.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (d)(1).

(f) Definitions.

For purposes of this section

(1) Adjusted exploration expenditures.

The term "adjusted exploration expenditures" means, with respect to any property or mine—

(A) the amount of the expenditures allowed for the taxable year and all preceding taxable years as deductions under subsection (a) to the taxpayer or any other person which are properly chargeable to such property or mine and which (but for the election under subsection (a)) would be reflected in the adjusted basis of such property or mine, reduced by

(B) for the taxable year and for each preceding taxable year, the amount (if any) by which (i) the amount which would have been allowable for percentage depletion under section 613 but for the deduction of such expenditures, exceeds (ii) the amount allowable for depletion under section 611,

properly adjusted for any amounts included in gross income under subsection (b) or (c) and for any amounts of gain to which subsection (d) applied.

(2) Mining property.

The term "mining property" means any property (within the meaning of section 614 after the application of subsections (c) and (e) thereof) with respect to which any expenditures allowed as a deduction under subsection (a)(1) are properly chargeable.

(3) Disposal of coal or domestic iron ore with a retained economic interest.

A transaction which constitutes a disposal of coal or iron ore under section 631(c) shall be treated as a disposition. In such a case, the excess

referred to in subsection (d)(1)(B) shall be treated as equal to the gain (if any) referred to in section 631(c).

(g) Special rules relating to partnership property.

(1) Property distributed to partner.

In the case of any property or mine received by the taxpayer in a distribution with respect to part or all of his interest in a partnership, the adjusted exploration expenditures with respect to such property or mine include the adjusted exploration expenditures (not otherwise included under subsection (f)(1)) with respect to such property or mine immediately prior to such distribution, but the adjusted exploration expenditures with respect to any such property or mine shall be reduced by the amount of gain to which section 751 (b) applied realized by the partnership (as constituted after the distribution) on the distribution of such property or mine.

(2) Property retained by partnership.

In the case of any property or mine held by a partnership after a distribution to a partner to which section 751(b) applied, the adjusted exploration expenditures with respect to such property or mine shall, under regulations prescribed by the Secretary or his delegate, be reduced by the amount of gain to which section 751(b) applied realized by such partner with respect to such distribution on account of such property or mine.

(b) Limitation.

(1) In general.

Subsection (a) shall apply to any amount paid or incurred after December 31, 1969, with respect to any deposit of ore or other mineral located outside the United States, only to the extent that such amount, when added to the amounts which are or have been deducted under subsection (a) and section 615(a) and the amounts which are or have been treated as deferred expenses under section 615(b), or the corresponding provisions of prior law, does not exceed $400,000.

(2) Amounts taken into account.

For purposes of paragraph (1), there shall be taken into account amounts deducted and amounts treated as deferred expenses by—

(A) the taxpayer, and

(B) any individual or corporation who has transferred to the taxpayer any mineral property.

(3) Application of paragraph (2)(B).

Paragraph (2)(B) shall apply with respect to all amounts deducted and all amounts treated as deferred expenses which were paid or incurred before the latest such transfer from the individual or corporation to the taxpayer. Paragraph (2)(B) shall apply only if—

(A) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make paragraph (7), (8), (11), (15), (17), (20), or (22) of section 113(a) of the Internal Revenue Code of 1939 apply to such transfer;

(B) the taxpayer would be entitled under section 381(c)(10) to deduct expenses deferred under section 615(b) had the distributor or transferor corporation elected to defer such expenses; or

(C) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make section 334(b), 362 (a) and (b), 372(a), 373(b)(1), 1051, or 1082 apply to such transfer.

(Added Pub. L. 89–570, § 1 (a), Sept 12, 1966, 80 Stat. 759, and amended Pub. L. 91–172, title V, § 504(b), Dec. 30, 1969, 83 Stat. 632.)

REFERENCE IN TEXT

Section 113(a) of the Internal Revenue Code of 1939, referred to in subsec. (h)(3)(A), is now covered by various sections of this title. See distribution tables for distribution of said section 113(a) of the Internal Revenue Code of 1939 to sections of this title.

AMENDMENTS

1969—Pub. L. 91–172, § 504(b)(1), substituted "Deduction and recapture of certain mining exploration expenditures" for "Additional exploration expenditures in the case of domestic mining" in the section catchline.

Subsec. (a)(1). Pub. L. 91–172, § 504(b)(2), struck out reference to United States, the Outer Continental Shelf and the Outer Continental Shelf Lands Act from general rule dealing with allowance of deductions for expenditures in ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral.

Subsec. (h). Pub. L. 91–172, § 504(b)(3), substituted provisions imposing limitations on the operation of this section for provision making cross reference to subsecs. (f) and (g) of section 615.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 504(b) of Pub. L. 91–172 applicable with respect to exploration expenditures paid or incurred after Dec. 31, 1969, and for purposes of this section, elections under section 615(e) of this title, effective with respect to exploration expenditures paid or incurred before Jan. 1, 1970, to be treated as an election under subsec. (a) of this section with respect to exploration expenditures paid or incurred after Dec. 31, 1969, see section 504(d) of Pub. L. 91–172, set out as a note under section 615 of this title.

EFFECTIVE DATE

Section 3 of Pub. L. 89–570 provided that: "The amendments made by this Act [enacting this section and amending sections 170, 301, 312, 341, 453, 615, 703, and 751 of this title] shall apply to taxable years ending after the date of the enactment of this Act [Sept. 12, 1966] but only in respect of expenditures paid or incurred after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 301, 312, 341, 381, 453, 615, 703, 751 of this title.

PART II.—EXCLUSIONS FROM GROSS INCOME

Sec.

621. Payments to encourage exploration, development, and mining for defense purposes.

§ 621. Paymeuts to encourage exploration, development, and mining for defense purposes.

There shall not be included in gross income any amount paid to a taxpayer by the United States (or any agency or instrumentality thereof), whether by grant or loan, and whether or not repayable, for the encouragement of exploration, development, or mining of critical and strategic minerals or metals pursuant to or in connection with any undertaking approved by the United States (or any of its agencies or instrumentalities) and for which an accounting is made or required to be made to an appropriate governmental agency, or any forgiveness or discharge of

any part of such amount. Any expenditures (other than expenditures made after the repayment of such grant or loan) attributable to such grant or loan shall not be deductible by the taxpayer as an expense nor increase the basis of the taxpayer's property either for determining gain or loss on sale, exchange, or other disposition or for computing depletion or depreciation, but on the repayment of any portion of any such grant or loan which has been expended in accordance with the terms thereof such deductions and such increase in basis shall to the extent of such repayment be allowed as if made at the time of such repayment. (Aug. 16, 1954, ch. 736, 68A Stat. 212.)

PART III.—SALES AND EXCHANGES

Sec.
631. Gain or loss in the case of timber, coal, or domestic iron ore.
632. Sale of oil or gas properties.

AMENDMENTS

1964—Pub. L. 88–272, title II, § 227(b)(2), Feb. 26, 1964, 78 Stat. 98, inserted the reference to domestic iron ore in item 631.

§ 631. Gain or loss in the case of timber, coal, or domestic iron ore.

(a) Election to consider cutting as sale or exchange.

If the taxpayer so elects on his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than 6 months before the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. If such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the fair market value of such timber, and the adjusted basis for depletion of such timber in the hands of the taxpayer. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under this subsection, such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has a contract right to cut and shall be binding on the taxpayer for the taxable year for which the election is made and for all subsequent years, unless the Secretary or his delegate, on showing of undue hardship, permits the taxpayer to revoke his election; such revocation, however, shall preclude any further elections under this subsection except with the consent of the Secretary or his delegate. For purposes of this subsection and subsection (b), the term "timber" includes evergreen trees which are more than 6 years old at the time severed from the roots and are sold for ornamental purposes.

(b) Disposal of timber with a retained economic interest.

In the case of the disposal of timber held for more than 6 months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. The date of disposal of such timber shall be deemed to be the date such timber is cut, but if payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term "owner" means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.

(c) Disposal of coal or domestic iron ore with a retained economic interest.

In the case of the disposal of coal (including lignite), or iron ore mined in the United States, held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal or iron ore, the difference between the amount realized from the disposal of such coal or iron ore and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal or iron ore. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal or iron ore, and the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor. The date of disposal of such coal or iron ore shall be deemed to be the date such coal or iron ore is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. This subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545(b)(5)). This subsection shall not apply to any disposal of iron ore—

(1) to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b), or

(2) to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore.

(Aug. 16, 1954, ch. 736, 68A Stat. 213; Feb. 26, 1964 Pub. L. 88–272, title II, § 227 (a)(1), (b)(1), 78 Stat. 97, 98.)

AMENDMENTS

1964—Pub. L. 88–272, § 227(b)(1), inserted the reference to domestic iron ore in the section catchline.

Subsec. (c). Pub. L. 88–272, § 227(a)(1), inserted "or domestic iron ore" in the subsection catchline, "or iron

ore mined in the United States" after "coal (including lignite)", "or iron ore" after "coal" wherever appearing, and provided that the subsection shall not apply to any disposal of iron ore to a person whose relationship to the person disposing of such ore would result in the disallowance of losses under section 267 of 717(b), or to a person owned or controlled by the same interests which own or control the person disposing of such iron ore.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88-272 applicable with respect to amounts received or accrued in taxable years beginning after Dec. 31, 1963, attributable to iron ore mined in such years, see section 227(c) of Pub. L. 88-272, set out as a note under section 272 of this title.

CROSS REFERENCES

Disposal of coal or domestic iron ore, see section 272 of this title.

Gain or loss under this section excluded from net earnings from self-employment, see section 1402 (a) (4) of this title.

Property used in trade or business as including timber, coal or domestic iron ore under this section, see section 1231 (b) (2) of this title.

Tax on foreign corporations not engaged in business in United States, applicability of subsections (b) and (c) of this section, see section 881 (a) of this title.

Tax on nonresident alien individuals, applicability of subsections (b) and (c) of this section to, see section 871 (a) (1) of this title.

Unrelated business taxable income, inapplicability of this section to, see section 512 (b) (5) of this title.

Withholding tax on nonresident aliens, applicability of subsections (b) and (c) of this section to, see section 1441 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 272, 512, 617, 871, 881, 882, 1201, 1231, 1402, 1441 of this title; title 42 section 411.

§ 632. Sale of oil or gas properties.

In the case of a bona fide sale of any oil or gas property, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration or discovery work done by the taxpayer, the portion of the tax imposed by section 1 attributable to such sale shall not exceed 33 percent of the selling price of such property or interest. (Aug. 16, 1954, ch. 736, 68A Stat. 214; Dec. 30, 1969, Pub. L. 91-172, title VIII, § 803(d) (4), 83 Stat. 684.)

AMENDMENTS

1969—Pub. L. 91-172 substituted "tax" for "surtax" and "33 per cent" for "30 per cent".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1970, see section 803(f) of Pub. L. 91-172, set out as a note under section 1 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 5 of this title.

PART IV.—MINERAL PRODUCTION PAYMENTS

Sec.
636. Income tax treatment of mineral production payments.

AMENDMENTS

1969—Pub. L. 91-172, title V, § 503(a), Dec. 30, 1969, 83 Stat. 630, added Part heading and section analysis.

§ 636. Income tax treatment of mineral production payments.

(a) Carved-out production payments.

A production payment carved out of mineral property shall be treatod, for purposes of this subtitle, as if it were a mortgage loan on the property, and shall not qualify as an economic interest in the mineral property. In the case of a production payment carved out for exploration or development of a mineral property, the preceding sentence shall apply only if and to the extent gross income from the property (for purposes of section 613) would be realized, in the absence of the application of such sentence, by the person creating the production payment.

(b) Retained production payment on sale of mineral property.

A production payment retained on the sale of a mineral property shall be treated, for purposes of this subtitle, as if it were a purchase money mortgage loan and shall not qualify as an economic interest in the mineral property.

(c) Retained production payment on lease of mineral property.

A production payment retained in a mineral property by the lessor in a leasing transaction shall be treated, for purposes of this subtitle, insofar as the lessee (or his successors in interest) is concerned, as if it were a bonus granted by the lessee to the lessor payable in installments. The treatment of the production payment in the hands of the lessor shall be determined without regard to the provisions of this subsection.

(d) Definition.

As used in this section, the term "mineral property" has the meaning assigned to the term "property" in section 614(a).

(e) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section. (Added Pub. L. 91-172, title V, § 503(a), Dec. 30, 1969, 83 Stat. 630.)

EFFECTIVE DATE

Section 503(c) of Pub. L. 91-172 provided that:

"(1) General rule.—The amendments made by this section [adding this section] shall apply with respect to mineral production payments created on or after August 7, 1969, other than mineral production payments created before January 1, 1971, pursuant to a binding contract entered into before August 7, 1969.

"(2) Election.—At the election of the taxpayer (made at such time and in such manner as the Secretary of the Treasury or his delegate prescribes by regulations), the amendments made by this section shall apply with respect to all mineral production payments which the taxpayer carved out of mineral properties after the beginning of his last taxable year ending before August 7, 1969. No interest shall be allowed on any refund or credit of any overpayment resulting from such election for any taxable year ending before August 7, 1969.

"(3) Special rule.—With respect to a taxpayer who does not elect the treatment provided in paragraph (2) and who carves out one or more mineral production payments on or after August 7, 1969, during the taxable year which includes such date, the amendments made by this section shall apply to such production payments only to the extent the aggregate amount of such production payments exceeds the lesser of—

"(A) the excess of

"(i) the aggregate amount of production payments carved out and sold by the taxpayer during the 12-month period immediately preceding his taxable year which includes August 7, 1969, over

"(ii) the aggregate amount of production payments carved out before August 7, 1969, by the taxpayer during his taxable year which includes such date, or

"(B) the amount necessary to increase the amount of the taxpayer's gross income, within the meaning of chapter 1 of subtitle A of the Internal Revenue Code of

1954 [this title], for the taxable year which includes August 7, 1969, to an amount equal to the amount of deductions (other than any deduction under section 172 of such Code) [section 172 of this title] allowable for such year under such chapter.

The preceding sentence shall not apply for purposes of determining the amount of any deduction allowable under section 611 [section 611 of this title] or the amount of foreign tax credit allowable under section 904 of such Code [section 904 of this title]."

PART V.—CONTINENTAL SHELF AREAS

Sec.
638. Continental shelf areas.

AMENDMENTS

1969—Pub. L. 91–172, title V, § 505(a), Dec. 30, 1969, 83 Stat. 634, added Part heading and section analysis.

§ 638. Continental shelf areas.

For purposes of applying the provisions of this chapter (including sections 861(a)(3) and 862(a)(3) in the case of the performance of personal services) with respect to mines, oil and gas wells, and other natural deposits—

(1) the term "United States" when used in a geographical sense includes the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources; and

(2) the terms "foreign country" and "possession of the United States" when used in a geographical sense include the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the foreign country or such possession and over which the foreign country (or the United States in case of such possession) has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources, but this paragraph shall apply in the case of a foreign country only if it exercises, directly or indirectly, taxing jurisdiction with respect to such exploration or exploitation.

No foreign country shall, by reason of the application of this section, be treated as a country contiguous to the United States. (Added Pub. L. 91–172 title V, § 505(a), Dec. 30, 1969, 83 Stat. 634.)

Subchapter J.—Estates, Trusts, Beneficiaries, and Decedents

Part
I. Estates, trusts, and beneficiaries.
II. Income in respect of decedents.

SUBCHAPTER REFERRED TO IN OTHER SECTIONS

This subchapter is referred to in section 511 of this title.

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

Subpart
A. General rules for taxation of estates and trusts.
B. Trusts which distribute current income only.
C. Estates and trusts which may accumulate income or which distribute corpus.
D. Treatment of excess distributions by trusts.
E. Grantors and others treated as substantial owners.
F. Miscellaneous.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in sections 543, 554 of this title.

SUBPART A.—GENERAL RULES FOR TAXATION OF ESTATES AND TRUSTS

Sec.
641. Imposition of tax.
642. Special rules for credits and deductions.
643. Definitions applicable to subparts A, B, C, and D.

§ 641. Imposition of tax.

(a) Application of tax.

The tax imposed by section 1(d) shall apply to the taxable income of estates or of any kind of property held in trust, including—

(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Computation and payment.

The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary. (Aug. 16, 1954, ch. 736, 68A Stat. 215; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 803(d)(3), 83 Stat. 684.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 substituted "The tax imposed by section 1(d)", for "The Taxes imposed by this chapter on individuals".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1970, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

CROSS REFERENCES

Charitable trusts subject to tax, see section 511 (b) of this title.

Income from an interest in an estate or trust as gross income, see section 61 (a) (15) of this title.

Rates of tax on individuals, see section 1 of this title.

Returns—

Estates and trusts, see section 6012 (a), (3), (4), (5), (b) (4) of this title.

Joint fiduciaries, see section 6012 (b) (5) of this title.

Taxable income defined, see section 63 of this title.

§ 642. Special rules for credits and deductions.

(a) Credits against tax.

(1) Partially tax-exempt interest.

An estate or trust shall be allowed the credit against tax for partially tax-exempt interest provided by section 35 only in respect of so much of such interest as is not properly allocable to any beneficiary under section 652 or 662. If the estate

or trust elects under section 171 to treat as amortizable the premium on bonds with respect to the interest on which the credit is allowable under section 35, such credit (whether allowable to the estate or trust or to the beneficiary) shall be reduced under section 171 (a) (3).

(2) Foreign taxes.

An estate or trust shall be allowed the credit against tax for taxes imposed by foreign countries and possessions of the United States, to the extent allowed by section 901, only in respect of so much of the taxes described in such section as is not properly allocable under such section to the beneficiaries.

(b) Deduction for personal exemption.

An estate shall be allowed a deduction of $600. A trust which, under its governing instrument, is required to distribute all of its income currently shall be allowed a deduction of $300. All other trusts shall be allowed a deduction of $100. The deductions allowed by this subsection shall be in lieu of the deductions allowed under section 151 (relating to deduction for personal exemption).

(c) Deduction for amounts paid or permanently set aside for a charitable purpose.

(1) General rule.

In the case of an estate or trust (other than [1] a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

(2) Amounts permanently set aside.

In the case of an estate, and in the case of a trust (other than a trust meeting the specifications of subpart B) required by the terms of its governing instrument to set aside amounts which was—

(A) created on or before October 9, 1969, if—

(i) an irrevocable remainder interest is transferred to or for the use of an organization described in section 170(c), or

(ii) the grantor is at all times after October 9, 1969, under a mental disability to change the terms of the trust; or

(B) established by a will executed on or befor October 9, 1969, if—

(i) the testator dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise,

(ii) the testator at no time after October 9, 1969, had the right to change the portions of the will which pertain to the trust, or

(iii) the will is not republished by codicil or otherwise before October 9, 1972, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise,

there shall also be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit. In the case of a trust, the preceding sentence shall apply only to gross income earned with respect to amounts transferred to the trust before October 9, 1969, or transferred under a will to which subparagraph (B) applies.

(3) Pooled income funds.

In the case of a pooled income fund (as defined in paragraph (5)), there shall also be allowed as a deduction in computing its taxable income any amount of the gross income attributable to gain from the sale of a capital asset held for more than 6 months, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c).

(4) Adjustments.

To the extent that the amount otherwise allowable as a deduction under this subsection consists of gain from the sale or exchange of capital assets held for more than 6 months, proper adjustment shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income).

(5) Definition of pooled income fund.

For purposes of paragraph (3), a pooled income fund is a trust—

(A) to which each donor transfers property, contributing an irrevocable remainder interest in such property to or for the use of an organization described in section 170(b)(1)(A) (other than in clauses (vii) or (viii)), and retaining an income interest for the life of one or more beneficiaries (living at the time of such transfer),

(B) in which the property transferred by each donor is commingled with property transferred by other donors who have made or make similar transfers,

(C) which cannot have investments in securities which are exempt from the taxes imposed by this subtitle,

[1] So in original.

(D) which includes only amounts received from transfers which meet the requirements of this paragraph,

(E) which is maintained by the organization to which the remainder interest is contributed and of which no donor or beneficiary of an income interest is a trustee, and

(F) from which each beneficiary of an income interest receives income, for each year for which he is entitled to receive the income interest referred to in subparagraph (A), determined by the rate of return earned by the trust for such year.

For purposes of determining the amount of any charitable contribution allowable by reason of a transfer of property to a pooled fund, the value of the income interest shall be determined on the basis of the highest rate of return earned by the fund for any of the 3 taxable years immediately preceding the taxable year of the fund in which the transfer is made. In the case of funds in existence less than 3 taxable years preceding the taxable year of the fund in which a transfer is made the rate of return shall be deemed to be 6 percent per annum, except that the Secretary or his delegate may prescribe a different rate of return.

(6) Taxable private foundations.

In the case of a private foundation which is not exempt from taxation under section 501(a) for the taxable year, the provisions of this subsection shall not apply and the provisions of section 170 shall apply.

(d) Net operating loss deduction.

The benefit of the deduction for net operating losses provided by section 172 shall be allowed to estates and trusts under regulations prescribed by the Secretary or his delegate.

(e) Deduction for depreciation and depletion.

An estate or trust shall be allowed the deduction for depreciation and depletion only to the extent not allowable to beneficiaries under sections 167 (h) and 611 (b).

(f) Amortization deductions.

The benefit of the deductions for amortization provided by sections 168, 169, 184, and 187 shall be allowed to estates and trusts in the same manner as in the case of an individual. The allowable deduction shall be apportioned between the income beneficiaries and the fiduciary under regulations prescribed by the Secretary or his delegate.

(g) Disallowance of double deductions.

Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary or his delegate, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of deeedents).

(h) Unused loss carryovers and excess deductions on termination available to beneficiaries.

If on the termination of an estate or trust, the estate or trust has—

(1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or

(2) for the last taxable year of the estate or trust deductions (other than the deductions allowed under subsections (b) or (c)) in excess of gross income for such year,

then such carryover or such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary or his delegate, to the beneficiaries succeeding to the property of the estate or trust.

(i) Cross references.

(1) For disallowance of standard deduction in case of estates and trusts, see section 142(b)(4).

(2) For special rnle for determining tbe time of receipt of dividends by a beneficiary under section 652 or 662, see section 116(c)(3).

(Aug. 16, 1954, ch. 736, 68A Stat. 215; Oct. 16, 1962, Pub. L. 87–834, § 13(c)(2)(A), 76 Stat. 1034; Feb. 26, 1964, Pub. L. 88–272, title II, § 201(d)(6)(A), (B), 78 Stat. 32; Oct. 4, 1966, Pub. L. 89–621, § 2(a), 80 Stat. 872; Dec. 30, 1969, Pub. L. 91–172, title II, § 201(b), title VII, § 704(b)(2), 83 Stat. 558, 669.)

AMENDMENTS

1969—Subsec. (c). Pub. L. 91–172, § 201(b), designated existing provisions, with minor changes, as par. (1) and added pars. (2) to (6).

Subsec. (f). Pub. L. 91–172, § 704(b)(2), removed reference to emergency or grain storage facilities both in subsec. catchline and in text, and added reference to sections 184 and 187 in text.

1966—Subsec. (g). Pub. L. 89–621 inserted "or of any other person" after "shall not be allowed as a deduction in computing the taxable income of the estate".

1964—Subsec. (a)(3). Pub. L. 88–272, § 201(d)(6)(A), deleted par. (3) which related to dividends received by individuals.

Subsec. (i). Pub. L. 88–272, § 201(d)(6)(B), designated existing provisions as par. (1), and added par. (2).

1962—Subsec. (e). Pub. L. 87–834 substituted a reference to section 167 (h) for a reference to section 167(g).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (c) of this section by section 201(b) of Pub. L. 91–172 applicable with respect to amounts paid, permanently set aside, or to be used for a charitable purpose in taxable years beginning after Dec. 31, 1969, except that subsec. (c)(5), as amended, applicable to transfers in trust made after July 31, 1969, see section 201(g) of Pub. L. 91–172, set out as a note under section 170 of this title.

Amendment of subsec. (f) by section 704(b)(2) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1968, see section 704(c) of Pub. L. 91–172, set out as a notc under section 169 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 2(b) of Pub. L. 89–621 provided that: "The amendment made by subsection (a) [amending subsec. (g) of this section] shall apply to taxable years ending after the date of the enactment of this Act [Oct. 4, 1966], but only with respect to amounts paid or incurred, and losses sustained, after such date."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (e) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec.

31, 1961, and ending after Oct. 16, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

CROSS REFERENCES

Deductions—
Estates and trusts accumulating income or distributing corpus, see section 661 of this title.
Trusts distributing current income only, see section 651 of this title.
Value of gross estate, see section 2053 et seq. of this title.
Limitation on charitable deductions, see section 681 of this title.
Returns by trust claiming charitable deduction under subsection (c) of this section, see section 6034 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 507, 508, 542, 643, 651, 661, 662, 663, 665, 681, 904, 2055, 2522, 4947, 4948, 6034 of this title.

§ 643. Definitions applicable to subparts A, B, C, and D.

(a) Distributable net income.

For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) Deduction for distributions.

No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) Deduction for personal exemption.

No deduction shall be taken under section 642 (b) (relating to deduction for personal exemptions).

(3) Capital gains and losses.

Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642 (c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(4) Extraordinary dividends and taxable stock dividends.

For purposes only of subpart B (relating to trusts which distribute current income only), there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

(5) Tax-exempt interest.

There shall be included any tax-exempt interest to which section 103 applies, reduced by any amounts which would be deductible in respect of disbursements allocable to such interest but for the provisions of section 265 (relating to disallowance of certain deductions).

(6) Income of foreign trust.

In the case of a foreign trust—

(A) There shall be included the amounts of gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265(1) (relating to disallowance of certain deductions).

(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

(C) Paragraph (3) shall not apply to a foreign trust created by a United States person. In the case of such a trust, (i) there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, and (ii) the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(7) Dividends.

There shall be included the amount of any dividends excluded from gross income pursuant to section 116 (relating to partial exclusion of dividends received).

If the estate or trust is allowed a deduction under section 642 (c), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 642 (c) is deemed to consist of items specified in those paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

(b) Income.

For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

(c) Beneficiary.

For purposes of this part, the term "beneficiary" includes heir, legatee, devisee.

(d) Foreign trusts created by United States persons.

For purposes of this part, the term "foreign trust created by a United States person" means that portion of a foreign trust (as defined in section 7701(a)(31)) attributable to money or property transferred directly or indirectly by a United States person (as defined in section 7701(a)(30), or under the will of a decedent who at the date of his death was a United

States citizen or resident. (Aug. 16, 1954, ch. 736, 68A Stat. 217; Oct. 16, 1962, Pub. L. 87–834, § 7(a), 76 Stat. 985.)

AMENDMENTS

1962—Subsec. (a)(6). Pub. L. 87–834, § 7(a)(1), substituted "Income of foreign trust" for "Foreign income" in the subsection catchline, designated existing provisions as subpar. (A), and added subpars. (B) and (C).

Subsec. (d). Pub. L. 87–834, § 7(a)(2), added subsec. (d).

EFFECTIVE DATE OF 1962 AMENDMENT

Section 7(j) of Pub. L. 87–834 provided that: "The amendments made by this section [amending this section and sections 665, 666 and 668 of this title and adding section 669 of this title] (other than by subsections (f), (g) and (h) [adding sections 6048, 6677 and 7701(a)(30), (31) of this title]), shall apply with respect to distributions made after December 31, 1962."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 512, 6166 of this title.

SUBPART B.—TRUSTS WHICH DISTRIBUTE CURRENT INCOME ONLY

Sec.
651. Deduction for trusts distributing current income only.
652. Inclusion of amounts in gross income of beneficiaries of trusts distributing current income only.

§ 651. Deduction for trusts distributing current income only.

(a) Deduction.

In the case of any trust the terms of which—

(1) provide that all of its income is required to be distributed currently, and

(2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 642 (c) (relating to deduction for charitable, etc., purposes),

there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently. This section shall not apply in any taxable year in which the trust distributes amounts other than amounts of income described in paragraph (1).

(b) Limitation on deduction.

If the amount of income required to be distributed currently exceeds the distributable net income of the trust for the taxable year, the deduction shall be limited to the amount of the distributable net income. For this purpose, the computation of distributable net income shall not include items of income which are not included in the gross income of the trust and the deductions allocable thereto. (Aug. 16, 1954, ch. 736, 68A Stat. 219.)

CROSS REFERENCES

Deduction for estates and trusts accumulating income or distributing copies, see section 661 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 643, 652, 663 of this title.

§ 652. Inclusion of amounts in gross income of beneficiaries of trusts distributing current income only.

(a) Inclusion.

Subject to subsection (b), the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. If such amount exceeds the distributable net income, there shall be included in the gross income of each beneficiary an amount which bears the same ratio to distributable net income as the amount of income required to be distributed to such beneficiary bears to the amount of income required to be distributed to all beneficiaries.

(b) Character of amounts.

The amounts specified in subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the trust as the total of each class bears to the total distributable net income of the trust, unless the terms of the trust specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary or his delegate.

(c) Different taxable years.

If the taxable year of a beneficiary is different from that of the trust, the amount which the beneficiary is required to include in gross income in accordance with the provisions of this section shall be based upon the amount of income of the trust for any taxable year or years of the trust ending within or with his taxable year. (Aug. 16, 1954, ch. 736, 68A Stat. 219.)

CROSS REFERENCES

Computation of deduction for capital gains in case of estate or trust, see section 1202 of this title.

Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus, see section 662 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 116, 642, 1202 of this title.

SUBPART C.—ESTATES AND TRUSTS WHICH MAY ACCUMULATE INCOME OR WHICH DISTRIBUTE CORPUS

Sec.
661. Deductions for estates and trusts accumulating income or distributing corpus.
662. Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus.
663. Special rules applicable to sections 661 and 662.
664. Charitable remainder trusts.

AMENDMENTS

1969—Pub. L. 91–172, title II, § 201(e)(2), Dec. 30, 1969, 83 Stat. 564, added item 664.

§ 661. Deduction for estates and trusts accumulating income or distributing corpus.

(a) Deduction.

In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including

any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

(b) Character of amounts distributed.

The amount determined under subsection (a) shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the estate or trust as the total of each class bears to the total distributable net income of the estate or trust in the absence of the allocation of different classes of income under the specific terms of the governing instrument. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642 (c)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary or his delegate.

(c) Limitation on deduction.

No deduction shall be allowed under subsection (a) in respect of any portion of the amount allowed as a deduction under that subsection (without regard to this subsection) which is treated under subsection (b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust. (Aug. 16, 1954, ch. 736, 68A Stat. 220.)

CROSS REFERENCES

Deduction for trusts distributing current income only, see section 651 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 643, 662, 663, 665, 666, 677, 678, 6166 of this title.

§ 662. Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus.

(a) Inclusion.

Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) Amounts required to be distributed currently.

The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 642 (c), relating to deduction for charitable, etc., purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase "the amount of income for the taxable year required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

(2) Other amounts distributed.

All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

(b) Character of amounts.

The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642 (c)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary or his delegate. In the application of this subsection to the amount determined under paragraph (1) of subsection (a), distributable net income shall be computed without regard to any portion of the deduction under section 642 (c) which is not attributable to income of the taxable year.

(c) Different taxable years.

If the taxable year of a beneficiary is different from that of the estate or trust, the amount to be included in the gross income of the beneficiary shall be based on the distributable net income of the estate or trust and the amounts properly paid, credited, or required to be distributed to the beneficiary during any taxable year or years of the estate or trust ending within or with his taxable year. (Aug. 16, 1954, ch. 736, 68A Stat. 220.)

CROSS REFERENCES

Computation of deduction for capital gains in cases of estate or trust, see section 1202 of this title.

Inclusion of amounts in gross income of beneficiaries of trusts distributing current income only, see section 652 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 116, 642, 663, 668, 677, 678, 1202 of this title.

§ 663. Special rules applicable to sections 661 and 662.

(a) Exclusions.

There shall not be included as amounts falling within section 661 (a) or 662 (a)—

(1) Gifts, bequests, etc.

Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

(2) Charitable, etc., distributions.

Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642 (c) (computed without regard to sections 508(d), 681, and 4948(c)(4)).

(3) Denial of double deduction.

Any amount paid, credited, or distributed in the taxable year, if section 651 or section 661 applied to such amount for a preceding taxable year of an estate or trust because credited or required to be distributed in such preceding taxable year.

(b) Distributions in first sixty-five days of taxable year.

(1) General rule.

If within the first 65 days of any taxable year of a trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year.

(2) Limitation.

Paragraph (1) shall apply with respect to any taxable year of a trust only if the fiduciary of such trust elects, in such manner and at such time as the Secretary or his delegate prescribes by regulations, to have paragraph (1) apply for such taxable year.

(c) Separate shares treated as separate trusts.

For the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary or his delegate. (Aug. 16, 1954, ch. 736, 68A Stat. 222; Dec. 30, 1969, Pub. L. 91–172, title I, § 101(j)(17), title III, § 331(b), 83 Stat. 528, 598.)

AMENDMENTS

1969—Subsec. (a)(2). Pub. L. 91–172, § 101(j)(17), substituted "sections 508(d), 681, and 4948(c)(4)", for "section 681".

Subsec. (b)(2). Pub. L. 91–172, § 331(b), incorporated existing provisions of subpar. (C) of former first sentence making subsec. (b) applicable only to a trust where the fiduciary elected to have the subsec. apply and part of former second sentence making the election applicable in accordance with prescribed regulations; substituted provisions for regulations to spell out manner and time of election for part of former second sentence requiring the election to be made not later than the time prescribed by law for filing the return for the year, including any extension; and omitted: subpars. (A) and (B) of former first sentence which had provided for application of subsec. (b) only to a trust "(A) which was in existence prior to January 1, 1954" and "(B) which, under the terms of its governing instrument, may not distribute in any taxable year amounts in excess of the income of the preceding taxable year"; part of former second sentence which required the election to be made for first taxable year to which this part is applicable; and the third sentence that "If such election is made with respect to a taxable year, this subsection shall apply to all amounts properly paid or credited within the first 65 days of all subsequent taxable years of such trust."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a)(2) by section 101(j)(17) of Pub. L. 91–172, to take effect on Jan. 1, 1970, see section 101(k)(1) of Pub. L. 91–172, set out as a note under section 4940 of this title.

Amendment of subsec. (b)(2) of this section by section 331(b) of Pub. L. 91–172 applicable to taxable years beginning before Jan. 1, 1970, see section 331(d) of Pub. L. 91–172, set out as a note under section 665 of this title.

§ 664. Charitable remainder trusts.

(a) General rule.

Notwithstanding any other provision of this subchapter, the provisions of this section shall, in accordance with regulations prescribed by the Secretary or his delegate, apply in the case of a charitable remainder annuity trust and a charitable remainder unitrust.

(b) Character of distributions.

Amounts distributed by a charitable remainder annuity trust or by a charitable remainder unitrust shall be considered as having the following characteristics in the hands of a beneficiary to whom is paid the annuity described in subsection (d)(1)(A) or the payment described in subsection (d)(2)(A):

(1) First, as amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years;

(2) Second, as a capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;

(3) Third, as other income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and

(4) Fourth, as a distribution of trust corpus.

For purposes of this section, the trust shall determine the amount of its undistributed capital gain on a cumulative net basis.

(c) Exemption from income taxes.

A charitable remainder annuity trust and a charitable remainder unitrust shall, for any taxable year, not be subject to any tax imposed by this subtitle, unless such trust, for such year, has unrelated business taxable income (within the meaning of section 512, determined as if part III of subchapter F applied to such trust).

(d) Definitions.

(1) Charitable remainder annuity trust.

For purposes of this section, a charitable remainder annuity trust is a trust—

(A) from which a sum certain (which is not less than 5 percent of the initial net fair market value of all property placed in trust) is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) may be paid to or for the use of any person other than an organization described in section 170(c), and

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

(2) Charitable remainder unitrust.

For purposes of this section, a charitable remainder unitrust is a trust—

(A) from which a fixed percentage (which is not less than 5 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) may be paid to or for the use of any person other than an organization described in section 170(c), and

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

(3) Exception.

Notwithstanding the provisions of paragraphs (2) (A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year—

(A) the amount of the trust income, if such amount is less than the amount required to be distributed under paragraph (2)(A), and

(B) any amount of the trust income which is in excess of the amount required to be distributed under paragraph (2)(A), to the extent that (by reason of subparagraph (A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

(e) Valuation for purposes of charitable contribution.

For purposes of determining the amount of any charitable contribution, the remainder interest of a charitable remainder annuity trust or charitable remainder unitrust shall be computed on the basis that an amount equal to 5 percent of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year. (Added Pub. L. 91–172, title II, § 201(e)(1), Dec. 30, 1969, 83 Stat. 562.)

EFFECTIVE DATE

Section applicable to transfers in trust made after July 31, 1969, see section 201(g)(5), set out as a note under section 170 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 2055, 2522 of this title.

SUBPART D.—TREATMENT OF EXCESS DISTRIBUTIONS BY TRUSTS

Sec.
665. Definitions applicable to subpart D.
666. Accumulation distribution allocated to preceding years.
667. Denial of refund to trusts; authorization of credit to beneficiaries.
668. Treatment of amounts deemed distributed in preceding years.
669. Treatment of capital gain deemed distributed in preceding years.

AMENDMENTS

1969—Pub. L. 91–172, title III, § 331(a), Dec. 30, 1969, 83 Stat. 592, deleted "5" following "allocated to" in item 666, inserted "authorization of credit to beneficiaries" in item 667, and substituted "Treatment of capital gain deemed distributed in preceding years" for "Special rules applicable to certain foreign trusts" in item 669.

1962—Pub. L. 87–834, § 7(1)(1), Oct. 16, 1962, 76 Stat. 988, added item 669.

§ 665. Definitions applicable to subpart D.

(a) Undistributed net income.

For purposes of this subpart, the term "undistributed net income" for any taxable year means the amount by which distributable net income of the trust for such taxable year exceeds the sum of—

(1) the amounts for such taxable year specified in paragraphs (1) and (2) of section 661(a), and

(2) the amount of taxes imposed on the trust attributable to such distributable net income.

(b) Accumulation distribution.

For purposes of this subpart, the term "accumulation distribution" means, for any taxable year of the trust, the amount by which—

(1) the amounts specified in paragraph (2) of section 661(a) for such taxable year, exceed

(2) distributable net income for such year reduced (but not below zero) by the amounts specified in paragraph (1) of section 661(a).

(c) Special rule applicable to distributions by certain foreign trusts.

For purposes of this subpart, any amount paid to a United States person which is from a payor who is not a United States person and which is derived directly or indirectly from a foreign trust created by a United States person shall be deemed in the year of payment to have been directly paid by the foreign trust.

(d) Taxes imposed on the trust.

For purposes of this subpart, the term "taxes imposed on the trust" means the amount of the taxes which are imposed for any taxable year of the trust under this chapter (without regard to this subpart) and which, under regulations prescribed by the Secretary or his delegate, are properly allocable to the undistributed portions of distributable net income and gains in excess of losses from sales or exchanges of capital assets. The amount determined in the preceding sentence shall be reduced by any amount of such taxes deemed distributed under section 666 (b) and (c) or 669 (d) and (e) to any beneficiary.

(e) Preceding taxable year.

For purposes of this subpart—

(1) in the case of a trust (other than a foreign trust created by a United States person), the term "preceding taxable year" does not include any taxable year of the trust—

(A) which precedes by more than 5 years the taxable year of the trust in which an accumulation distribution is made, if it is made in a taxable year beginning before January 1, 1974,

(B) which begins before January 1, 1969, in the case of an accumulation distribution made during a taxable year beginning after December 31, 1973, or

(C) which begins before January 1, 1969, in the case of a capital gain distribution made during a taxable year beginning after December 31, 1968; and

(2) in the case of a foreign trust created by a United States person, such term does not include any taxable year of the trust to which this part does not apply.

In the case of a preceding taxable year with respect to which a trust qualifies (without regard to this subpart) under the provisions of subpart B, for purposes of the application of this subpart to such trust for such taxable year, such trust shall, in accordance with regulations prescribed by the Secretary or his delegate, be treated as a trust to which subpart C applies.

(f) Undistributed capital gain.

For purposes of this subpart, the term "undistributed capital gain" means, for any taxable year of the trust beginning after December 31, 1968, the amount by which—

(1) gains in excess of losses from the sale or exchange of capital assets, to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during such taxable year, or (B) paid, permanently set aside, or used for the purposes specified in section 642(c), exceed

(2) the amount of taxes imposed on the trust attributable to such gains.

For purposes of paragraph (1), the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(g) Capital gain distribution.

For purposes of this subpart, the term "capital gain distribution" for any taxable year of the trust means, to the extent of undistributed capital gain for such taxable year, that portion of—

(1) the excess of the amounts specified in paragraph (2) of section 661(a) for such taxable year over distributable net income for such year reduced (but not below zero) by the amounts specified in paragraph (1) of section 661(a), over

(2) the undistributed net income of the trust for all preceding taxable years.

(Aug. 16, 1954, ch. 736, 68A Stat. 223; Oct. 16, 1962, Pub. L. 87–834, § 7(b), 76 Stat. 985; Dec. 30, 1969, Pub. L. 91–172, title III, § 331(a), 83 Stat. 592.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 inserted "attributable to such distributable net income" following "on the trust" in par. (2).

Subsec. (b). Pub. L. 91–172 substituted "Accumulation distribution" for "Accumulation distributions of trusts other than certain foreign trusts" as subsec. heading, combined existing provisions of subsecs. (b) and (c) defining "accumulation distribution" in the case of a trust (other than a foreign trust created by a United States person) and of a foreign trust created by a United States person, respectively, in provisions now designated as pars. (1) and (2), deleting "the amount (if in excess of $2,000)" preceding "by which" in the introductory text and inserting "(but not below zero)" in par. (2), and deleted the second sentence providing that for purposes of this subsection, the amount specified in par. (2) of section 661(a) shall be determined without regard to section 666 and excepting from "accumulation distributions": accumulations before birth or attainment of age 21; distributions for emergency needs; distributions, where beneficiary attained specified age or ages and there were not more than 4 distributions, at intervals of 4 or more years; and final distribution of trust was made more than 9 years after date of last transfer to the trust.

Subsec. (c). Pub. L. 91–172 substituted "Special rule applicable to distributions by certain foreign trusts" for "Accumulation distribution of certain foreign trusts" as subsec. heading, inserted introductory phrase "For purposes of this subpart", reenacted provisions of former third sentence as the subsection, deleted the first sentence which defined in the case of a foreign trust created by a United States person the term "accumulation distribution", now covered by subsec. (b) of this section, and deleted the second sentence which stated that "For purposes of this subsection, the amount specified in paragraph (2) of section 661(a) shall be determined without regard to section 666."

Subsec. (d). Pub. L. 91–172 substituted "taxable year of the trust" for "taxable year on the trust", "allocable to the undistributed portions of distributable net income and gains to excess of losses from sales or exchanges of capital assets" for "allocable to the undistributed portion of the distributable net income", and "reduced by any amount of such taxes deemed distributed under section 666(b) and (c) or 669(d) and (e) to any beneficiary" for "reduced by any amount of such taxes allowed, under sections 667 and 668, as a credit to any beneficiary on account of any accumulation distribution determined for any taxable year".

Subsec. (e). Pub. L. 91–172 substituted provisions of the first sentence contained in pars. 1(A) to (C) and (2) for prior first sentence which read "For purposes of this subpart, the term 'preceding taxable year' does not include any taxable year of the trust to which this part does not apply" and reenacted the provisions of the second sentence.

Subsecs. (f), (g). Pub. L. 91–172 added subsecs. (f) and (g).

1962—Subsec. (b). Pub. L. 87–834, § 7(b)(1), substituted "Accumulation distributions of trusts other than certain foreign trusts" for "Accumulation distribution" in the subsection catchline, and inserted "in the case of a trust (other than a foreign trust created by a United States person)," following "purposes of this subpart,".

Subsec. (c). Pub. L. 87–834, § 7(b)(2), added subsec. (c) and redesignated former subsec. (c) as (d).

Subsecs. (d), (e). Pub. L. 87–834, § 7(b)(2), redesignated former subsecs. (c) and (d) as (d) and (e), respectively.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 331(d) of Pub. L. 91–172 provided that:

"(1) General Rule.—Except as otherwise provided in this subsection, the amendments made by this section [to sections 663(b)(2), 665 to 669, and 6401(b) of this title] shall apply to taxable years beginning after December 31, 1968.

"(2) Exceptions.—

"(A) Amounts paid, credited, or required to be distributed by a trust (other than a foreign trust created by a United States person) on or before the last day of a taxable year of the trust beginning before January 1, 1974, shall not be deemed to be accumulation distributions to the extent that such amounts were accumulated by a trust in taxable years of such trust beginning before January 1, 1969, and would have been excepted from the definition of an accumulation distribution by reason of paragraphs (1), (2), (3), or (4) of section 665(b) of the Internal Revenue Code of 1954, as in effect on December 31, 1968 [former subsec. (b)(1), (2), (3), or (4) of this section], if they had been distributed on the last day of the last taxable year of the trust beginning before January 1, 1969.

"(B) For taxable years of a trust beginning before January 1, 1970, the first sentence of section 666(a) of the Internal Revenue Code of 1954 (as amended by this section) [section 666(a) of this title] shall not apply, and the amount of the accumulation distribution of the trust for such taxable years shall be deemed to be an amount within the meaning of paragraph (2) of section 661(a) [section 661(a)(2) of this title] distributed on the last day of each of the preceding taxable years to the extent that such amount exceeds the total of any undistributed net income for any taxable years intervening between the taxable year with respect of which the accumulation distribution is determined and such preceding taxable year.

"(C) In the case of a trust which was in existence on December 31, 1969, section 669 of the Internal Revenue Code of 1954, as amended by this section [section 669 of this title], shall not apply to capital gain distributions made to a beneficiary before January 1, 1972. If the beneficiary receives capital gain distributions from more than one such trust before January 1, 1972, the preceding sentence shall apply to capital gain distributions from only one of such trusts, such one to be designated by the taxpayer in accordance with regulations prescribed by the Secretary or his delegate. For purposes of the preceding sentence, capital gain distributions received from a trust qualifying under section 2056(b)(5) of the Internal Revenue Code of 1954 [section 2056(b)(5) of this title] by a surviving spouse (who is the beneficiary of only one such trust) shall be disregarded."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–834 applicable with respect to distributions made after Dec. 31, 1962, see section 7(j) of Pub. L. 87–834, set out as a note under section 643 of this title.

§ 666. Accumulation distribution allocated to preceding years.

(a) Amount allocated.

In the case of a trust which is subject to subpart C, the amount of the accumulation distribution of such trust for a taxable year shall be deemed to be an amount within the meaning of paragraph (2) of section 661(a) distributed on the last day of each of the preceding taxable years, commencing with the earliest of such years, to the extent that such amount exceeds the total of any undistributed net income for all earlier preceding taxable years. The amount deemed to be distributed in any such preceding taxable year under the preceding sentence shall not exceed the undistributed net income for such preceding taxable year. For purposes of this subsection, undistributed net income for each of such preceding taxable years shall be computed without regard to such accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

(b) Total taxes deemed distributed.

If any portion of an accumulation distribution for any taxable year is deemed under subsection (a) to be an amount within the meaning of paragraph (2) of section 661(a) distributed on the last day of any preceding taxable year, and such portion of such distribution is not less than the undistributed net income for such preceding taxable year, the trust shall be deemed to have distributed on the last day of such preceding taxable year an additional amount within the meaning of paragraph (2) of section 661(a). Such additional amount shall be equal to the taxes imposed on the trust for such preceding taxable year attributable to the undistributed net income. For purposes of this subsection, the undistributed net income and the taxes imposed on the trust for such preceding taxable year attributable to such undistributed net income shall be computed without regard to such accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

(c) Pro rata portion of taxes deemed distributed.

If any portion of an accumulation distribution for any taxable year is deemed under subsection (a) to be an amount within the meaning of paragraph (2) of section 661 (a) distributed on the last day of any preceding taxable year and such portion of the accumulation distribution is less than the undistributed net income for such preceding taxable year, the trust shall be deemed to have distributed on the last day of such preceding taxable year an additional amount within the meaning of paragraph (2) of section 661 (a). Such additional amount shall be equal to the taxes imposed on the trust for such taxable year attributable to the undistributed net income multiplied by the ratio of the portion of the accumulation distribution to the undistributed net income of the trust for such year. For purposes of this subsection, the undistributed net income and the taxes imposed on the trust for such preceding taxable year attributable to such undistributed net income shall be computed without regard to the accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

(d) Rule when information is not available.

If adequate records are not available to determine the proper application of this subpart to an amount distributed by a trust, such amount shall be deemed to be an accumulation distribution consisting of undistributed net income earned during the earliest preceding taxable year of the trust in which it can be established that the trust was in existence. (Aug. 16, 1954, ch. 736, 68A Stat. 224; Oct. 16, 1962, Pub. L. 87–834, § 7(c), 76 Stat. 986; Dec. 30, 1969, Pub. L. 91–172, title III, § 331(a), 83 Stat. 593.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 substituted in the first sentence "In the case of a trust which is subject to

subpart (C)" for "In the case of a trust (other than a foreign trust created by a United States person) which for a taxable year beginning after December 31, 1953, is subject to subpart (C)", "for a taxable year" for "for such taxable year", and "undistributed net income for all earlier preceding taxable years" for "undistributed net incomes for any taxable years intervening between the taxable year with respect to which the accumulation distribution is determined and such preceding taxable year" and in the second sentence "for such" for "of such", inserted in the first sentence ", commencing with the earliest of such years," following "preceding taxable years", deleted "5" preceding "preceding taxable years" in the first and third sentences and the last sentence reading "In the case of a foreign trust created by a United States person, this subsection shall apply to the preceding taxable years of the trust without regard to any provision of the preceding sentences which would (but for this sentence) limit its application to the 5 preceding taxable years."

Subsec. (b). Pub. L. 91–172 inserted "attributable to the undistributed net income" following "taxable year" in the second sentence and "attributable to such undistributed net income" preceding "shall be computed" in the third sentence.

Subsec. (c). Pub. L. 91–172 inserted "attributable to the undistributed net income" preceding "multiplied by the ratio" in the second sentence and "attributable to such undistributed net income" preceding "shall be computed" in the third sentence.

Subsec. (d). Pub. L. 91–172 added subsec. (d).

1962—Subsec. (a). Pub. L. 87–834 inserted words "(other than a foreign trust created by a United States person)" following "In the case of a trust", and inserted sentence making this subsection applicable, in the case of a foreign trust created by a United States person, to the preceding taxable years of the trust without regard to any provision of the preceding sentences of this subsection which would (but for this sentence) limit its application to the 5 preceding taxable years.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1968, except that for taxable years of a trust beginning before Jan. 1, 1970, first sentence of subsec. (a) not applicable and amount of accumulation distribution stated, see section 331(d)(1) and (2)(B) of Pub. L. 91–172, set out as a note under section 665 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–834 applicable with respect to distributions made after Dec. 31, 1962, see section 7(j) of Pub. L. 87–834, set out as a note under section 643 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 665, 667, 668, 669 of this title.

§ 667. Denial of refund to trusts; authorization of credit to beneficiaries.

(a) Denial of refund to trusts.

No refund or credit shall be allowed to a trust for any preceding taxable year by reason of a distribution deemed to have been made by such trust in such year under section 666 or 669.

(b) Authorization of credit to beneficiary.

There shall be allowed as a credit (without interest) against the tax imposed by this subtitle on the beneficiary an amount equal to the amount of the taxes deemed distributed to such beneficiary by the trust under sections 666 (b) and (c) and 669 (d) and (e) during preceding taxable years of the trust on the last day of which the beneficiary was in being, reduced by the amount of the taxes deemed distributed to such beneficiary for such preeeding taxable years to the extent that such taxes are taken into account under sections 668(b)(1) and 669(b) in determining the amount of the tax imposed by section 668. (Aug. 16, 1954, ch. 736, 68A Stat. 225; Dec. 30, 1969, Pub. L. 91–172, title III, § 331(a), 83 Stat. 594.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 incorporated existing provisions of first sentence in provisions designated as subsec. (a), included distributions made under section 669 of this title, and eliminated provisions for credit of taxes imposed on the trust against tax of beneficiary, now covered in subsec. (b) of this section.

Subsec. (b). Pub. L. 91–172 incorporated provision of first sentence for credit of taxes imposed on the trust against tax of beneficiary, and provided for interest free credit and method of computation of its amount. The second sentence had provided that the amount of taxes which may not be refunded or credited to the trust shall be an amount equal to the excess of (1) the taxes imposed on the trust for any preceding taxable year (computed without regard to the accumulation distribution for the taxable year) over (2) the amount of taxes for such preceding taxable year imposed on the undistributed portion of distributable net income of the trust for such preceding taxable year after the application of this subpart on account of the accumulation distribution determined for such taxable year.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1968, see section 331(d) of Pub. L. 91–172, set out as a note under section 665 of this title.

§ 668. Treatment of amounts deemed distributed in preceding years.

(a) General rule.

The total of the amounts which are treated under sections 666 and 669 as having been distributed by the trust in a preceding taxable year shall be included in the income of a beneficiary of the trust when paid, credited, or required to be distributed to the extent that such total would have been included in the income of such beneficiary under section 662 (a)(2) and (b) if such total had been paid to such beneficiary on the last day of such preceding taxable year. The tax imposed by this subtitle on a beneficiary for a taxable year in which any such amount is included in his income shall be determined only as provided in this section and shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by an amount equal to the total of such amounts, at the rate and in the manner as if this section had not been enacted,

(2) a partial tax determined as provided in subsection (b) of this section, and

(3) in the case of a beneficiary of a trust which is not required to distribute all of its income currently, a partial tax determined as provided in section 669.

For purposes of this subpart, a trust shall not be considered to be a trust which is not required to distribute all of its income currently for any taxable year prior to the first taxable year in which income is accumulated.

(b) Tax on distribution.

(1) Alternative methods.

Except as provided in paragraph (2), the partial tax imposed by subsection (a)(2) shall be the lesser of—

(A) the aggregate of the taxes attributable to the amounts deemed distributed under section

666 had they been included in the gross income of the beneficiary on the last day of each respective preceding taxable year, or

(B) the tax determined by multiplying, by the number of preceding taxable years of the trust, on the last day of which an amount is deemed under section 666(a) to have been distributed, the average of the increase in tax attributable to recomputing the beneficiary's gross income for each of the beneficiary's 3 taxable years immediately preceding the year of the accumulation distribution by adding to the income of each of such years an amount determined by dividing the amount deemed distributed under section 666 and required to be included in income under subsection (a) by such number of preceding taxable years of the trust,

less an amount equal to the amount of taxes deemed distributed to the beneficiary under sections 666 (b) and (c).

(2) Special rules.

(A) If a beneficiary was not in existence on the last day of a preceding taxable year of the trust with respect to which a distribution is deemed made under section 666(a), the partial tax under either paragraph (1)(A) or (1)(B) shall be computed as if the beneficiary were in existence on the last day of such year on the basis that the beneficiary had no gross income (other than amounts deemed distributed to him under sections 666 and 669 by the same or other trusts) and no deductions for such year.

(B) The partial tax shall not be computed under the provisions of subparagraph (B) of paragraph (1) if, in the same prior taxable year of the beneficiary in which any part of the accumulation distribution is deemed under section 666(a) to have been distributed to such beneficiary, some part of prior accumulation distributions by each of two or more other trusts is deemed under section 666(a) to have been distributed to such beneficiary.

(C) If the partial tax is computed under paragraph (1)(B), and the amount of the undistributed net income deemed distributed in any preceding taxable year of the trust is less than 25 percent of the amount of the accumulation distribution divided by the number of preceding taxable years to which the accumulation distribution is allocated under section 666(a), the number of preceding taxable years of the trust with respect to which an amount is deemed distributed to a beneficiary under section 666(a) shall be determined without regard to such year.

(3) Effect of other accumulation distributions and capital gain distributions.

In computing the partial tax under paragraph (1) for any beneficiary, the income of such beneficiary for each of his prior taxable years—

(A) shall include amounts previously deemed distributed to such beneficiary in such year under section 666 or 669 as a result of prior accumulation distributions or capital gain distributions (whether from the same or another trust), and

(B) shall not include amounts deemed distributed to such beneficiary in such year under section 669 as a result of a capital gain distribution from the same trust in the current year.

(4) Multiple distributions in the same taxable year.

In the case of accumulation distributions made from more than one trust which are includible in the income of a beneficiary in the same taxable year, the distributions shall be deemed to have been made consecutively in whichever order the beneficiary shall determine.

(5) Information requirements with respect to beneficiary.

(A) Except as provided in subparagraph (B), the partial tax shall not be computed under the provisions of paragraph (1)(A) unless the beneficiary supplies such information with respect to his income, for each taxable year with which or in which ends a taxable year of the trust on the last day of which an amount is deemed distributed under section 666(a), as the Secretary or his delegate prescribes by regulations.

(B) If by reason of paragraph (2)(B) the provisions of paragraph (1)(B) do not apply, the determination of the amount of the beneficiary's income for a taxable year for which the beneficiary has not supplied the information required under subparagraph (A) shall be made by the Secretary or his delegate on the basis of information available to him.

(Aug. 16, 1954, ch. 736, 68A Stat. 225; Oct. 16, 1962, Pub. L. 87–834, § 7(d), 76 Stat. 986; Dec. 30, 1969, Pub. L. 91–172, title III, § 331(a), 83 Stat. 594.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 substituted "General rule" for "Amounts treated as received in prior taxable years" as subsec. heading, reenacted existing first sentence, inserting therein reference to section 669 and deleting therefrom "or beneficiaries" following "beneficiary" in three instances, inserted the second sentence for determination and computation of tax on beneficiary of distributions and the third sentence declaring a trust shall not be considered to be a trust which is not required to distribute all of its income currently for any taxable year prior to the first taxable year in which income is accumulated, and deleted former second, third and fourth sentences, the second sentence stating that "The portion of such total included under the preceding sentence in the income of any beneficiary shall be based upon the same ratio as determined under the second sentence of section 662(a)(2) for the taxable year in respect of which the accumulation distribution is determined, except that proper adjustment of such ratio shall be made, in accordance with regulations prescribed by the Secretary or his delegate, for amounts which fall within paragraphs (1) through (4) of section 665(b).", the third sentence stating that "The tax of the beneficiaries attributable to the amounts treated as having been received on the last day of such preceding taxable year of the trust shall not be greater than the aggregate of the taxes attributable to those amounts had they been included in the gross income of the beneficiaries on such day in accordance with section 662(a)(2) and (b).", now incorporated in subsec. (b)(1)(A) of this section, and the third sentence reading "Except as provided in section 669, in the case of a foreign trust created by a United States person the preceding sentence shall not apply to any beneficiary who is a United States person."

Subsec. (b). Pub. L. 91–172 substituted provisions relating to tax on distribution, par. (1) providing for alternative methods and incorporating in subpar. (A) former third sentence of subsec. (a) of this section and former section 669(a)(1)(A) of this title and in subpar. (B)

former section 669(a)(1)(B), pars. (2) to (5) relating to special rules, effect of other accumulation distributions and capital gain distributions, multiple distributions in the same taxable year, and information requirements with respect to beneficiary, the latter incorporating provisions of former section 669(b) of this title, for prior provisions relating to credit for taxes paid by trust and now incorporated in section 667 of this title.

1962—Subsec. (a). Pub. L. 87–834 inserted sentence providing "Except as provided in section 669, in the case of a foreign trust created by a United States person the preceding sentence shall not apply to any beneficiary who is a United States person."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1968, see section 331(d) of Pub. L. 91–172, set out as a note under section 665 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–834 applicable with respect to distributions made after Dec. 31, 1962, see section 7(j) of Pub. L. 87–834, set out as a note under section 643 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 667, 669, 1302 of this title.

§ 669. Treatment of capital gain deemed distributed in preceding years.

(a) Amount allocated.

In the case of a trust which is not required to distribute all of its income currently, the amount of a capital gain distribution of such trust for a taxable year shall be deemed to be an amount properly paid, credited, or required to be distributed on the last day of each of the preceding taxable years, commencing with the earliest of such years, to the extent that such amount exceeds the total of any undistributed capital gain for all earlier preceding taxable years. The amount deemed to be distributed in any such preceding taxable year under the preceding sentence shall not exceed the undistributed capital gain for such preceding taxable year. For purposes of this subsection, undistributed capital gain for each of such preceding taxable years shall be computed without regard to such capital gain distribution and without regard to any capital gain distribution determined for any succeeding taxable year.

(b) Tax on distribution.

The partial tax imposed by section 668(a)(3) shall be the lesser of—

(1) the aggregate of the taxes attributable to the amounts deemed distributed under this section, had such amounts been included in the gross income of the beneficiary on the last day of each respective preceding taxable year, or

(2) the tax determined by multiplying by the number of preceding taxable years of the trust, on the last day of which net gains from the sale or exchange of capital assets are deemed under subsection (a) to have been distributed, the average of the increase in tax attributable to recomputing the beneficiary's gross income for each of the beneficiary's 3 taxable years immediately preceding the year of the capital gain distribution by adding to the income of each of such years an amount determined by dividing the total of the amounts deemed distributed under this section and required to be included in income under section 668(a) by such number of preceding taxable years of the trust,

less an amount equal to the amount of taxes deemed distributed to the beneficiary under subsections (d) and (e) which are attributable to the capital gain distribution.

(c) Effect of other distributions; special rules, etc.

In computing the partial tax under subsection (b) for any beneficiary, the income of such beneficiary for each of his prior taxable years—

(1) shall include amounts previously deemed distributed to such beneficiary in such year under section 666 or 669 as a result of prior accumulation distributions or capital gain distributions (whether from the same or another trust), and

(2) shall include amounts deemed distributed to such beneficiary in such year under section 666 as a result of an accumulation distribution from the same trust in the current year.

Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (2), (4), and (5) of section 668(b) shall be applied for purposes of this section.

(d) Total taxes deemed distributed.

If any portion of a capital gain distribution for any taxable year is deemed under subsection (a) to be an amount properly paid, credited or required to be distributed on the last day of any preceding taxable year, and such portion of such capital gain distribution is not less than the undistributed capital gain for such preceding taxable year, the trust shall be deemed to have properly distributed on the last day of such preceding taxable year an additional amount. Such additional amount shall be equal to the taxes imposed on the trust for such preceding taxable year attributable to such undistributed capital gain. For purposes of this subsection, the undistributed capital gain and the taxes imposed on the trust for such preceding taxable year attributable to such gain shall be computed without regard to such capital gain distribution and without regard to any capital gain distribution determined for any succeeding taxable year.

(e) Pro rata portion of taxes deemed distributed.

If any portion of a capital gain distribution for any taxable year is deemed under subsection (a) to be an amount properly paid, credited, or required to be distributed on the last day of any preceding taxable year and such portion of the capital gain distribution is less than the undistributed capital gain for such preceding taxable year, the trust shall be deemed to have properly distributed on the last day of such preceding taxable year an additional amount. Such additional amount shall be equal to the taxes imposed on the trust for such taxable year attributable to such undistributed capital gain multiplied by the ratio of the portion of the capital gain distribution to the undistributed capital gain of the trust for such year. For purposes of this subsection, the undistributed capital gain and the taxes imposed on the trust for such preceding taxable year attributable to such gain shall be computed

without regard to the capital gain distribution and without regard to any capital gain distribution determined for any succeeding taxable year.

(f) Character of capital gain.

For purposes of this section, the character of the capital gain of a trust for any taxable year with respect to a beneficiary shall be the same as it was with respect to the trust. (Added Pub. L. 87–834, § 7(e), Oct. 16, 1962, 76 Stat. 986, and amended Pub. L. 91–172, title III, § 331(a), Dec. 30, 1969, 83 Stat. 596.)

AMENDMENTS

1969—Pub. L. 91–172 substituted provisions relating to treatment of capital gain deemed distributed in preceding years (subsecs. (a) to (f) providing for amount allocated; tax on distributions; effect of other distributions, special rules, etc.; total taxes deemed distributed; pro rata portion of taxes deemed distributed; and character of capital gain), for prior provisions for special rules applicable to certain foreign trusts (former subsec. (a) respecting limitation on tax par. (1) stating the general rule (now covered in section 668(b)(1)(A), (B) of this title), par. (2) the exceptions, and par. (3) the effect of prior election, where the subsequent election is under par. (1)(A) and (B) and former subsec. (b) respecting information requirement (now covered in section 668(b)(5) of this title), such former provisions of this section now covered generally throughout this part.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1968, except that in the case of a trust in existence on Dec. 31, 1969, this section not applicable to capital gain distribution to a beneficiary before Jan. 1, 1972, or to the distribution designated by the taxpayer when made from more than one trust, see section 331(d)(1) and (2)(C) of Pub. L. 91–172, set out as a note under section 665 of this title.

EFFECTIVE DATE

Section applicable with respect to distributions made after Dec. 31, 1962, see section 7(j) of Pub. L. 87–834, set out as a note under section 643 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 665, 667, 668 of this title.

SUBPART E.—GRANTORS AND OTHERS TREATED AS SUBSTANTIAL OWNERS

Sec.
671. Trust income, deductions, and credits attributable to grantors and others as substantial owners.
672. Definitions and rules.
673. Reversionary interests.
674. Power to control beneficial enjoyment.
675. Administrative powers.
676. Power to revoke.
677. Income for benefit of grantor.
678. Person other than grantor treated as substantial owner.

§ 671. Trust income, deductions, and credits attributable to grantors and others as substantial owners.

Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart. (Aug. 16, 1954, ch. 736, 68A Stat. 226.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 678 of this title.

§ 672. Definitions and rules.

(a) Adverse party.

For purposes of this subpart, the term "adverse party" means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

(b) Nonadverse party.

For purposes of this subpart, the term "nonadverse party" means any person who is not an adverse party.

(c) Related or subordinate party.

For purposes of this subpart, the term "related or subordinate party" means any nonadverse party who is—

(1) the grantor's spouse if living with the grantor;

(2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

For purposes of sections 674 and 675, a related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

(d) Rule where power is subject to condition precedent.

A person shall be considered to have a power described in this subpart even though the exercise of the power is subject to a precedent giving of notice or takes effect only on the expiration of a certain period after the exercise of the power. (Aug. 16, 1954, ch. 736, 68A Stat. 226.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 678 of this title.

§ 673. Reversionary interests.

(a) General rule.

The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of the transfer of that portion of the trust.

(b) Repealed. Pub. L. 91–172, title II, § 201(c), Dec. 30, 1969, 83 Stat. 560.

(c) Reversionary interest taking effect at death of income beneficiary.

The grantor shall not be treated under subsection (a) as the owner of any portion of a trust where his reversionary interest in such portion is not to take effect in possession or enjoyment until the death of the person or persons to whom the income therefrom is payable.

(d) Postponement of date specified for reacquisition.

Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest shall be treated as a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. However, income for any period shall not be included in the income of the grantor by reason of the preceding sentence if such income would not be so includible in the absence of such postponement. (Aug. 16, 1954, ch. 736, 68A Stat. 227; Dec. 30, 1969, Pub. L. 91–172, title II, § 201(c), 83 Stat. 560.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91–172 struck out provisions relating to trusts where the income was payable to a charitable beneficiary for at least a two-year period.

EFFECTIVE DATE OF 1969 AMENDMENT

Repeal of subsec. (b) of this section applicable to transfers in trust made after April 22, 1969, see section 201(g) of Pub. L. 91–172, set out as a note under section 170 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 674, 676, 677, 678 of this title.

§ 674. Power to control beneficial enjoyment.

(a) General rule.

The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(b) Exceptions for certain powers.

Subsection (a) shall not apply to the following powers regardless of by whom held:

(1) Power to apply income to support of a dependent.

A power described in section 677 (b) to the extent that the grantor would not be subject to tax under that section.

(2) Power affecting beneficial enjoyment only after expiration of 10-year period.

A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

(3) Power exercisable only by will.

A power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(4) Power to allocate among charitable beneficiaries.

A power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170 (c) (relating to definition of charitable contributions).

(5) Power to distribute corpus.

A power to distribute corpus either—

(A) to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument; or

(B) to or for any current income beneficiary, provided that the distribution of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to the beneficiary as if the corpus constituted a separate trust.

A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(6) Power to withhold income temporarily.

A power to distribute or apply income to or for any current income beneficiary or to accumulate the income for him, provided that any accumulated income must ultimately be payable—

(A) to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate, or

(B) on termination of the trust, or in conjunction with a distribution of corpus which is augmented by such accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument.

Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive a date of distribution which could reasonably have been expected to occur within the beneficiary's lifetime, the share of the deceased beneficiary is to be paid to his appointees or to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

(7) Power to withhold income during disability of a beneficiary.

A power exercisable only during—

(A) the existence of a legal disability of any current income beneficiary, or

(B) the period during which any income beneficiary shall be under the age of 21 years, to distribute or apply income to or for such beneficiary or to accumulate and add the income to corpus. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(8) Power to allocate between corpus and income.

A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.

(c) Exception for certain powers of independent trustees.

Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor—

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

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

A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(d) Power to allocate income if limited by a standard.

Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions of paragraph (6) or (7) of subsection (b) are satisfied, if such power is limited by a reasonably definite external standard which is set forth in the trust instrument. A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children. (Aug. 16, 1954, ch. 736, 68A Stat. 227.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 672, 677, 678 of this title.

§ 675. Administrative powers.

The grantor shall be treated as the owner of any portion of a trust in respect of which—

(1) Power to deal for less than adequate and full consideration.

A power exercisable by the grantor or a non-adverse party, or both, without the approval or consent of any adverse party enables the grantor or any person to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate consideration in money or money's worth.

(2) Power to borrow without adequate interest or security.

A power exercisable by the grantor or a non-adverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security except where a trustee (other than the grantor) is authorized under a general lending power to make loans to any person without regard to interest or security.

(3) Borrowing of the trust funds.

The grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year. The preceding sentence shall not apply to a loan which provides for adequate interest and adequato security, if such loan is made by a trustee other than the grantor and other than a related or subordinate trustee subservient to the grantor.

(4) General powers of administration.

A power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term "power of administration" means any one or more of the following powers: (A) a power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; (B) a power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

(Aug. 16, 1954, ch. 736, 68A Stat. 229.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 672, 678 of this title.

§ 676. Power to revoke.

(a) General rule.

The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a non-adverse party, or both.

(b) Power affecting beneficial enjoyment only after expiration of 10-year period.

Subsection (a) shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the expiration of such period unless the power is relinquished. (Aug. 16, 1954, ch. 736, 68A Stat. 230.)

CROSS REFERENCES

Nonadverse party defined, see section 672 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This sections is referred to in section 678 of this title.

§ 677. Income for benefit of grantor.

(a) General rule.

The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—

(1) distributed to the grantor or the grantor's spouse;

(2) held or accumulated for future distribution to the grantor or the grantor's spouse; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

(b) Obligations of support.

Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661 (a) and shall be taxed to the grantor under section 662. (Aug. 16, 1954, ch. 736, 68A Stat. 230; Dec. 30, 1969, Pub. L. 91-172, title III, § 332(a), 83 Stat. 599.)

AMENDMENTS

1969—Subsec. (a)(1)-(3). Pub. L. 91-172, § 332(a)(1), inserted "or the grantor's spouse" following "the grantor" in pars. (1), (2), and (3).

Subsec. (b). Pub. L. 91-172, § 332(a)(2), inserted "(other than the grantor's spouse)" following "beneficiary".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 332(b) of Pub. L. 91-172 provided that: "The amendments made by subsection (a) [to subsecs. (a)(1) to (3) and (b) of this section] shall apply in respect of property transferred in trust after October 9, 1969."

CROSS REFERENCES

Definitions—

Adverse party, see section 672 (a) of this title.

Non-adverse party, see section 672 (b) of this title.

Income from interest in an estate or trust as gross income, in section 61 (a) (15) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 674, 678, 1246 of this title.

§ 678. Person other than grantor treated as substantial owner.

(a) General rule.

A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject to grantor of a trust to treatment as the owner thereof.

(b) Exception where grantor is taxable.

Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is otherwise treated as the owner under sections 671 to 677, inclusive.

(c) Obligations of support.

Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or cotrustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661 (a) and shall be taxed to the holder of the power under section 662.

(d) Effect of renunciation or disclaimer.

Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence. (Aug. 16, 1954, ch. 736, 68A Stat. 231.)

SUBPART F.—MISCELLANEOUS

Sec.
681. Limitation on charitable deduction.
682. Income of an estate or trust in case of divorce, etc.
683. Applicability of provisions.

§ 681. Limitation on charitable deduction.

(a) Trade or business income.

In computing the deduction allowable under section 642 (c) to a trust, no amount otherwise allow-

able under section 642 (c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its unrelated business income for such year. For purposes of the preceding sentence, the term "unrelated business income" means an amount equal to the amount which, if such trust were exempt from tax under section 501 (a) by reason of section 501 (c) (3), would be computed as its unrelated business taxable income under section 512 (relating to income derived from certain business activities and from certain property acquired with borrowed funds).

(b) Cross reference.

For disallowance of certain charitable, etc., deductions otherwise allowable under section 642(c), see sections 508(d) and 4948 (c)(4).

(Aug. 16, 1954, ch. 736, 68A Stat. 232; Oct. 22, 1968, Pub. L. 90–630, § 6(b), 82 Stat. 1330; Dec. 30, 1969, Pub. L. 91–172, title I, §§ 101(j) (18), (19), 121(d) (2)(B), 83 Stat. 528, 547.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 121(d)(2)(B), substituted reference to certain property acquired with borrowed funds for reference to certain leases.

Subsec. (b). Pub. L. 91–172, § 101(j)(18), (19), redesignated former subsec. (d) as subsec. (b), and, in subsec. (b), as so redesignated, substituted "sections 518(d) and 4948(c)(4)" for section 503(e). Former subsec. (b) dealing generally with the operation of trusts, was striken.

Subsec. (c). Pub. L. 91–172, § 101(j)(18), struck out former subsec. (c) dealing with accumulated income.

Subsec. (d). Pub. L. 91–172, § 101(j)(19) redesignated former subsec. (d) as subsec. (b).

1968—Subsec. (c). Pub. L. 90–630 added provision that par. (1) does not apply to income attributable to property transferred to a trust before January 1, 1951, by the creator thereof if the trust was irrevocable on such date and if the income is required to be accumulated pursuant to the mandatory terms of the instrument creating the trust.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a) by section 121(d)(2)(B) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

Amendment of subsecs. (b)–(d) by section 101(j)(18), (19) of Pub. L. 91–172 to take effect on Jan. 1, 1970, see section 101(k)(1) of Pub. L. 91–172, set out as a note under section 4940 of this title.

EFFECTIVE DATE OF 1968 AMENDMENT

Amendment of section by section 6(b) of Pub. L. 90–630 applicable with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954, with provisions having the same effect as such amendment for purposes of sections 3814 and 162(g)(4) of the Internal Revenue Code of 1939 being treated as included in such sections with respect to taxable years beginning after December 31, 1950, see section 6(c) of Pub. L. 90–630, set out as a note under section 504 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 513, 642, 663 of this title.

§ 682. Income of an estate or trust in case of divorce, etc.

(a) Inclusion in gross income of wife.

There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance (or who is separated from her husband under a written separation agreement) the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not, despite any other provision of this subtitle, be includible in the gross income of such husband. This subsection shall not apply to that part of any such income of the trust which the terms of the decree, written separation agreement, or trust instrument fix, in terms of an amount of money or a portion of such income, as a sum which is payable for the support of minor children of such husband. In case such income is less than the amount specified in the decree, agreement, or instrument, for the purpose of applying the preceding sentence, such income, to the extent of such sum payable for such support, shall be considered a payment for such support.

(b) Wife considered a beneficiary.

For purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom subsection (a) or section 71 applies, such wife shall be considered as the beneficiary specified in this part. A periodic payment under section 71 to any portion of which this part applies shall be included in the gross income of the beneficiary in the taxable year in which under this part such portion is required to be included.

(c) Cross reference.

For definitions of "husband" and "wife," as used in this section, see section 7701 (a) (17).

(Aug. 16, 1954, ch. 736, 68A Stat. 234.)

CROSS REFERENCES

Deductions for payments under this section not allowed, see section 215 of this title.

Definition of husband and wife, see section 7701 (a) (17) of this title.

Payment under this section not treated as payment for support of defendant, see section 152 (b) (4) of this title.

Wife taxable on alimony and separate maintenance payments received, see section 71 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 71, 72, 101, 215, 7701 of this title.

§ 683. Applicability of provisions.

(a) General rule.

This part shall apply only to taxable years beginning after December 31, 1953, and ending after the date of the enactment of this title.

(b) Exceptions.

In the case of any beneficiary of an estate or trust—

(1) this part shall not apply to any amount paid, credited, or to be distributed by the estate or trust in any taxable year of such estate or trust to which this part does not apply, and

(2) the Internal Revenue Code of 1939 shall apply for purposes of determining the amount includible in the gross income of the beneficiary.

To the extent that any amount paid, credited, or to be distributed by an estate or trust in the first taxable year of such estate or trust to which this part applies would be treated, if the Internal Revenue Code of 1939 were applicable, as paid, credited, or to be distributed on the last day of the preceding taxable year, such amount shall not be taken into account for purposes of this part but shall be taken into account as provided in the Internal Revenue Code of 1939. (Aug. 16, 1954, ch. 736, 68A Stat. 235.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 691 of this title.

PART II.—INCOME IN RESPECT OF DECEDENTS

Sec.
691. Recipients of income in respect of decedents.
692. Income taxes of members of Armed Forces on death.

§ 691. Recipients of income in respect of decedents.

(a) Inclusion in gross income.

(1) General rule.

The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

(2) Income in case of sale, etc.

If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) Character of income determined by reference to decedent.

The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

(4) Installment obligations acquired from decedent.

In the case of an installment obligation received by a decedent on the sale or other disposition of property, the income from which was properly reportable by the decedent on the installment basis under section 453, if such obligation is acquired by the decedent's estate from the decedent or by any person by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent—

(A) an amount equal to the excess of the face amount of such obligation over the basis of the obligation in the hands of the decedent (determined under section 453 (d)) shall, for the purpose of paragraph (1), be considered as an item of gross income in respect of the decedent; and

(B) such obligation shall, for purposes of paragraphs (2) and (3), be considered a right to receive an item of gross income in respect of the decedent, but the amount includible in gross income under paragraph (2) shall be reduced by an amount equal to the basis of the obligation in the hands of the decedent (determined under section 453 (d)).

(b) Allowance of deductions and credit.

The amount of any deduction specified in section 162, 163, 164, 212, or 611 (relating to deductions for expenses, interest, taxes, and depletion) or credit specified in section 33 (relating to foreign tax credit), in respect of a decedent which is not properly allowable to the decedent in respect of the taxable period in which falls the date of his death, or a prior period, shall be allowed:

(1) Expenses, interest, and taxes.

In the case of a deduction specified in section 162, 163, 164, or 212 and a credit specified in section 33, in the taxable year when paid—

(A) to the estate of the decedent; except that

(B) if the estate of the decedent is not liable to discharge the obligation to which the deduction or credit relates, to the person who, by reason of the death of the decedent or by bequest, devise, or inheritance acquires, subject to such obligation, from the decedent an interest in property of the decedent.

(2) Depletion.

In the case of the deduction specified in section 611, to the person described in subsection (a) (1) (A), (B), or (C) who, in the manner described therein, receives the income to which the deduction relates, in the taxable year when such income is received.

(c) Deduction for estate tax.

(1) Allowance of deduction.

(A) General rule.

A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an

amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a) (1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a) (1).

(B) Estates and trusts.

In the case of an estate or trust, the amount allowed as a deduction under subparagraph (A) shall be computed by excluding from the gross income of the estate or trust the portion (if any) of the items described in subsection (a) (1) which is properly paid, credited, or to be distributed to the beneficiaries during the taxable year. This subparagraph shall apply to the same taxable years, and to the same extent, as is provided in section 683.

(2) Method of computing deduction.

For purposes of paragraph (1)—

(A) The term "estate tax" means the tax imposed on the estate of the decedent or any prior decedent under section 2001 or 2101, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a) (1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a) (1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b). Such net value shall be determined with respect to the provisions of section 421(c)(2), relating to the deduction for estate tax with respect to stock options to which part II of subchapter D applies.

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value.

(d) Amounts received by surviving annuitant under joint and survivor annuity contract.

(1) Deduction for estate tax.

For purposes of computing the deduction under subsection (c) (1) (A), amounts received by a surviving annuitant—

(A) by determining the excess of the value annuity contract where the decedent annuitant died after December 31, 1953, and after the annuity starting date (as defined in section 72 (c) (4)), and

(B) during the surviving annuitant's life expectancy period, shall, to the extent included in gross income under section 72, be considered as amounts included in gross income under subsection (a).

(2) Net value for estate tax purposes.

In determining the net value for estate tax purposes under subsection (c) (2) (B) for purposes of this subsection, the value for estate tax purposes of the items described in paragraph (1) of this subsection shall be computed—

(A) as an annuity under a joint and survivor of the annuity at the date of the death of the deceased annuitant over the total amount excludable from the gross income of the surviving annuitant under section 72 during the surviving annuitant's life expectancy period, and

(B) by multiplying the figure so obtained by the ratio which the value of the annuity for estate tax purposes bears to the value of the annuity at the date of the death of the deceased.

(3) Definitions.

For purposes of this subsection—

(A) The term "life expectancy period" means the period beginning with the first day of the first period for which an amount is received by the surviving annuitant under the contract and ending with the close of the taxable year with or in which falls the termination of the life expectancy of the surviving annuitant. For purposes of this subparagraph, the life expectancy of the surviving annuitant shall be determined, as of the date of the death of the deceased annuitant, with reference to actuarial tables prescribed by the Secretary or his delegate.

(B) The surviving annuitant's expected return under the contract shall be computed, as of the death of the deceased annuitant, with reference to actuarial tables prescribed by the Secretary or his delegate.

(e) Installment obligations transmitted at death when prior law applied to transmission.

(1) In general.

Effective with respect to the first taxable year to which the election referred to in paragraph (2) applies and to each taxable year thereafter, subsection (a) (4) shall apply in the case of installment obligations in respect of which section 44(d) of the Internal Revenue Code of 1939 (or the corresponding provisions of prior law) did not apply by reason of the filing of the bond referred to in such section or provisions. Subsection (c) of this section shall not apply in respect of any amount included in gross income by reason of this paragraph.

(2) Election.

Installment obligations referred to in paragraph (1) may, at the election of the taxpayer holding such obligations, be treated as obligations in respect of which subsection (a) (4) applies. An election under this subsection for any taxable year shall be made not later than the time prescribed by law (including extensions thereof) for filing the return for such taxable year. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe.

(3) Release of bond.

The liability under any bond filed under section 44(d) of the Internal Revenue Code of 1939 (or the corresponding provisions of prior law) in respect of which an election under this subsection applies is hereby released with respect to taxable years to which such election applies.

(f) Cross reference.

For application of this section to income in respect of a deceased partner, see section 753.

(Aug. 16, 1954, ch. 736, 68A Stat. 235; Feb. 26, 1964, Pub. L. 88–272, title II, § 221(c)(2), 78 Stat. 75; Sept. 2, 1964, Pub. L. 88–570, § 1, 78 Stat. 854.)

AMENDMENTS

1964—Subsec. (c)(2)(B). Pub. L. 88–272 substituted "421(c)(2), relating to the deduction for estate tax with respect to stock options to which part II of subchapter D applies" for "421(d)(6)(B), relating to the deduction for estate tax with respect to restricted stock options."

Subsec. (e). Pub. L. 88–570 added subsec. (e) and redesignated former subsec. (e) as (f).

Subsec. (f). Pub. L. 88–570 redesignated former subsec. (e) as (f).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years ending after Dec. 31, 1963, see section 221(e) of Pub. L. 88–272, set out as a note under section 421 of this title.

CROSS REFERENCES

Basis of property acquired from decedent, inapplicability of section 1014 to this section, see section 1014 (c) of this title.

Income in respect of decedent as gross income, see section 61 (a) (14) of this title.

Partner receiving income in respect of decedent, see section 753 of this title.

Returns of decedents, see section 6012 (b) (1) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 421, 452, 753, 1014, 1245, 1250, 1251 of this title.

§ 692. Income taxes on members of Armed Forces on death.

In the case of any individual who dies during an induction period (as defined in section 112 (c) (5)) while in active service as a member of the Armed Forces of the United States, if such death occurred while serving in a combat zone (as determined under section 112) or as a result of wounds, disease, or injury incurred while so serving—

(1) any tax imposed by this subtitle shall not apply with respect to the taxable year in which falls the date of his death, or with respect to any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950; and

(2) any tax under this subtitle and under the corresponding provisions of prior revenue laws for taxable years preceding those specified in paragraph (1) which is unpaid at the date of his death (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

(Aug. 16, 1954, ch. 736, 68A Stat. 238.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 5 of this title.

Subchapter K.—Partners and Partnerships

Part
I. Determination of tax liability.
II. Contributions, distributions, and transfers.
III. Definitions.
IV. Effective date for subchapter.

PART I.—DETERMINATION OF TAX LIABILITY

Sec.
701. Partners, not partnership, subject to tax.
702. Income and credits of partner.
703. Partnership computations.
704. Partner's distributive share.
705. Determination of basis of partner's interest.
706. Taxable years of partner and partnership.
707. Transactions between partner and partnership.
708. Continuation of partnership.

§ 701. Partners, not partnership, subject to tax.

A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.

(Aug. 16, 1954, ch. 736, 68A Stat. 239.)

CROSS REFERENCES

Definitions of partnership, see sections 761 (a), 7701 (a) (2) of this title.

Partnerships electing to be taxed as corporations, see section 1361 of this title.

§ 702. Income and credits of partner.

(a) General rule.

In determining his income tax, each partner shall take into account separately his distributive share of the partnership's—

(1) gains and losses from sales or exchanges of capital assets held for not more than 6 months,

(2) gains and losses from sales or exchanges of capital assets held for more than 6 months,

(3) gains and losses from sales or exchanges of property described in section 1231 (relating to certain property used in a trade or business and involuntary conversions),

(4) charitable contributions (as defined in section 170 (c)),

(5) dividends with respect to which there is provided an exclusion under section 116 or a deduction under part VIII of subchapter B,

(6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(7) partially tax-exempt interest on obligations of the United States or on obligations of instrumentalities of the United States as described in section 35 or section 242 (but, if the partnership elects to amortize the premiums on bonds as provided in section 171, the amount received on such obligations shall be reduced by the reduction provided under section 171 (a) (3)),

(8) other items of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary or his delegate, and

(9) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

(b) Character of items constituting distributive share.

The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(c) Gross income of a partner.

In any case where it is necessary to determine the gross income of a partner for purposes of this title, such amount shall include his distributive share of the gross income of the partnership. (Aug. 16, 1954, ch. 736, 68A Stat. 239; Feb. 26, 1964, Pub. L. 88-272, title II, § 201(d)(7), 78 Stat. 32.)

AMENDMENTS

1964—Subsec. (a)(5). Pub. L. 88-272 deleted "a credit under section 34," preceding "an exclusion."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88-272 applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88-272, set out as a note under section 35 of this title.

CROSS REFERENCES

Computation of partnership income, see section 703 of this title.
Partner's distributive share, see section 704 of this title.
Self-employment income, see section 1402 of this title.
Taxable years of partner and partnership, see section 706 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 703, 704, 706, 1402 of this title; title 42 sections 403, 411.

§ 703. Partnership computations.

(a) Income and deductions.

The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that—

(1) the items described in section 702 (a) shall be separately stated, and

(2) the following deductions shall not be allowed to the partnership:

(A) the standard deduction provided in section 141,

(B) the deductions for personal exemptions provided in section 151,

(C) the deduction for taxes provided in section 164 (a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(D) the deduction for charitable contributions provided in section 170,

(E) the net operating loss deduction provided in section 172, and

(F) the additional itemized deductions for individuals provided in part VII of subchapter B (sec. 211 and following).

(b) Elections of the partnership.

Any election affecting the computation of taxable income derived from a partnership shall be made by the partnership, except that the election under section 901, relating to taxes of foreign countries and possessions of the United States, and any election under section 615 (relating to pre-1970 exploration expenditures) or under section 617 (relating to deduction and recapture of certain mining exploration expenditures), shall be made by each partner separately. (Aug. 16, 1954, ch. 736, 68A Sat. 240; Sept. 12, 1966, Pub. L. 89-570, § 2(b), 80 Stat. 764; Dec. 30, 1969, Pub. L. 91-172, title V, § 504(c)(3), 83 Stat. 633.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91-172 substituted "(relating to pre-1970 exploration expenditures) or under section 617 (relating to deduction and recapture of certain mining exploration expenditures)" for "(relating to exploration expenditures) or under section 617 (relating to additional exploration expenditures in the case of domestic mining)."

1966—Subsec. (b). Pub. L. 89-570 provided for election under section 615 (relating to exploration expenditures) or under section 617 (relating to additional exploration expenditures in the case of domestic mining).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable with respect to exploration expenditures paid or incurred after Dec. 31, 1969, see section 504(d)(1) of Pub. L. 91-172, set out as a note under section 615 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date, see section 3 of Pub. L. 89-570, set out as a note under section 617 of this title.

CROSS REFERENCES

Determination of basis of partner's interest, see section 705 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 705 of this title.

§ 704. Partner's distributive share.

(a) Effect of partnership agreement.

A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this section, be determined by the partnership agreement.

(b) Distributive share determined by income or loss ratio.

A partner's distributive share of any item of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702 (a) (9), for the taxable year, if—

(1) the partnership agreement does not provide as to the partner's distributive share of such item, or

(2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such item is the avoidance or evasion of any tax imposed by this subtitle.

(c) Contributed property.

(1) General rule.

In determining a partner's distributive share of items described in section 702 (a), depreciation, depletion, or gain or loss with respect to property contributed to the partnership by a partner shall, except to the extent otherwise provided in paragraph (2) or (3), be allocated among the partners in the same manner as if such property had been purchased by the partnership.

(2) Effect of partnership agreement.

If the partnership agreement so provides, depreciation, depletion, or gain or loss with respect to property contributed to the partnership by a partner shall, under regulations prescribed by the Secretary or his delegate, be shared among the partners so as to take account of the variation

between the basis of the property to the partnership and its fair market value at the time of contribution.

(3) Undivided interests.

If the partnership agreement does not provide otherwise, depreciation, depletion, or gain or loss with respect to undivided interests in property contributed to a partnership shall be determined as though such undivided interests had not been contributed to the partnership. This paragraph shall apply only if all the partners had undivided interests in such property prior to contribution and their interests in the capital and profits of the partnership correspond with such undivided interests.

(d) Limitation on allowance of losses.

A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

(e) Family partnerships.

(1) Recognition of interest created by purchase or gift.

A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) Distributive share of donee includible in gross income.

In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) Purchase of interest by member of family.

For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons. (Aug. 16, 1954, ch. 736, 68A Stat. 240.)

CROSS REFERENCES

Optional adjustment to basis of partnership property, see section 743 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 743, 1251, 1375 of this title.

§ 705. Determination of basis of partner's interest.

(a) General rule.

The adjusted basis of a partner's interest in a partnership shall, except as provided in subsection (b) be the basis of such interest determined under section 722 (relating to contributions to a partnership) or section 742 (relating to transfers of partnership interests)—

(1) increased by the sum of his distributive share for the taxable year and prior taxable years of—

(A) taxable income of the partnership as determined under section 703 (a),

(B) income of the partnership exempt from tax under this title, and

(C) the excess of the deductions for depletion over the basis of the property subject to depletion; and

(2) decreased (but not below zero) by distributions by the partnership as provided in section 733 and by the sum of his distributive share for the taxable year and prior taxable years of—

(A) losses of the partnership, and

(B) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account.

(b) Alternative rule.

The Secretary or his delegate shall prescribe by regulations the circumstances under which the adjusted basis of a partner's interest in a partnership may be determined by reference to his proportionate share of the adjusted basis of partnership property upon a termination of the partnership. (Aug. 16, 1954, ch. 736, 68A Stat. 242.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 771 of this title.

§ 706. Taxable years of partner and partnership.

(a) Year in which partnership income is includible.

In computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 707 (c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

(b) Adoption of taxable year.

(1) Partnership's taxable year.

The taxable year of a partnership shall be determined as though the partnership were a taxpayer. A partnership may not change to, or adopt, a taxable year other than that of all its principal partners unless it establishes, to the satisfaction of the Secretary or his delegate, a business purpose therefor.

(2) Partner's taxable year.

A partner may not change to a taxable year other than that of a partnership in which he is a principal partner unless he establishes, to the satisfaction of the Secretary or his delegate, a business purpose therefor.

(3) Principal partner.

For the purpose of this subsection, a principal partner is a partner having an interest of 5 percent or more in partnership profits or capital.

(c) Closing of partnership year.

(1) General rule.

Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

(2) Partner who retires or sells interest in partnership.

(A) Disposition of entire interest.

The taxable year of a partnership shall close—

(i) with respect to a partner who sells or exchanges his entire interest in a partnership, and

(ii) with respect to a partner whose interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies shall not close prior to the end of the partnership's taxable year.

Such partner's distributive share of items described in section 702 (a) for such year shall be determined, under regulations prescribed by the Secretary or his delegate, for the period ending with such sale, exchange, or liquidation.

(B) Disposition of less than entire interest.

The taxable year of a partnership shall not close (other than at the end of a partnership's taxable year as determined under subsection (b) (1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced, but such partner's distributive share of items described in section 702 (a) shall be determined by taking into account his varying interests in the partnership during the taxable year.

(Aug. 16, 1954, ch. 736, 68A Stat. 242.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 771 of this title.

§ 707. Transactions between partner and partnership.

(a) Partner not acting in capacity as partner.

If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

(h) Certain sales or exchanges of property with respect to controlled partnerships.

(1) Losses disallowed.

No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between—

(A) a partnership and a partner owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or

(B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267 (d) shall be applicable as if the loss were disallowed under section 267 (a) (1).

(2) Gains treated as ordinary income.

In the case of a sale or exchange, directly or indirectly, of property, which in the hands of the transferee, is property other than a capital asset as defined in section 1221—

(A) between a partnership and a partner owning, directly or indirectly, more than 80 percent of the capital interest, or profits interest, in such partnership, or

(B) between two partnerships in which the same persons own, directly or indirectly, more than 80 percent of the capital interest or profits interests,

any gain recognized shall be considered as gain from the sale or exchange of property other than a capital asset.

(3) Ownership of a capital or profits interest.

For purposes of paragraphs (1) and (2) of this subsection, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267 (c) other than paragraph (3) of such section.

(c) Guaranteed payments.

To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61 (a) (relating to gross income) and section 162 (a) (relating to trade or business expenses). (Aug. 16, 1954, ch. 736, 68A Stat. 243.)

CROSS REFERENCES

Payments to retiring partner or deceased partner's successor in interest, see section 736 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 103, 179, 631, 706, 736, 1402 of this title and in title 42 section 411.

§ 708. Continuation of partnership.

(a) General rule.

For purposes of this subchapter, an existing partnership shall be considered as continuing if it is not terminated.

(b) Termination.

(1) General rule.

For purposes of subsection (a), a partnership shall be considered as terminated only if—

(A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or

(B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

(2) Special rules.

(A) Merger or consolidation.

In the case of the merger or consolidation of two or more partnerships, the resulting partnership shall, for purposes of this section, be considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership.

(B) Division of a partnership.

In the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) shall, for purposes of this section, be considered a continuation of the prior partnership.

(Aug. 16, 1954, ch. 736, 68A Stat. 244.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 771, 4383 of this title.

PART II.—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

Subpart
A. Contributions to a partnership.
B. Distributions by a partnership.
C. Transfers of interests in a partnership.
D. Provisions common to other subparts.

SUBPART A.—CONTRIBUTIONS TO A PARTNERSHIP

Sec.
721. Nonrecognition of gain or loss on contribution.
722. Basis of contributing partner's interest.
723. Basis of property contributed to partnership.

§ 721. Nonrecognition of gain or loss on contribution.

No gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership. (Aug. 16, 1954, ch. 736, 68A Stat. 245.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 1245, 1250, 1251 of this title.

§ 722. Basis of contributing partner's interest.

The basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution. (Aug. 16, 1954, ch. 736, 68A Stat. 245.)

CROSS REFERENCES

Determination of basis of partner's interest, see section 705 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 705 of this title.

§ 723. Basis of property contributed to partnership.

The basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution. (Aug. 16, 1954, ch. 736, 68A Stat. 245.)

CROSS REFERENCES

Exploration expenditures, see section 615 of this title.

SUBPART B.—DISTRIBUTIONS BY A PARTNERSHIP

Sec.
731. Extent of recognition of gain or loss on distribution.
732. Basis of distributed property other than money.
733. Basis of distributee partner's interest.
734. Optional adjustment to basis of undistributed partnership property.
735. Character of gain or loss on disposition of distributed property.
736. Payments to a retiring partner or a deceased partner's successor in interest.

§ 731. Extent of recognition of gain or loss on distribution.

(a) Partners.

In the case of a distribution by a partnership to a partner—

(1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution, and

(2) loss shall not be recognized to such partner, except that upon a distribution in liquidation of a partner's interest in a partnership where no property other than that described in subparagraph (A) or (B) is distributed to such partner, loss shall be recognized to the extent of the excess of the adjusted basis of such partner's interest in the partnership over the sum of—

(A) any money distributed, and

(B) the basis to the distributee, as determined under section 732, of any unrealized receivables (as defined in section 751 (c)) and inventory (as defined in section 751 (d) (2)).

Any gain or loss recognized under this subsection shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner.

(b) Partnerships.

No gain or loss shall be recognized to a partnership on a distribution to a partner of property, including money.

(c) Exceptions.

This section shall not apply to the extent otherwise provided by section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest) and section 751 (relating to unrealized receivables and inventory items). (Aug. 16, 1954, ch. 736, 68A Stat. 245.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 49, 734, 751, 771, 1245, 1250 of this title.

§ 732. Basis of distributed property other than money.

(a) Distributions other than in liquidation of a partner's interest.

(1) General rule.

The basis of property (other than money) distributed by a partnership to a partner other than in liquidation of the partner's interest shall, ex-

cept as provided in paragraph (2), be its adjusted basis to the partnership immediately before such distribution.

(2) Limitation.

The basis to the distributee partner of property to which paragraph (1) is applicable shall not exceed the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction.

(b) Distributions in liquidation.

The basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction.

(c) Allocation of basis.

The basis of distributed properties to which subsection (a) (2) or subsection (b) is applicable shall be allocated—

(1) first to any unrealized receivables (as defined in section 751 (c)) and inventory items (as defined in section 751 (d) (2)) in an amount equal to the adjusted basis of each such property to the partnership (or if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, in proportion to such bases), and

(2) to the extent of any remaining basis, to any other distributed properties in proportion to their adjusted bases to the partnership.

(d) Special partnership basis to transferee.

For purposes of subsections (a), (b), and (c), a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in section 754 is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within 2 years after such transfer, may elect, under regulations prescribed by the Secretary or his delegate, to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in section 743 (b) were in effect with respect to the partnership property. The Secretary or his delegate may by regulations require the application of this subsection in the case of a distribution to a transferee partner, whether or not made within 2 years after the transfer, if at the time of the transfer the fair market value of the partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership.

(e) Exception.

This section shall not apply to the extent that a distribution is treated as a sale or exchange of property under section 751 (b) (relating to unrealized receivables and inventory items). (Aug. 16, 1954, ch. 736, 68A Stat. 246.)

Cross References

Effective date, see section 771 of this title.

Exploration expenditures, see section 615 of this title.

Section Referred to in Other Sections

This section is referred to in sections 731, 733, 734, 771 of this title.

§ 733. Basis of distributee partner's interest.

In the case of a distribution by a partnership to a partner other than in liquidation of a partner's interest, the adjusted basis to such partner of his interest in the partnership shall be reduced (but not below zero) by—

(1) the amount of any money distributed to such partner, and

(2) the amount of the basis to such partner of distributed property other than money, as determined under section 732.

(Aug. 16, 1954, ch. 736, 68A Stat. 247.)

Cross References

Determination of basis of partner's interest, see section 705 of this title.

Effective date, see section 771 of this title.

Section Referred to in Other Sections

This section is referred to in sections 705, 771 of this title.

§ 734. Optional adjustment to basis of undistributed partnership property.

(a) General rule.

The basis of partnership property shall not be adjusted as the result of a distribution of property to a partner unless the election, provided in section 754 (relating to optional adjustment to basis of partnership property), is in effect with respect to such partnership.

(b) Method of adjustment.

In the case of a distribution of property to a partner, a partnership, with respect to which the election provided in section 754 is in effect, shall—

(1) increase the adjusted basis of partnership property by—

(A) the amount of any gain recognized to the distributee partner with respect to such distribution under section 731 (a) (1), and

(B) in the case of distributed property to which section 732 (a) (2) or (b) applies, the excess of the adjusted basis of the distributed property to the partnership immediately before the distribution (as adjusted by section 732 (d)) over the basis of the distributed property to the distributee, as determined under section 732, or

(2) decrease the adjusted basis of partnership property by—

(A) the amount of any loss recognized to the distributee partner with respect to such distribution under section 731 (a) (2), and

(B) in the case of distributed property to which section 732 (b) applies, the excess of the basis of the distributed property to the distributee, as determined under section 732, over the adjusted basis of the distributed property to the partnership immediately before such distribution (as adjusted by section 732 (d)).

(c) Allocation of basis.

The allocation of basis among partnership properties where subsection (b) is applicable shall be made in accordance with the rules provided in section 755. (Aug. 16, 1954, ch. 736, 68A Stat. 247.)

Section Referred to in Other Sections

This section is referred to in sections 754, 755 of this title.

§ 735. Character of gain or loss on disposition of distributed property.

(a) Sale or exchange of certain distributed property.

(1) Unrealized receivables.

Gain or loss on the disposition by a distributee partner of unrealized receivables (as defined in section 751 (c)) distributed by a partnership, shall be considered gain or loss from the sale or exchange of property other than a capital asset.

(2) Inventory items.

Gain or loss on the sale or exchange by a distributee partner of inventory items (as defined in section 751 (d) (2)) distributed by a partnership shall, if sold or exchanged within 5 years from the date of the distribution, be considered gain or loss from the sale or exchange of property other than a capital asset.

(b) Holding period for distributed property.

In determining the period for which a partner has held property received in a distribution from a partnership (other than for purposes of subsection (a) (2)), there shall be included the holding period of the partnership, as determined under section 1223, with respect to such property. (Aug. 16, 1954, ch. 763, 68A Stat. 247.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 771 of this title.

§ 736. Payments to a retiring partner or a deceased partner's successor in interest.

(a) Payments considered as distributive share or guaranteed payment.

Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, except as provided in subsection (b), be considered—

(1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or

(2) as a guaranteed payment described in section 707 (c) if the amount thereof is determined without regard to the income of the partnership.

(b) Payments for interest in partnership.

(1) General rule.

Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments (other than payments described in paragraph (2)) are determined, under regulations prescribed by the Secretary or his delegate, to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under subsection (a).

(2) Special rules.

For purposes of this subsection, payments in exchange for an interest in partnership property shall not include amounts paid for—

(A) unrealized receivables of the partnership (as defined in section 751 (c)), or

(B) good will of the partnership, except to the extent that the partnership agreement provides for a payment with respect to good will.

(Aug. 16, 1594, ch. 736, 68A Stat. 248.)

CROSS REFERENCES

Extent of recognition of gain or loss on distribution, see section 731 of this title.

Partner receiving income in respect of decedent, see section 753 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 731, 751, 753 of this title.

SUBPART C.—TRANSFERS OF INTEREST IN A PARTNERSHIP

Sec.

741. Recognition and character of gain or loss on sale or exchange.

742. Basis of transferee partner's interest.

743. Optional adjustment to basis of partnership property.

§ 741. Recognition and character of gain or loss on sale or exchange.

In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value). (Aug. 16, 1954, ch. 736, 68A Stat. 248.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 751 of this title.

§ 742. Basis of transferee partner's interest.

The basis of an interest in a partnership acquired other than by contribution shall be determined under part II of subchapter O (sec. 1011 and following). (Aug. 16, 1954, ch. 736, 68A Stat. 249.)

CROSS REFERENCES

Determination of basis of partner's interest, see section 705 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 705 of this title.

§ 743. Optional adjustment to basis of partnership property.

(a) General rule.

The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to such partnership.

(b) Adjustment to basis of partnership property.

In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect shall—

(1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property, or

(2) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of his interest in the partnership.

Under regulations prescribed by the Secretary or his delegate, such increase or decrease shall constitute an adjustment to the basis of partnership property with respect to the transferee partner only. A partner's proportionate share of the adjusted basis of partnership property shall be determined in accordance with his interest in partnership capital and, in the case of an agreement described in section 704 (c) (2) (relating to effect of partnership agreement on contributed property), such share shall be determined by taking such agreement into account. In the case of an adjustment under this subsection to the basis of partnership property subject to depletion, any depletion allowable shall be determined separately for the transferee partner with respect to his interest in such property.

(c) Allocation of basis.

The allocation of basis among partnership properties where subsection (b) is applicable shall be made in accordance with the rules provided in section 755. (Aug. 16, 1954, ch. 736, 68A Stat. 249.)

CROSS REFERENCES

Manner of electing optional adjustment to basis of partnership property, see section 754 of this title.

Rules for allocation of basis, see section 755 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 732, 754, 755 of this title.

SUBPART D.—PROVISIONS COMMON TO OTHER SUBPARTS

Sec.
751. Unrealized receivables and inventory items.
752. Treatment of certain liabilities.
753. Partner receiving income in respect of decedent.
754. Manner of electing optional adjustment to basis of partnership property.
755. Rules for allocation of basis.

§ 751. Unrealized receivables and inventory items.

(a) Sale or exchange of interest in partnership.

The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

(1) unrealized receivables of the partnership, or

(2) inventory items of the partnership which have appreciated substantially in value,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

(b) Certain distributions treated as sales or exchanges.

(1) General rule.

To the extent a partner receives in a distribution—

(A) partnership property described in subsection (a) (1) or (2) in exchange for all or a part of his interest in other partnership property (including money), or

(B) partnership property (including money) other than property described in subsection (a) (1) or (2) in exchange for all or a part of his interest in partnership property described in subsection (a) (1) or (2),

such transactions shall, under regulations prescribed by the Secretary or his delegate, be considered as a sale or exchange of such property between the distributee and the partnership (as constituted after the distribution).

(2) Exceptions.

Paragraph (1) shall not apply to—

(A) a distribution of property which the distributee contributed to the partnership, or

(B) payments, described in section 736 (a), to a retiring partner or successor in interest of a deceased partner.

(c) Unrealized receivables.

For purposes of this subchapter, the term "unrealized receivables" includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for—

(1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(2) services rendered, or to be rendered.

For purposes of this section and sections 731, 736, and 741, such term also includes mining property (as defined in section 617(f)(2)), section 1245 property (as defined in section 1245(a)(3)), section 1250 property (as defined in section 1250(c)), farm recapture property (as defined in section 1251(e)(1)), and farm land (as defined in section 1252(a)), but only to the extent of the amount which would be treated as gain to which section 617(d)(1), 1245(a), or 1250(a), 1251(c), or 1252(a) would apply if (at the time of the transaction described in this section or sections 731, 736, or 741, as the case may be) such property had been sold by the partnership at its fair market value.

(d) Inventory items which have appreciated substantially in value.

(1) Substantial appreciation.

Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds—

(A) 120 percent of the adjusted basis to the partnership of such property, and

(B) 10 percent of the fair market value of all partnership property, other than money.

(2) Inventory items.

For purposes of this subchapter the term "inventory items" means—

(A) property of the partnership of the kind described in section 1221(1),

(B) any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in section 1231,

(C) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under subsection (a) of section 1246 (relating to gain on foreign investment company stock), and

(D) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in subparagraph (A), (B), or (C).

(Aug. 16, 1954, ch. 736, 68A Stat. 250; Oct. 16, 1962, Pub. L. 87–834, §§ 13(f)(1), 14(b)(2), 76 Stat. 1035, 1041; Feb. 26, 1964, Pub. L. 88–272, title II, § 231(b)(6), 78 Stat. 105; Sept. 12, 1966, Pub. L. 89–570, § 1(c), 80 Stat. 762; Dec. 30, 1969, Pub. L. 91–172, title II, § 211(b)(6), 83 Stat. 570.)

AMENDMENTS

1969—Subsec. (c). Pub. L. 91–172 substituted "section 1250 property (as defined in section 1250(c)), farm recapture property (as defined in section 1251(e)(1)), and farm land (as defined in section 1252(a))", and "1250(a), 1251(c), or 1252(a)", for "and section 1250 property (as defined in section 1250(c))" and "1250(a)", respectively.

1966—Subsec. (c). Pub. L. 89–570 included reference to mining property (as defined in section 617(f)(2)) and to section 617(d)(1) in the last sentence.

1964—Subsec. (c). Pub. L. 88–272 inserted the reference to section 1250.

1962—Subsec. (c). Pub. L. 87–834, § 13(f)(1), defined "unrealized receivables" for purposes of this section and section 731, 736, and 741, as including section 1245 property, but only to the extent of the amount which would be treated as gain to which section 1245(a) would apply if (at the time of the transaction described in this section or section 731, 736, or 741, as the case may be) such property had been sold by the partnership at its fair market value.

Subsec. (d)(2). Pub. L. 87–834, § 14(b)(2), added subpar. (C), and redesignated former subpar. (C) as (D) and substituted therein "subparagraph (A), (B), or (C)" for "subparagraph (A) or (B)."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 211(c) of Pub. L. 91–172, set out as a note under section 1251 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–570 applicable to taxable years ending after Sept. 12, 1966, but only in respect of expenditures paid or incurred after such date see section 3 of Pub. L. 89–570, set out as a note under section 617 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 231(c) of Pub. L. 88–272, set out as a note under section 1250 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (c) of this section by Pub. L. 87–834 applicable to taxable years beginning after Dec. 31, 1962, see section 13(g) of Pub. L. 87–834, set out as a note under section 1245 of this title.

Amendment of subsec. (d)(2) of this section by Pub. L. 87–834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 14(c) of Pub. L. 87–834, set out as a note under section 1246 of this title.

CROSS REFERENCES

Effective date, see section 771 of this title.

Extent of recognition of gain or loss on distribution, see section 731 of this title.

Recognition and character of gain or loss on sale or exchange, see section 741 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 617, 731, 732, 735, 736, 741, 771, 1245, 1250 of this title.

§ 752. Treatment of certain liabilities.

(a) Increase in partner's liabilities.

Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership.

(b) Decrease in partner's liabilities.

Any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

(c) Liability to which property is subject.

For purposes of this section, a liability to which property is subject shall, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

(d) Sale or exchange of an interest.

In the case of a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships. (Aug. 16, 1954, ch. 736, 68A Stat. 251.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 771 of this title.

§ 753. Partner receiving income in respect of decedent.

The amount includible in the gross income of a successor in interest of a deceased partner under section 736 (a) shall be considered income in respect of a decedent under section 691. (Aug. 16, 1954, ch. 736, 68A Stat. 251.)

CROSS REFERENCES

Effective date, see section 771 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 771 of this title.

§ 754. Manner of electing optional adjustment to basis of partnership property.

If a partnership files an election, in accordance with regulations prescribed by the Secretary or his delegate, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided in section 734 and, in the case of a transfer of a partnership interest, in the manner provided in section 743. Such an election shall apply with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which such election was filed and all subsequent taxable years. Such election may be revoked by the partnership, subject to such limitations as may be provided by regulations prescribed by the Secretary or his delegate. (Aug. 16, 1954, ch. 736, 68A Stat. 251.)

CROSS REFERENCES

Optional adjustment to basis of—
Partnership property, see section 743 of this title.
Undistributed partnership property, see section 734 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section referred to in sections 732, 734, 743 of this title.

§ 755. Rules for allocation of basis.

(a) General rule.

Any increase or decrease in the adjusted basis of partnership property under section 734 (b) (relating to the optional adjustment to the basis of undis-

tributed partnership property) or section 743 (b) (relating to the optional adjustment to the basis of partnership property in the case of a transfer of an interest in a partnership) shall, except as provided in subsection (b), be allocated—

(1) in a manner which has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties, or

(2) in any other manner permitted by regulations prescribed by the Secretary or his delegate.

(b) Special rule.

In applying the allocation rules provided in subsection (a), increases or decreases in the adjusted basis of partnership property arising from a distribution of, or a transfer of an interest attributable to, property consisting of—

(1) capital assets and property described in section 1231 (b), or

(2) any other property of the partnership,

shall be allocated to partnership property of a like character except that the basis of any such partnership property shall not be reduced below zero. If, in the case of a distribution, the adjustment to basis of property described in paragraph (1) or (2) is prevented by the absence of such property or by insufficient adjusted basis for such property, such adjustment shall be applied to subsequently acquired property of a like character in accordance with regulations prescribed by the Secretary or his delegate. (Aug. 16, 1954, ch. 736, 68A Stat. 252.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 734, 743 of this title.

PART III.—DEFINITIONS

Sec.
761. Terms defined.

§ 761. Terms defined.

(a) Partnership.

For purposes of this subtitle, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate. Under regulations the Secretary or his delegate may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of—

(1) for investment purposes only and not for the active conduct of a business, or

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

(b) Partner.

For purposes of this subtitle, the term "partner" means a member of a partnership.

(c) Partnership agreement.

For purposes of this subchapter, a partnership agreement includes any modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not including extensions) which are agreed to by all the partners, or which are adopted in such other manner as may be provided by the partnership agreement.

(d) Liquidation of a partner's interest.

For purposes of this subchapter, the term "liquidation of a partner's interest" means the termination of a partner's entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership. (Aug. 16, 1954, ch. 736, 68A Stat. 252.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 603, 771 of this title.

PART IV.—EFFECTIVE DATE FOR SUBCHAPTER

Sec.
771. Effective date.

§ 771. Effective date.

(a) General rule.

(1) Taxable years beginning after December 31, 1954.

Except as provided in subsection (b), this subchapter shall apply with respect to—

(A) any partnership taxable year beginning after December 31, 1954, and

(B) any part of a partner's taxable year falling within such partnership taxable year.

(2) Application of prior provisions.

Except as provided in subsection (b), sections 113 (a) (13), 181 to 191 (inclusive), and 3797 (a) (2) of the Internal Revenue Code of 1939 shall apply with respect to—

(A) any partnership taxable year beginning before January 1, 1955, and

(B) any part of a partner's taxable year falling within such partnership taxable year.

(b) Special rules.

(1) Adoption of taxable year.

Section 706 (b) (relating to the adoption of a taxable year by a partnership or partner) shall apply to—

(A) any partnership which adopts, or changes to, a taxable year beginning after April 1, 1954, and

(B) any partner who changes to a taxable year beginning after April 1, 1954.

For the purpose of applying this paragraph, section 708 (relating to the continuation of a partnership) shall be effective for taxable years beginning after April 1, 1954.

(2) Property distributed by a partnership.

Section 735 (a) (relating to the character of gain or loss on the disposition of property distributed by a partnership) shall apply only to property distributed by a partnership after March 9, 1954.

(3) Unrealized receivables and inventory items.

Section 751 (relating to unrealized receivables and inventory items) shall apply with respect to gain or loss to a seller, distributee, or partnership in the case of a sale, exchange, or distribution occurring after March 9, 1954. For the purpose

of applying this paragraph in the case of a taxable year beginning before January 1, 1955, the other sections of this subchapter shall be applicable to the extent provided by regulations prescribed by the Secretary or his delegate.

(4) Partner receiving income in respect of decedent.

Section 753 (relating to income in respect of a decedent) shall apply only in the case of payments made with respect to decedents dying after December 31, 1954.

(c) Optional treatment of certain distributions.

In the case of a partnership taxable year beginning after December 31, 1953, and before January 1, 1955, a partnership may elect, under regulations prescribed by the Secretary or his delegate, with respect to distributions made during such year to any partner, other than in liquidation of the partner's interest, to apply the rules in sections 731, 732 (a), (c), and (e), 733, 735, and 751 (b), (c), and (d) (and, to the extent applicable, the rules provided in sections 705, 752, and 761 (d)). If a partnership so elects, such rules shall be effective for the partnership and all members of such partnership with respect to such distributions. (Aug. 16, 1954, ch. 736, 68A Stat. 253.)

Subchapter L.—Insurance Companies

Part
I. Life insurance companies.
II. Mutual insurance companies (other than life and certain marine insurance companies and other than fire or flood insurance companies which operate on basis of perpetual policies or premium deposits).
III. Other insurance companies.
IV. Provisions of general application.

AMENDMENTS

1962—Pub. L. 87-834, § 8(g)(4)(A), Oct. 16, 1962, 76 Stat. 999, substituted "and certain marine insurance companies and other than fire or flood insurance companies which operate on basis of perpetual policies or premium deposits" for "or marine or fire insurance companies issuing perpetual policies" in the heading of Part II.

PART I.—LIFE INSURANCE COMPANIES

Subpart
A. Definition; tax imposed.
B. Investment income.
C. Gain and loss from operations.
D. Distributions to shareholders.
E. Miscellaneous provisions.

AMENDMENTS

1959—Pub. L. 86-69, § 2(a), June 25, 1959, 73 Stat. 112, amended analysis of Part I and subparts generally.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in sections 361, 6154, 6425, 6655 of this title.

SUBPART A.—DEFINITION; TAX IMPOSED

Sec.
801. Definition of life insurance company.
802. Tax imposed.

AMENDMENTS

1959—Pub. L. 86-69, § 2(a), June 25, 1959, 73 Stat. 112, amended analysis generally.

1958—Pub. L. 85-345, § 2(b), Mar. 17, 1958, 72 Stat. 37, eliminated "for 1955 and 1956" following the words "Tax imposed" in item 802.

1958—Act July 24, 1956, ch. 696, § 2(a), 70 Stat. 633, inserted "and 1956" in item 802.

Act Mar. 13, 1956, ch. 83, § 2, 70 Stat. 36, amended analysis generally.

§ 801. Definition of life insurance company.

(a) Life insurance company defined.

For purposes of this subtitle, the term "life insurance company" means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, if—

(1) its life insurance reserves (as defined in subsection (b)), plus

(2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, health, or accident policies not included in life insurance reserves,

comprise more than 50 percent of its total reserves (as defined in subsection (c)).

(b) Life insurance reserves defined.

(1) In general.

For purposes of this part, the term "life insurance reserves" means amounts—

(A) which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interests, and

(B) which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies.

(2) Reserves must be required by law.

Except—

(A) in the case of policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, and

(B) as provided in paragraph (3),

in addition to the requirements set forth in paragraph (1), life insurance reserves must be required by law.

(3) Assessment companies.

In the case of an assessment life insurance company or association, the term "life insurance reserves" includes—

(A) sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and

(B) any funds maintained, under the charter or articles of incorporation or association (or bylaws approved by a State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued on the assessment plan and not subject to any other use.

For purposes of this part, the rate of interest assumed in calculating the reserves described in subparagraphs (A) and (B) shall be 3 percent.

(4) Deficiency reserves excluded.

The term "life insurance reserves" does not include deficiency reserves. For purposes of this subsection and subsection (c), the deficiency reserve for any contract is that portion of the reserve for such contract equal to the amount (if any) by which—

(A) the present value of the future net premiums required for such contract, exceeds

(B) the present value of the future actual premiums and consideration charged for such contract.

(5) Amount of reserves.

For purposes of this subsection, subsection (a), and subsection (c), the amount of any reserve (or portion thereof) for any taxable year shall be the mean of such reserve (or portion thereof) at the beginning and end of the taxable year.

(c) Total reserves defined.

For purposes of subsection (a), the term "total reserves" means—

(1) life insurance reserves,

(2) unearned premiums, and unpaid losses (whether or not ascertained), not included in life insurance reserves, and

(3) all other insurance reserves required by law.

The term "total reserves" does not include deficiency reserves (within the meaning of subsection (b)(4)).

(d) Adjustments in reserves for policy loans.

For purposes only of determining under subsection (a) whether or not an insurance company is a life insurance company, the life insurance reserves, and the total reserves, shall each be reduced by an amount equal to the mean of the aggregates, at the beginning and end of the taxable year, of the policy loans outstanding with respect to contracts for which life insurance reserves are maintained.

(e) Guaranteed renewable contracts.

For purposes of this part, guaranteed renewable life, health, and accident insurance shall be treated in the same manner as noncancellable life, health, and accident insurance.

(f) Burial and funeral benefit insurance companies.

A burial or funeral benefit insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services shall not be taxable under this part but shall be taxable under section 821 or section 831.

(g) Contracts with reserves based on segregated asset accounts.

(1) Definitions.

(A) Annuity contracts include variable annuity contracts.

For purposes of this part, an "annuity contract" includes a contract which provides for the payment of a variable annuity computed on the basis of recognized mortality tables and the investment experience of the company issuing the contract.

(B) Contracts with reserves based on a segregated asset account.

For purposes of this part, a "contract with reserves based on a segregated asset account" is a contract—

(i) which provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company,

(ii) which provides for the payment of annuities, and

(iii) under which the amounts paid in, or the amount paid as annuities, reflect the investment return and the market value of the segregated asset account.

If a contract ceases to reflect current investment return and current market value, such contract shall not be considered as meeting the requirements of clause (iii) after such cessation.

(2) Life insurance reserves.

For purposes of subsection (b)(1)(A) of this section, the reflection of the investment return and the market value of the segregated asset account shall be considered an assumed rate of interest.

(3) Separate accounting.

For purposes of this part, a life insurance company which issues contracts with reserves based on segregated asset accounts shall separately account for the various income, exclusion, deduction, asset, reserve, and other liability items properly attributable to such segregated asset accounts. For such items as are not accounted for directly, separate accounting shall be made—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

(4) Investment yield.

(A) In general.

For purposes of this part, the policy and other contract liability requirements, and the life insurance company's share of investment yield, shall be separately computed—

(i) with respect to the items separately accounted for in accordance with paragraph (3), and

(ii) excluding the items taken into account under clause (i).

(B) Capital gains and losses.

If, without regard to subparagraph (A), the net short-term capital gain exceeds the net long-term capital loss, such excess shall be allocated between clauses (i) and (ii) of subparagraph (A) in proportion to the respective contributions to such excess of the items taken into account under each such clause.

(5) Policy and other contract liability requirements.

For purposes of this part—

(A) with respect to life insurance reserves based on segregated asset accounts, the adjusted reserves rate and the current earnings rate for

purposes of section 805(b), and the rate of interest assumed by the taxpayer for purposes of sections 805(c) and 809(a)(2), shall be a rate equal to the current earnings rate determined under section 805(b)(2) with respect to the items separately accounted for in accordance with paragraph (3) reduced by the percentage obtained by dividing—

(i) any amount retained with respect to such reserves by the life insurance company from gross investment income (as defined *in* section 804(b) on segregated assets, to the extent such retained amount exceeds the deductions allowable under section 804(c) which are attributable to such reserves, by

(ii) the means of such reserves; and

(B) with respect to reserves based on segregated asset accounts other than life insurance reserves, an amount equal to the product of—

(i) the rate of interest assumed as defined in subparagraph (A), and

(ii) the means of such reserves,

shall be included as interest paid within the meaning of section 805(e)(1).

(6) Increases and decreases in reserves.

For purposes of subsections (a) and (b) of section 810, the sum of the items described in section 810(c) taken into account as of the close of the taxable year shall, under regulations prescribed by the Secretary or his delegate, be adjusted—

(A) by subtracting therefrom an amount equal to the sum of the amounts added from time to time (for the taxable year) to the reserves separately accounted for in accordance with paragraph (3) by reason of appreciation in value of assets (whether or not the assets have been disposed of), and

(B) by adding thereto an amount equal to the sum of the amounts subtracted from time to time (for the taxable year) from such reserves by reason of depreciation in value of assets (whether or not the assets have been disposed of).

The deduction allowable for items described in paragraphs (1) and (7) of section 809(d) with respect to segregated asset accounts shall be reduced to the extent that the amount of such items is increased for the taxable year by appreciation (or increased to the extent that the amount of such items is decreased for the taxable year by depreciation) not reflected in adjustments under the preceding sentence.

(7) Basis of assets held for qualified pension plan contracts.

In the case of contracts described in subparagraph (A), (B), (C), or (D) of section 805(d)(1), the basis of each asset in a segregated asset account shall (in addition to all other adjustments to basis) be—

(A) increased by the amount of any appreciation in value, and

(B) decreased by the amount of any depreciation in value, to the extent that such appreciation and depreciation are from time to time reflected in the increases and decreases in reserves or other items in paragraph (6) with respect to such contracts.

(8) Additional separate computations.

Under regulations prescribed by the Secretary or his delegate, such additional separate computations shall be made, with respect to the items separately accounted for in accordance with paragraph (3), as may be necessary to carry out the purposes of this subsection and this part.

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 112, and amended Pub. L. 87–858, § 3(a), Oct. 23, 1962, 76 Stat. 1134; Pub. L. 91–172, title I, § 121(b)(5)(B), Dec. 30, 1969, 83 Stat. 541.)

CODIFICATION

Provisions similar to those comprising this section were contained in a prior section 801, acts Aug. 16, 1954, ch. 736, 68A Stat. 255; Mar. 13, 1956, ch. 83, § 2, 70 Stat. 36, prior to the general revision of this part by Pub. L. 86–69.

AMENDMENTS

1969—Subsec. (b)(2). Pub. L. 91–172 redesignated former subpar. (C) as (B). Former subpar. (B), dealing with policies issued by organizations that substantially met the requirements of section 501(c)(9) of this title, was stricken.

1962—Subsec. (g). Pub. L. 87–858 substituted as the subsec. catchline "contracts with reserves based on segregated asset accounts" for "Variable annuities."

Subsec. (g)(1). Pub. L. 87–858 substituted as par. (1) catchline "Definitions" for "In general", designated existing provisions as subpar. (A) and added subpar. (B).

Subsec. (g)(2). Pub. L. 87–858 substituted provisions respecting life insurance reserves for provisions relating to adjusted reserves rate and assumed rate.

Subsec. (g)(3). Pub. L. 87–858 substituted provisions respecting separate accounting for provisions relating to current earnings rate.

Subsec. (g)(4). Pub. L. 87–858 substituted provisions respecting investment yield for provisions relating to increases and decreases in reserves, incorporated in par. (6)(A) and (B).

Subsec. (g)(5). Pub. L. 87–858 substituted provisions respecting policy and other contract liability requirements for provisions relating to companies issuing variable annuities and other contracts.

Subsec. (g)(6). Pub. L. 87–858 redesignated former par. (4) as (6) and added provision relating to reduction of deduction allowed for certain items with respect to segregated asset accounts. Former par. (6) had provided that former pars. (1)—(5) would not apply with respect to any taxable year beginning after Dec. 31, 1962.

Subsec. (g)(7). Pub. L. 87–858 added par. (7).

Subsec. (g)(8). Pub. L. 87–853 redesignated subpar. (B) of former par. (5) as par. (8), substituting "with respect to the items separately accounted for in accordance with paragraph (3)" for "with respect to such annuity contracts and such other contracts."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginnnig after Dec. 31, 1969, see section 121(g) of Pub. L. 91–172, set out as a note under section 511 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Section 3(f) of Pub. L. 87–858 provided that: "Except as provided in subsection (d)(2) [set out as a note under section 812 of this title], the amendments made by this section [to this section and sections 802, 804, 809, 815, and 6501 of this title] shall apply with respect to taxable years beginning after December 31, 1961."

EFFECTIVE DATE

Section 4 of Pub. L. 86–69 provided that: "Except as otherwise provided in this Act, the amendments made by this Act [to this part and sections 381(c), (d), 841, 842, 891, 1016(a), 1201(a), (c), 1232(a), 1504(b), 4371(2) and 6501(c) of this title] shall apply only with respect to taxable years beginning after December 31, 1957."

SHORT TITLE

Section 1 of Pub. L. 86–69 provided that Pub. L. 86–69, which amended this part and sections 34(c), 116(b), 381 (c), (d), 841, 842, 891, 1016(a), 1201(a), (c), 1232(a), 1504(b), 4371(2) and 6501(c) of this title, and enacted notes set out under this section and sections 6072 and 6655 of this title, may be cited as the "Life Insurance Company Income Tax Act of 1959."

CROSS REFERENCES

Certain exchanges of insurance policies, see section 1035 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 11, 453, 805, 810, 818, 819, 820, 832, 1035, 4914 of this title.

§ 802. Tax imposed.

(a) Tax imposed.

(1) In general.

A tax is hereby imposed for each taxable year beginning after December 31, 1957, on the life insurance company taxable income of every life insurance company. Such tax shall consist of a normal tax and surtax computed as provided in section 11 as though the life insurance company taxable income were the taxable income referred to in section 11.

(2) Alternative tax in case of capital gains.

If for any taxable year beginining after December 31, 1961, the net long-term capital gain of any life insurance company exceeds the net short-term capital loss, then, in lieu of the tax imposed by paragraph (1), there is hereby imposed a tax (if such tax is less than the tax imposed by such paragraph) which shall consist of the sum of—

(A) a partial tax, computed as provided by paragraph (1), on the life insurance company taxable income determined by reducing the taxable investment income, and the gain from operations, by the amount of such excess, and

(B) an amount determined as provided in section 1201(a) on such excess.

(3) Special rule for 1959 and 1960.

If any amount is subtracted from the policyholders surplus account under section 815(c)(3) for a taxable year beginning in 1959 or 1960 on account of a distribution in 1959 or 1960 (not including any distribution treated under section 815(d)(2)(B) as made in 1959 or 1960), the tax imposed for such taxable year on the life insurance company taxable income shall be the amount determined under paragraph (1) reduced by the following percentage of the amount by which the tax imposed by paragraph (1) is (without regard to this paragraph) increased, on account of the amount so subtracted, by reason of section 802(b)(3)—

(A) in the case of a taxable year beginning in 1959, 66⅔ percent; and

(B) in the case of a taxable year beginning in 1960, 33⅓ percent.

The preceding sentence shall not apply with respect to any payment treated as a distribution under section 815(d)(3).

(b) Life insurance company taxable income defined.

For purposes of this part, the term "life insurance company taxable income" means the sum of—

(1) the taxable investment income (as defined in section 804) or, if smaller, the gain from operations (as defined in section 809),

(2) if the gain from operations exceeds the taxable investment income, an amount equal to 50 percent of such excess, plus

(3) the amount subtracted from the policyholders surplus account for the taxable year, as determined under section 815.

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 115, and amended Pub. L. 87–858, § 3(b)(1), Oct. 23, 1962, 76 Stat. 1136; Pub. L. 88–272, title II, § 235(c)(1), Feb. 26, 1964, 78 Stat. 126; Pub. L. 91–172, title V, § 511(c)(1), Dec. 30, 1969, 83 Stat. 637.)

CODIFICATION

Provisions similar to those comprising this section were contained in a prior section 802, acts Aug. 16, 1954, ch. 736, 68A Stat. 255; Mar. 13, 1956, ch. 83, § 2, 70 Stat. 38; July 24, 1956, ch. 696, §§ 1, 2(b), 70 Stat. 633; Mar. 17, 1958, Pub. L. 85–345, §§ 1, 2(a), 72 Stat. 36.

Former section 803, acts Aug. 16, 1954, ch. 736, 68A Stat. 256; Mar. 13, 1956, ch. 83, § 2, 70 Stat. 39, which related to income and deductions in the case of life insurance companies, was omitted from this part by Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 112, which amended this part in its entirety. See section 804 of this title.

AMENDMENTS

1969—Subsec. (a)(2)(B). Pub. L. 91–172 substituted "(B) an amount determined as provided in section 1201(a) on such excess" for "(B) an amount equal to 25 percent of such excess."

1964—Subsec. (a)(1). Pub. L. 88–272 substituted provisions that the tax shall consist of a normal tax and surtax computed as provided in section 11 as though the life insurance company taxable income were the income referred to in section 11, for provisions that it consist of a normal tax computed at the rate provided by section 11(b) and a surtax on the income which exceeds $25,000 computed at the rate provided by section 11(c).

1962—Subsec. (a)(2). Pub. L. 87–858 added "Alternative tax" to the heading of par. (2) and substituted in such par. (2) "1961" for "1958" and provisions imposing a tax consisting of the sum of "(A) a partial tax, computed as provided by paragraph (1), on the life insurance company taxable income determined by reducing the taxable investment income, and the gain from operations, by the amount of such excess, and (B) an amount equal to 25 percent of such excess" for "there is hereby imposed a tax equal to 25 percent of such excess."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 511(d) of Pub. L. 91–172, set out as a note under section 1201 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years ending after Dec. 31, 1963, see section 235(d) of Pub. L. 88–272 set out as a note under section 1551 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of this section by Pub. L. 87–858 applicable with respect to taxable years beginning after Dec. 31, 1961, see section 3(f) of Pub. L. 87–858, set out as a note under section 801 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 6072 of this title.

FILING OF INCOME TAX RETURNS FOR 1958

Every life insurance company subject to the tax imposed by this section required to make a return after June 25, 1959, and on or before Sept. 15, 1959 for its taxable year beginning in 1958, see section 3(i) of Pub. L. 86–69, set out as a note under section 6072 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 80, 243, 809, 812, 815, 818, 819, 841, 891, 1351, 1504, 1562, 1563, 4914, 6501 of this title.

SUBPART B.—INVESTMENT INCOME

Sec.
804. Taxable investment income.
805. Policy and other contract liability requirements.
806. Certain changes in reserves and assets.

§ 804. Taxable investment income.

(a) In general.

(1) Exclusion of policyholders' share of investment yield.

The policyholders' share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received) of any life insurance company shall not be included in taxable investment income. For purposes of the preceding sentence, the policyholders' share of any item shall be that percentage obtained by dividing the policy and other contract liability requirements by the investment yield; except that if the policy and other contract liability requirements exceed the investment yield, then the policyholders' share of any item shall be 100 percent.

(2) Taxable investment income defined.

For purposes of this part, the taxable investment income for any taxable year shall be an amount (not less than zero) equal to the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss plus the sum of the life insurance company's share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received), reduced by—

(A) the sum of—

(i) the life insurance company's share of interest which under section 103 is excluded from gross income,

(ii) the deduction for partially tax-exempt interest provided by section 242 (as modified by paragraph (3)) computed with respect to the life insurance company's share of such interest, and

(iii) the deductions for dividends received provided by sections 243, 244, and 245 (as modified by paragraph (5)) computed with respect to the life insurance company's share of the dividends received; and

(B) the small business deduction provided by paragraph (4).

For purposes of the preceding sentence, the life insurance company's share of any item shall be that percentage which, when added to the percentage obtained under the second sentence of paragraph (1), equals 100 percent.

(3) Partially tax-exempt interest.

For purposes of this part, the deduction allowed by section 242 shall be an amount which bears the same ratio to the amount determined under such section without regard to this paragraph as (A) the normal tax rate for the taxable year prescribed by section 11, bears to (B) the sum of the normal tax rate and the surtax rate for the taxable year prescribed by section 11.

(4) Small business deduction.

For purposes of this part, the small business deduction is an amount equal to 10 percent of the investment yield for the taxable year. The deduction under this paragraph shall not exceed $25,000.

(5) Application of section 246(b).

In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of this subsection, the limit on the aggregate amount of the deductions allowed by sections 243(a)(1), 244(a), and 245 shall be 85 percent of the taxable investment income computed without regard to the deductions allowed by such sections.

(6) Exception.

If it is established in any case that the application of the definition of taxable investment income contained in paragraph (2) results in the imposition of tax on—

(A) any interest which under section 103 is excluded from gross income,

(B) any amount of interest which under section 242 (as modified by paragraph (3)) is allowable as a deduction, or

(C) any amount of dividends received which under sections 243, 244, and 245 (as modified by paragraph (5)) is allowable as a deduction,

adjustment shall be made to the extent necessary to prevent such imposition.

(b) Gross investment income.

For purposes of this part, the term "gross investment income" means the sum of the following:

(1) Interest, etc.

The gross amount of income from—

(A) interest, dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the life insurance company derives interest, rents, or royalties, and

(C) the alteration or termination of any instrument or agreement described in subparagraph (B).

(2) Short-term capital gain.

In the case of a taxable year beginning after December 31, 1958, the amount (if any) by which the net short-term capital gain exceeds the net long-term capital loss.

(3) Trade or business income.

The gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

Except as provided in paragraph (2), in computing gross investment income under this subsection, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

(c) Investment yield defined.

For purposes of this part, the term "investment yield" means the gross investment income less the following deductions—

(1) Investment expenses.

Investment expenses for the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed the sum of—

(A) one-fourth of one percent of the mean of the assets (as defined in section 805(b)(4)) held at the beginning and end of the taxable year,

(B) the amount of the mortgage service fees for the taxable year, plus

(C) whichever of the following is the greater:

(i) one-fourth of the amount by which the investment yield (computed without any deduction for investment expenses allowed by this paragraph) exceeds 3¾ percent of the mean of the assets (as defined in section 805(b)(4)) held at the beginning and end of the taxable year, reduced by the amount described in subparagraph (B), or

(ii) one-fourth of one percent of the mean of the value of mortgages held at the beginning and end of the taxable year for which there are no mortgage service fees for the taxable year.

(2) Real estate expenses.

The amount of taxes (as provided in section 164), and other expenses, for the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

(3) Depreciation.

The deduction allowed by section 167. The deduction under this paragraph and paragraph (2) on account of any real estate owned and occupied for insurance purposes in whole or in part by a life insurance company shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this sentence) as the rental value of the space not so occupied bears to the rental value of the entire property.

(4) Depletion.

The deduction allowed by section 611 (relating to depletion).

(5) Trade or business deductions.

The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner; except that in computing the deduction under this paragraph—

(A) There shall be excluded losses—

(i) from (or considered as from) sales or exchanges of capital assets,

(ii) from sales or exchanges of property used in the trade or business (as defined in section 1231(b)), and

(iii) from the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business (as so defined).

(B) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account.

(C) The deduction for net operating losses provided in section 172, and the special deductions for corporations provided in part VIII of subchapter B, shall not be allowed.

(d) Cross reference.

For reduction of the $25,000 amount provided in subsection (a)(4) in the case of certain controlled corporations, see sections 1561 and 1564.

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 115, and amended Pub. L. 87–858, § 3(b)(2), Oct. 23, 1962, 76 Stat. 1137; Pub. L. 88–272, title II, § 214(b)(3), Feb. 26, 1964, 78 Stat. 55; Pub. L. 91–172, title IV, § 401(b)(2)(D), Dec. 30, 1969, 83 Stat. 602.)

CODIFICATION

Provisions similar to those comprising this section were contained in former section 803 of this title.

PRIOR PROVISIONS

A prior section 804, acts Aug. 16, 1954, ch. 736, 68A Stat. 258; Mar. 13, 1956, ch. 83, § 2, 70 Stat. 41, related to reserve and other policy liability deductions.

AMENDMENTS

1969—Subsec. (d). Pub. L. 91–172 added subsec. (d).

1964—Subsec. (a)(5). Pub. L. 88–272 substituted "243(a)(1), 244(a)" for "243(a), 244."

1962—Subsec. (a)(2). Pub. L. 87–858 substituted "equal to the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss plus the sum" for "equal to the sum."

EFFECTIVE DATE OF 1969 AMENDMENT

Subsec. (d) of this section applicable with respect to taxable years beginning after Dec. 31, 1969, see section 401(h)(2) of Pub. L. 91–172, set out as a note under section 1561 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to dividends received in taxable years ending after Dec. 31, 1963, see section 214(c) of Pub. L. 88–272, set out as a note under section 243 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of this section by Pub. L. 87–858 applicable with respect to taxable years beginning after Dec. 31, 1961, see section 3(f) of Pub. L. 87–858, set out as a note under section 801 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 243, 801, 802, 809, 815, 818, 1562, 1564 of this title.

§ 805. Policy and other contract liability requirements.

(a) In general.

For purposes of this part, the term "policy and other contract liability requirements" means, for any taxable year, the sum of—

(1) the adjusted life insurance reserves, multiplied by the adjusted reserves rate,

(2) the mean of the pension plan reserves at the beginning and end of the taxable year, multiplied by the current earnings rate, and

(3) the interest paid.

(b) Adjusted reserves rate and earnings rates.

(1) Adjusted reserves rate.

For purposes of this part, the adjusted reserves rate for any taxable year is the average earnings rate or, if lower, the current earnings rate.

(2) Current earnings rate.

For purposes of this part, the current earnings rate for any taxable year is the amount determined by dividing—

(A) the taxpayer's investment yield for such taxable year, by

(B) the mean of the taxpayer's assets at the beginning and end of the taxable year.

(3) Average earnings rate.

(A) In general.

For purposes of this part, the average earnings rate for any taxable year is the average of the current earnings rates for such taxable year and for each of the 4 taxable years immediately preceding such taxable year (excluding any of such 4 taxable years for which the taxpayer was not an insurance company).

(B) Special rules.

For purposes of subparagraph (A)—

(i) the current earnings rate for any taxable year beginning before January 1, 1958, shall be determined as if this part (as in effect for 1958) and section 381(c)(22) applied to such taxable year, and

(ii) the current earnings rate for any taxable year of any company which, for such year, is an insurance company (but not a life insurance company) shall be determined as if this part applied to such company for such year.

(4) Assets.

For purposes of this part, the term "assets" means all assets of the company (including nonadmitted assets), other than real and personal property (excluding money) used by it in carrying on an insurance trade or business. For purposes of this paragraph, the amount attributable to—

(A) real property and stock shall be the fair market value thereof, and

(B) any other asset shall be the adjusted basis (determined without regard to fair market value on December 31, 1958) of such asset for purposes of determining gain on sale or other disposition.

(c) Adjusted life insurance reserves.

(1) Adjusted life insurance reserves defined.

For purposes of this part, the term "adjusted life insurance reserves" means—

(A) the mean of the life insurance reserves (as defined in section 801(b)), other than pension plan reserves, at the beginning and end of the taxable year, multiplied by

(B) that percentage which equals 100 percent—

(i) increased by that percentage which is 10 times the average rate of interest assumed by the taxpayer in calculating such reserves, and

(ii) reduced by that percentage which is 10 times the adjusted reserves rate.

(2) Average interest rate assumed.

For purposes of this part, the average rate of interest assumed in calculating reserves shall be computed—

(A) by multiplying each assumed rate of interest by the means of the amounts of such reserves computed at that rate at the beginning and end of the taxable year, and

(B) by dividing (i) the sum of the products ascertained under subparagraph (A), by (ii) the mean of the total of such reserves at the beginning and end of the taxable year.

(d) Pension plan reserves.

(1) Pension plan reserves defined.

For purposes of this part, the term "pension plan reserves" means that portion of the life insurance reserves which is allocable to contracts—

(A) purchased under contracts entered into with trusts which (as of the time the contracts were entered into) were deemed to be (i) trusts described in section 401(a) and exempt from tax under section 501(a), or (ii) trusts exempt from tax under section 165 of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws;

(B) purchased under contracts entered into under plans which (as of the time the contracts were entered into) were deemed to be plans described in section 403(a), or plans meeting the requirements of section 165(a)(3), (4), (5), and (6) of the Internal Revenue Code of 1939;

(C) provided for employees of the life insurance company under a plan which, for the taxable year, meets the requirements of section 401(a)(3), (4), (5), (6), (7), and (8); or

(D) purchased to provide retirement annuities for its employees by an organization which (as of the time the contracts were purchased) was an organization described in section 501(c)(3) which was exempt from tax under section 501(a) or was an organization exempt from tax under section 101(6) of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws, or purchased to provide retirement annuities for employees described in section 403(b)(1)(A)(ii) by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing.

(2) Special transitional rule.

For purposes of this part, the amount taken into account as pension plan reserves shall be—

(A) in the case of a taxable year beginning after December 31, 1957, and before January 1, 1959, zero;

(B) in the case of a taxable year beginning after December 31, 1958, and before January 1, 1960, 33⅓ percent of the amount thereof (determined without regard to this paragraph);

(C) in the case of a taxable year beginning after December 31, 1959, and before January 1, 1961, 66⅔ percent of the amount thereof (determined without regard to this paragraph); and

(D) in the case of a taxable year beginning after December 31, 1960, 100 percent of the amount thereof.

(e) Interest paid.

For purposes of this part, the interest paid for any taxable year is the sum of—

(1) Interest on indebtedness.

All interest for the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from taxation under this chapter.

(2) Amounts in the nature of interest.

All amounts in the nature of interest, whether or not guaranteed, for the taxable year on insurance or annuity contracts (including contracts supplementary thereto) which do not involve, at the time of accrual, life, health, or accident contingencies.

(3) Discount on prepaid premiums.

All amounts accrued for the taxable year for discounts in the nature of interest, whether or not guaranteed, on premiums or other consideration paid in advance on insurance or annuity contracts.

(4) Interest on certain special contingency reserves.

Interest for the taxable year on special contingency reserves under contracts of group term life insurance or group health and accident insurance which are established and maintained for the provision of insurance on retired lives, for premium stabilization, or for a combination thercof.

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 118, and amended Pub. L. 87–792, § 7(g), Oct. 10, 1962, 76 Stat. 829; Pub. L. 88–571, § 5(a), Sept. 2, 1964, 78 Stat. 860; Pub. L. 91–172, title IX, § 907(a)(1), Dec. 30, 1969, 83 Stat. 715.)

PRIOR PROVISIONS

A prior section 805, acts Aug. 16, 1954, ch. 736, 68A Stat. 258; Mar. 13, 1956, ch. 83, § 2, 70 Stat. 43, authorized a special interest deduction.

AMENDMENTS

1969—Subsec. (e)(4). Pub. L. 91–172 made express reference to interest on special contingency reserves under specific insurance contracts established and maintained for the provision of insurance on retired lives and premium stabilization.

1964—Subsec. (d)(1)(D). Pub. L. 88–571 inserted ", or purchased to provide retirement annuities for employees described in section 403(b)(1)(A)(ii) by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing."

1962—Subsec. (d)(1). Pub. L. 87–792 substituted "described in section 403(a), or plans meeting" for "meeting the requirements of section 401(a) (3), (4), (5), and (6) or" in subpar. (B), and "(5), (6), (7), and (8)" for "(5), and (6)" in subpar. (C).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 907(d) of Pub. L. 91–172 provided that: "The amendments made by subsection (a) [amending this section and section 810(c) of this title] shall apply to taxable years beginning after December 31, 1957. The amendments made by subsection (b) [amending section 815 of this title] shall apply to taxable years beginning after December 31, 1968. The amendments made by subsection (c) [adding section 844 and amending sections 809, 823, and 825 of this title] shall apply with respect to losses occurred in taxable years beginnnig after December 31, 1962, but shall not affect any tax liability for any taxable year beginning before January 1, 1967."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 5(b) of Pub. L. 88–571 provided that: "The amendment made by subsection (a) [to this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87–792 applicable to taxable years beginning after Dec. 31, 1962, see section 8 of Pub. L. 87–792, set out as a note under section 37 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 801, 804, 811, 818 of this title.

§ 806. Certain changes in reserves and assets.

(a) Adjustments to means for certain transfers of liabilities.

For purposes of this part, if, during the taxable year, there is a change in life insurance reserves attributable to the transfer between the taxpayer and another person of liabilities under contracts taken into account in computing such reserves, then, under regulations prescribed by the Secretary or his delegate, the means of such reserves, and the mean of the assets, shall be appropriately adjusted, on a daily basis, to reflect the amounts involved in such transfer. This subsection shall not apply to reinsurance ceded to the taxpayer or to another person.

(b) Change of basis in computing reserves.

If the basis for determining the amount of any item referred to in section 810(c) as of the close of the taxable year differs from the basis for such determination as of the beginning of the taxable year, then for purposes of this subpart the amount of such item—

(1) as of the close of the taxable year shall be computed on the old basis, and

(2) as of the beginning of the next taxable year shall be computed on the new basis.

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 120.)

PRIOR PROVISIONS

A prior section 806, act Aug. 16, 1954, ch. 736, 68A Stat. 258, related to adjustment for certain reserves.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

CODIFICATION

Former section 807, act Aug. 16, 1954, ch. 736, 68A Stat. 259, was omitted from this part by act Mar. 13, 1956, ch. 83, § 2, 70 Stat. 36, which amended this part in its entirely.

SUBPART C.—GAIN AND LOSS FROM OPERATIONS

Sec.
809. In general.
810. Rules for certain reserves.
811. Dividends to policyholders.
812. Operations loss deduction.

§ 809. In general.

(a) Exclusion of share of investment yield set aside for policyholders.

(1) Amount.

The share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received) of any life insurance company set aside for policyholders shall not be included in gain or loss from operations. For purposes of the preceding sentence, the share of any item set aside for policyholders shall be that percentage obtained by dividing the required interest by the investment yield; except that if the required interest exceeds the investment yield, then the share of any item set aside for policyholders shall be 100 percent.

(2) Required interest.

For purposes of this part, the required interest for any taxable year is the sum of the products obtained by multiplying—

(A) each rate of interest required, or assumed by the taxpayer, in calculating the reserves described in section 810(c), by

(B) the means of the amount of such reserves computed at that rate at the beginning and end of the taxable year.

(b) Gain and loss from operations.

(1) Gain from operations defined.

For purposes of this part, the term "gain from operations" means the amount by which the sum of the following exceeds the deductions provided by subsection (d):

(A) the life insurance company's share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received);

(B) the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss; and

(C) the sum of the items referred to in subsection (c).

(2) Loss from operations defined.

For purposes of this part, the term "loss from operations" means the amount by which the sum of the deductions provided by subsection (d) exceeds the sum of—

(A) the life insurance company's share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received);

(B) the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss; and

(C) the sum of the items referred to in subsection (c).

(3) Life insurance company's share.

For purposes of this subpart, the life insurance company's share of any item shall be that percentage which, when added to the percentage obtained under the second sentence of subsection (a)(1), equals 100 percent.

(4) Exception.

If it is established in any case that the application of the definition of gain from operations contained in paragraph (1) results in the imposition of tax on—

(A) any interest which under section 103 is excluded from gross income,

(B) any amount of interest which under section 242 (as modified by section 804(a)(3)) is allowable as a deduction, or

(C) any amount of dividends received which under sections 243, 244, and 245 (as modified by subsection (d)(8)(B)) is allowable as a deduction,

adjustment shall be made to the extent necessary to prevent such imposition.

(c) Gross amount.

For purposes of subsections (b) (1) and (2), the following items shall be taken into account:

(1) Premiums.

The gross amount of premiums and other consideration (including advance premiums, deposits, fees, assessments, and consideration in respect of assuming liabilities under contracts not issued by the taxpayer) on insurance and annuity contracts (including contracts supplementary thereto); less return premiums, and premiums and other consideration arising out of reinsurance ceded. Except in the case of amounts of premiums or other consideration returned to another life insurance company in respect of reinsurance ceded, amounts returned where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management shall not be included in return premiums.

(2) Decreases in certain reserves.

Each net decrease in reserves which is required by section 810 or 811(b)(2) to be taken into account for purposes of this paragraph.

(3) Other amounts.

All amounts, not included in computing investment yield and not includible under paragraph (1) or (2), which under this subtitle are includible in gross income.

Except as included in computing investment yield, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

(d) Deductions.

For purposes of subsections (b) (1) and (2), there shall be allowed the following deductions:

(1) Death benefits, etc.

All claims and benefits accrued, and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts (including contracts supplementary thereto).

(2) Increases in certain reserves.

The net increase in reserves which is required by section 810 to be taken into account for purposes of this paragraph.

(3) Dividends to policyholders.

The deduction for dividends to policyholders (determined under section 811(b)).

(4) Operations loss deduction.

The operations loss deduction (determined under section 812).

(5) Certain nonparticipating contracts.

An amount equal to 10 percent of the increase for the taxable year in the reserves for nonparticipating contracts or (if greater) an amount equal to 3 percent of the premiums for the taxable year (excluding that portion of the premiums which is allocable to annuity features) attributable to nonparticipating contracts (other than group contracts) which are issued or renewed for periods of 5 years or more. For purposes of this paragraph, the term "reserves for nonparticipating contracts" means such part of the life insurance reserves (excluding that portion of the reserves which is allocable to annuity features) as relates to nonparticipating contracts (other than group contracts). For purposes of this paragraph and paragraph (6), the term "premiums" means the net amount of the premiums and other consideration taken into account under subsection (c)(1).

(6) Certain accident and health insurance and group life insurance.

An amount equal to 2 percent of the premiums for the taxable year attributable to accident and health insurance contracts (other than those to which paragraph (5) applies) and group life insurance contracts. The deduction under this paragraph for the taxable year and all preceding taxable years shall not exceed an amount equal to 50 percent of the premiums for the taxable year attributable to such contracts.

(7) Assumption by another person of liabilities under insurance, etc., contracts.

The consideration (other than consideration arising out of reinsurance ceded) in respect of the assumption by another person of liabilities under insurance and annuity contracts (including contracts supplementary thereto).

(8) Tax-exempt interest, dividends, etc.

(A) Life insurance company's share.

Each of the following items:

(i) the life insurance company's share of interest which under section 103 is excluded from gross income,

(ii) the deduction for partially tax-exempt interest provided by section 242 (as modified by section 804(a)(3)) computed with respect to the life insurance company's share of such interest, and

(iii) the deductions for dividends received provided by sections 243, 244, and 245 (as modified by subparagraph (B)) computed with respect to the life insurance company's share of the dividends received.

(B) Application of section 246(b).

In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of subparagraph (A) (iii), the limit on the aggregate amount of the deductions allowed by sections 243(a)(1), 244(a), and 245 shall be 85 percent of the gain from operations computed without regard to—

(i) the deductions provided by paragraphs (3), (5), and (6) of this subsection,

(ii) the operations loss deduction provided by section 812, and

(iii) the deductions allowed by sections 243(a)(1), 244(a), and 245,

but such limit shall not apply for any taxable year for which there is a loss from operations.

(9) Investment expenses, etc.

Investment expenses to the extent not allowed as a deduction under section 804(c)(1) in computing investment yield, and the amount (if any) by which the sum of the deductions allowable under section 804(c) exceeds the gross investment income.

(10) Small business deduction.

A small business deduction in an amount equal to the amount determined under section 804(a)(4).

(11) Certain mutualization distributions.

The amount of distributions to shareholders made in 1958, 1959, 1960, 1961, and 1962 in acquisition of stock pursuant to a plan of mutualization adopted before January 1, 1958.

(12) Other deductions.

Subject to the modifications provided by subsection (e), all other deductions allowed under this subtitle for purposes of computing taxable income to the extent not allowed as deductions in computing investment yield.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this subsection in respect of dividends to policyholders.

(e) Modifications.

The modifications referred to in subsection (d)(12) are as follows:

(1) Interest.

In applying section 163 (relating to deduction for interest), no deduction shall be allowed for interest in respect of items described in section 810(c).

(2) Bad debts.

Section 166(c) (relating to reserve for bad debts) shall not apply.

(3) Charitable, etc., contributions and gifts.

In applying section 170—

(A) the limit on the total deductions under such section provided by section 170(b)(2) shall be 5 percent of the gain from operations computed without regard to—

(i) the deduction provided by section 170,

(ii) the deductions provided by paragraphs (3), (5), (6), and (8) of subsection (d), and

(iii) any operations loss carryback to the taxable year under section 812: and

(B) under regulations prescribed by the Secretary or his delegate, a rule similar to the rule contained in section 170(d)(2)(B) shall be applied.

(4) Amortizable bond premium.
Section 171 shall not apply.

(5) Net operating loss deduction.
Except as provided by section 844, the deduction for net operating losses provided in section 172 shall not be allowed.

(6) Partially tax-exempt interest.
The deduction for partially tax-exempt interest provided by section 242 shall not be allowed.

(7) Dividends received.
The deductions for dividends received provided by sections 243, 244, and 245 shall not be allowed.

(f) Limitation on certain deductions.

(1) In general.
The amount of the deductions under paragraphs (3), (5), and (6) of subsection (d) shall not exceed $250,000 plus the amount (if any) by which—

(A) the gain from operations for the taxable year, computed without regard to such deductions, exceeds

(B) the taxable investment income for the taxable year.

(2) Application of limitation.
The limitation provided by paragraph (1) shall apply first to the amount of the deduction under subsection (d)(3), then to the amount of the deduction under subsection (d)(6), and finally to the amount of the deduction under subsection (d)(5).

(g) Limitations on deduction for certain mutualization distributions.

(1) Deduction not to reduce taxable investment income.
The amount of the deduction under subsection (d)(11) shall not exceed the amount (if any) by which—

(A) the gain from operations for the taxable year, computed without regard to such deduction (but after the application of subsection (f)), exceeds

(B) the taxable investment income for the taxable year.

(2) Deduction not to reduce tax below 1957 law.
The deduction under subsection (d)(11) for the taxable year shall be allowed only to the extent that such deduction (after the application of all other deductions provided by subsection (d)) does not reduce the amount of the tax imposed by section 802(a)(1) for such taxable year below the amount of tax which would have been imposed by section 802(a) as in effect for 1957, if this part, as in effect for 1957, applied for such taxable year.

(3) Application of section 815.
That portion of any distribution with respect to which a deduction is allowed under subsection (d)(11) shall not be treated as a distribution to shareholders for purposes of section 815; except that in the case of any distribution made in 1959, 1960, 1961, or 1962, such portion shall be treated as a distribution with respect to which a reduction is required under section 815(e)(2)(B).

(Added Pub. L. 86-69, § 2(a), June 25, 1959, 73 Stat. 121, and amended Pub. L. 87-59, § 2 (a), (b), June 27, 1961, 75 Stat. 120; Pub. L. 87-790, § 3(a), Oct. 10, 1962, 76 Stat. 808; Pub. L. 87-858, § 3 (b)(3), (c), Oct. 23, 1962, 76 Stat. 1137; Pub. L. 88-272, title II, §§ 214(b)(4), 228(a), Feb. 26, 1964, 78 Stat. 55, 98; Pub. L. 91-172, title II, § 201(a)(2)(C), title IX, § 907(c)(2)(B), Dec. 30, 1969, 83 Stat. 558, 717.)

AMENDMENTS

1969—Subsec. (e)(3). Pub. L. 91-172, § 201(a)(2)(C), struck out "the first sentence of" in subparagraph (A) and, in subparagraph (B), substituted "section 170(d)(2)(B)" for "section 170(b)(3)".

Subsec. (e)(5). Pub. L. 91-172, § 907(c)(2)(B), provided that section 844 of this title be excepted from the nondeduction operating loss provisions of section 172 of this title.

1964—Subsec. (d)(8)(B). Pub. L. 88-272, § 214(b)(4), substituted "243(a)(1), 244(a)" for "243(a), 244" wherever appearing.

Subsec. (d)(11). Pub. L. 88-272, § 228(a)(1), included the year 1962.

Subsec. (g)(3). Pub. L. 88-272, § 228(a)(2), included the year 1962.

1962—Subsec. (b)(1), (2). Pub L. 87-858, § 3(b)(3), added subpar. (B) to pars. (1) and (2) and redesignated former subpar. (B) as (C) in such pars. (1) and (2).

Subsec. (d)(6). Pub. L. 87-790 substituted "Certain accident and health insurance and group life insurance" for "Group life, accident, and health insurance" in the subsection catchline, and "accident and health insurance contracts (other than those to which paragraph (5) applies) and group life insurance contracts" for "group life insurance and group accident and health insurance contracts" in the text.

Subsec. (f)(2). Pub. L. 87-858, § 3(c), substituted "(d)(3)", "(d)(6)" and "(d)(5)" for "(d)(6)", "(d)(5)" and "(d)(3)", respectively.

1961—Subsec. (d)(11). Pub. L. 87-59, § 2(a), authorized the deduction of certain mutualization distributions made in 1960 and 1961.

Subsec. (g)(3). Pub. L. 87-59, § 2(b), included within its provisions certain mutualization distributions made in 1960 and 1961.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (e)(3) by section 201(a)(2)(C) of Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1969, see section 201(g) of Pub. L. 91-172, set out as a note under section 170 of this title.

Amendment of subsec. (e)(5) by section 907(c)(2)(B) of Pub. L. 91-172 applicable with respect to losses incurred in taxable year beginning after Dec. 31, 1962, but not affecting any tax liability for any taxable year beginning before Jan. 1, 1967, see section 907(d) of Pub. L. 91-172, set out as a note under section 805 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88-272 applicable to dividends received in taxable years ending after Dec. 31, 1963, see section 214(c) of Pub. L. 88-272, set out as a note under section 243 of this title.

Section 228(d) of Pub. L. 88-272 provided that: "The amendment made by subsection (a) [to this section] shall apply to taxable years beginning after December 31, 1961. The amendment made by subsection (c) [to section 832 of this title] shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954."

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of this section by Pub. L. 87-858 applicable with respect to taxable years beginning after Dec. 31, 1961, see section 3(f) of Pub. L. 87-858, set out as a note under section 801 of this title.

Section 3(c) of Pub. L. 87-790 provided that: "The amendments made by this section [to subsec. (d)(6) of this section and to section 815(c)(2)(C) of this title] shall apply to taxable years beginning after December 31, 1962."

EFFECTIVE DATE OF 1961 AMENDMENT

Section 2(c) of Pub. L. 87-59 provided that: "The amendments made by subsections (a) and (b) [to subsecs. (d)(11) and (g)(3) of this section] shall apply to taxable years beginning after December 31, 1959."

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 243, 801, 802, 810, 811, 812, 815, 819, 820, 953, 1564 of this title.

§ 810. Rules for certain reserves.

(a) Adjustment for decrease.

If the sum of the items described in subsection (c) as of the beginning of the taxable year exceeds the sum of such items as of the close of the taxable year (reduced by the amount of investment yield not included in gain or loss from operations for the taxable year by reason of section 809(a)(1)), the excess shall be taken into account as a net decrease referred to in section 809(c)(2).

(b) Adjustment for increase.

If the sum of the items described in subsection (c) as of the close of the taxable year (reduced by the amount of investment yield not included in gain or loss from operations for the taxable year by reason of section 809(a)(1)) exceeds the sum of such items as of the beginning of the taxable year, the excess shall be taken into account as a net increase referred to in section 809(d)(2).

(c) Items taken into account.

The items referred to in subsections (a) and (b) are as follows:

(1) The life insurance reserves (as defined in section 801(b)).

(2) The unearned premiums and unpaid losses included in total reserves under section 801(c)(2).

(3) The amounts (discounted at the rates of interest assumed by the company) necessary to satisfy the obligations under insurance or annuity contracts (including contracts supplementary thereto), but only if such obligations do not involve (at the time with respect to which the computation is made under this paragraph) life, health, or accident contingencies.

(4) Dividend accumulations, and other amounts, held at interest in connection with insurance or annuity contracts (including contracts supplementary thereto).

(5) Premiums received in advance, and liabilities for premium deposit funds.

(6) Special contingency reserves under contracts of group term life insurance or group health and accident insurance which are established and maintained for the provision of insurance on retired lives, for premium stabilization, or for a combination thereof.

In applying this subsection, the same item shall be counted only once.

(d) Adjustment for change in computing reserves.

(1) In general.

If the basis for determining any item referred to in subsection (c) as of the close of any taxable year differs from the basis for such determination as of the close of the preceding taxable year, then so much of the difference between—

(A) the amount of the item at the close of the taxable year, computed on the new basis, and

(B) the amount of the item at the close of the taxable year, computed on the old basis, as is attributable to contracts issued before the taxable year shall be taken into account for purposes of this subpart as follows:

(i) if the amount determined under subparagraph (A) exceeds the amount determined under subparagraph (B), 1/10 of such excess shall be taken into account, for each of the succeeding 10 taxable years, as a net increase to which section 809(d)(2) applies; or

(ii) if the amount determined under subparagraph (B) exceeds the amount determined under subparagraph (A), 1/10 of such excess shall be taken into account for each of the 10 succeeding taxable years, as a net decrease to which section 809(c)(2) applies.

(2) Termination as life insurance company.

Except as provided in section 381(c)(22) (relating to carryovers in certain corporate readjustments), if for any taxable year the taxpayer is not a life insurance company, the balance of any adjustments under this paragraph shall be taken into account for the preceding taxable year.

(3) Effect of preliminary term election.

An election under section 818(c) shall not be treated as a change in the basis for determining an item referred to in subsection (c) to which this subsection applies. If an election under section 818(c) applies for the taxable year, the amounts of the items referred to in subparagraphs (A) and (B) of paragraph (1) shall be determined without regard to such election. If such an election would apply in respect of such item for the taxable year but for the new basis, the amount of the item referred to in subparagraph (B) shall be determined on the basis which would have been applicable under section 818(c) if the election applied in respect of the item for the taxable year.

(Added Pub. L. 86-69, § 2(a), June 25, 1959, 73 Stat. 125, and amended Pub. L. 91-172, title I, § 121(b)(5)(B), title IX, § 907(a)(2), Dec. 30, 1969, 83 Stat. 541, 715.)

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

AMENDMENTS

1969—Subsec. (c). Pub. L. 91-172, § 907(a)(2), added par. (6).

Subsec. (e). Pub. L. 91-172, § 121(b)(5)(B), struck out subsec. (e), which dealt with certain decreases in reserves of voluntary employees' beneficiary associations.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (c) by section 907(a)(2) of Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1957, see section 907(d) of Pub. L. 91-172, set out as a note under section 805 of this title.

Repeal of subsec. (e) applicable to taxable years beginning after Dec. 31, 1969, see section 121(g) of Pub. L. 91-172, set out as a note under section 511 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 801, 806, 809, 819, 1351, 4914 of this title.

§ 811. Dividends to policyholders.

(a) Dividends to policyholders defined.

For purposes of this part, the term "dividends to policyholders" means dividends and similar distributions to policyholders in their capacity as such. Such term does not include interest paid (as defined in section 805(e)).

(b) Amount of deduction.

(1) In general.

Except as limited by section 809(f), the deduction for dividends to policyholders for any taxable year shall be an amount equal to the dividends to policyholders paid during the taxable year—

(A) increased by the excess of (i) the amounts held at the end of the taxable year as reserves for dividends to policyholders (as defined in subsection (a)) payable during the year following the taxable year, over (ii) such amounts held at the end of the preceding taxable year, or

(B) decreased by the excess of (i) such amounts held at the end of the preceding taxable year, over (ii) such amounts held at the end of the taxable year.

For purposes of subparagraphs (A) and (B), there shall be included as amounts held at the end of any taxable year amounts set aside, before the 16th day of the third month of the year following such taxable year (or, in the case of a mutual savings bank subject to the tax imposed by section 594, before the 16th day of the fourth month of the year following such taxable year), for payment during the year following such taxable year.

(2) Certain amounts to be treated as net decreases.

If the amount determined under paragraph (1)(B) exceeds the dividends to policyholders paid during the taxable year, the amount of such excess shall be a net decrease referred to in section 809(c)(2).

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 126.)

PRIOR PROVISIONS

A prior section 811, act Aug. 16, 1954, ch. 736, § 811, as added Mar. 13, 1956, ch. 83, § 2, 70 Stat. 44, and amended July 24, 1956, ch. 696, § 2(c), 70 Stat. 633; Mar. 17, 1958, Pub. L. 85–345, § 2(c), 72 Stat. 37, imposed a tax on the life insurance company taxable income of all life insurance companies for taxable years beginning after Dec. 31, 1957.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 809 of this title.

§ 812. Operations loss deduction.

(a) Deductiou allowed.

There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of—

(1) the operations loss carryovers to such year, plus

(2) the operations loss carrybacks to such year.

For purposes of this part, the term "operations loss deduction" means the deduction allowed by this subsection.

(b) Operations loss carrybacks and carryovers.

(1) Years to which loss may be carried.

(A) In general.

The loss from operations for any taxable year (hereinafter in this section referred to as the "loss year") beginning after December 31, 1954, shall be—

(i) an operations loss carryback to each of the 3 taxable years preceding the loss year,

(ii) an operations loss carryover to each of the 5 taxable years following the loss year, and

(iii) subject to subsection (e), if the life insurance company is a new company for the loss year, an operations loss carryover to each of the 3 taxable years following the 5 taxable years described in clause (ii).

(B) Special transitional rules for carrybacks.

A loss from operations for any taxable year beginning before January 1, 1958, shall not be an operations loss carryback to any taxable year beginning before January 1, 1955. A loss from operations for any taxable year beginning after December 31, 1957, shall not be an operations loss carryback to any taxable year beginning before January 1, 1958.

(C) Application for years prior to 1958.

For purposes of this section, this part (as in effect for 1958) and section 381(c)(22) shall be treated as applying to all taxable years beginning after December 31, 1954, and before January 1, 1958.

(2) Amount of carrybacks and carryovers.

The entire amount of the loss from operations for any loss year shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess (if any) of the amount of such loss over the sum of the offsets (as defined in subsection (d)) for each of the prior taxable years to which such loss may be carried.

(c) Computation of loss from operations.

In computing the loss from operations for purposes of this section—

(1) The operations loss deduction shall not be allowed.

(2) The deductions allowed by sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) as modified by section 809(d)(8)(B).

(d) Offset defined.

(1) In general.

For purposes of subsection (b)(2), the term "offset" means, with respect to any taxable year, an amount equal to that increase in the operations loss deduction for the taxable year which reduces the life insurance company taxable income (computed without regard to section 802(b)(3)) for such year to zero.

(2) Operations loss deduction.

For purposes of paragraph (1), the operations loss deduction for any taxable year shall be computed without regard to the loss from operations for the loss year or for any taxable year thereafter.

(e) New company defined.

For purposes of this part, a life insurance company is a new company for any taxable year only if such taxable year begins not more than 5 years after the first day on which it (or any predecessor, if section 381(c)(22) applies or would have applied if in effect) was authorized to do business as an insurance company.

(f) Application of subtitle A and subtitle F.

Except as provided in section 809(e), subtitle A and subtitle F shall apply in respect of operations loss carrybacks, operations loss carryovers, and the operations loss deduction under this part in the same manner and to the same extent as such subtitles apply in respect of net operating loss carrybacks, net operating loss carryovers, and the net operating loss deduction. (Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 127, and amended Pub. L. 87–858, § 3(d)(1), Oct. 23, 1962, 76 Stat. 1137; Pub. L. 88–571, §1(a), Sept. 2, 1964, 78 Stat. 857.)

PRIOR PROVISIONS

A prior section 812, act Aug. 16, 1954, ch. 736, § 812, as added Mar. 13, 1956, ch. 83, § 2, 70 Stat. 45, related to reserve and other policy liability deduction.

CODIFICATION

Former section 813, act Aug. 16, 1954, ch. 736, § 813, as added Mar. 13, 1956, ch. 83, § 2, 70 Stat. 46, which related to adjustment for certain reserves, was omitted from this part by Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 112, which amended this part in its entirety.

AMENDMENTS

1964—Subsec. (e). Pub. L. 88–571 eliminated provisions which imposed limitations on the eight year carryover by the exclusion of nonqualified corporations.

1962—Subsec. (e)(2)(B). Pub. L. 87–858 inserted in the first sentence "(except a corporation taxable under part II or part III of this subchapter)" following "with any other corporation."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 1(b) of Pub. L. 88–571 provided that:

"The amendment made by subsection (a) [to subsec. (e) of this section] shall apply to a loss from operations for taxable years beginning after December 31, 1955; except that, in the case of a nonqualified corporation as defined in section 812(e)(2)(B) of the Internal Revenue Code of 1954 [subsec. (e)(2)(B) of this section] as in effect before such amendment—

"(1) a loss from operations for a taxable year beginning in 1956 shall not be an operating loss carryover to the years 1962 and 1963, and there shall be no reduction in the portion of such loss from operations which may be carried to 1964 by reason of an offset with respect to the year 1962 or 1963, and

"(2) a loss from operations for a taxable year beginning in 1957 shall not be an operating loss carryover to the year 1963, and there shall be no reduction in the portion of such loss from operations which may be carried to 1964 and 1965 by reason of an offset with respect to the year 1963."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 3(d)(2) of Pub. L. 87–858 provided that: "The amendment made by paragraph (1) [to subsec. (e)(2)(B) of this section] shall apply with respect to all taxable years beginning after December 31, 1954, except that in the case of a nonqualified corporation, as defined in section 812(e)(2)(B) of the Internal Revenue Code of 1954 as in effect prior to the amendment made by paragraph (1), a loss from operations for a taxable year beginning in 1955 shall not be an operations loss carryover to the year 1961, and there shall be no reduction in the portion of such loss from operations which may be carried to 1962 or 1963 by reason of an offset with respect to the year 1961."

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 809, 844, 1351, 6511, 6601, 6611 of this title.

SUBPART D.—DISTRIBUTIONS TO SHAREHOLDERS

Sec.
815. Distributions to shareholders.

§ 815. Distributions to shareholders.

(a) General rule.

For purposes of this section and section 802(b)(3), any distribution to shareholders after December 31, 1958, shall be treated as made—

(1) first out of the shareholders surplus account, to the extent thereof,

(2) then out of the policyholders surplus account, to the extent thereof, and

(3) finally out of other accounts.

(b) Shareholders surplus account.

(1) In general.

Each stock life insurance company shall, for purposes of this part, establish and maintain a shareholders surplus account. The amount in such account on January 1, 1958, shall be zero.

(2) Additions to account.

The amount added to the shareholders surplus account for any taxable year beginning after December 31, 1957, shall be the amount by which—

(A) the sum of—

(i) the life insurance company taxable income (computed without regard to section 802(b)(3)),

(ii) in the case of a taxable year beginning after December 31, 1958, the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss, reduced (in the case of a taxable year beginning after December 31, 1961) by the amount referred to in clause (i),

(iii) the deduction for partially tax-exempt interest provided by section 242 (as modified by section 804(a)(3)), the deductions for dividends received provided by sections 243, 244, and 245 (as modified by section

809(d)(8)(B)), and the amount of interest excluded from gross income under section 103, and

(iv) the small business deduction provided by section 809(d)(10), exceeds

(B) the taxes imposed for the taxable year by section 802(a), determined without regard to section 802(b)(3).

(3) Subtractions from account.

(A) In general.

There shall be subtracted from the shareholders surplus account for any taxable year the amount which is treated under this section as distributed out of such account.

(B) Commodities.

There shall be subtracted from the shareholders surplus account (to the extent thereof) for any taxable year beginning in 1958 the amount of distributions to shareholders made during 1958.

(c) Policyholders surplus account.

(1) In general.

Each stock life insurance company shall, for purposes of this part, establish and maintain a policyholders surplus account. The amount in such account on January 1, 1959, shall be zero.

(2) Additions to account.

The amount added to the policyholders surplus account for any taxable year beginning after December 31, 1958, shall be the sum of—

(A) an amount equal to 50 percent of the amount by which the gain from operations exceeds the taxable investment income,

(B) the deduction for certain nonparticipating contracts provided by section 809(d)(5) (as limited by section 809(f)), and

(C) the deduction for accident and health insurance and group life insurance contracts provided by section 809(d)(6) (as limited by section 809(f)).

(3) Subtractions from account.

There shall be subtracted from the policyholders surplus account for any taxable year an amount equal to the sum of—

(A) the amount which (without regard to subparagraph (B)) is treated under this section as distributed out of the policyholders surplus account, and

(B) the amount (determined without regard to section 802(a)(3)) by which the tax imposed for the taxable year by section 802(a) is increased by reason of section 802(b)(3).

(d) Special rules.

(1) Election to transfer amounts from policyholders surplus account to shareholders surplus account.

(A) In general.

A taxpayer may elect for any taxable year for which it is a life insurance company to subtract from its policyholders surplus account any amount in such account as of the close of such taxable year. The amount so subtracted, less the amount of the tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account as of the beginning of the succeeding taxable year.

(B) Manner and effect of election.

The election provided by subparagraph (A) shall be made (in such manner and in such form as the Secretary or his delegate may by regulations prescribe) after the close of the taxable year and not later than the time prescribed by law for filing the return (including extensions thereof) for the taxable year. Such an election, once made, may not be revoked.

(2) Termiuation as life insurance company.

(A) Effect of termination.

Except as provided in section 381(c)(22) (relating to carryovers in certain corporate readjustments), if—

(i) for any taxable year the taxpayer is not an insurance company, or

(ii) for any two successive taxable years the taxpayer is not a life insurance company,

then the amount taken into account under section 802(b)(3) for the last preceding taxable year for which it was a life insurance company shall be increased (after the application of subparagraph (B)) by the amount remaining in its policyholders surplus account at the close of such last preceding taxable year.

(B) Effect of certain distributions.

If for any taxable year the taxpayer is an insurance company but not a life insurance company, then any distribution to shareholders during such taxable year shall be treated as made on the last day of the last preceding taxable year for which the taxpayer was a life insurance company.

(3) Treatment of certain indebtedness.

If—

(A) the taxpayer makes any payment in discharge of its indebtedness, and

(B) such indebtedness is attributable to a distribution by the taxpayer to its shareholders after February 9, 1959,

then the amount of such payment shall, for purposes of this section and section 802(b)(3), be treated as a distribution in cash to shareholders, but only to the extent that the distribution referred to in subparagraph (B) was treated as made out of accounts other than the shareholders and policyholders surplus accounts.

(4) Limitation or amount in policyholders surplus account.

There shall be treated as a subtraction from the policyholders surplus account for a taxable year for which the taxpayer is a life insurance company the amount by which the policyholders surplus account (computed at the end of the taxable year without regard to this paragraph) exceeds whichever of the following is the greatest—

(A) 15 percent of life insurance reserves at the end of the taxable year,

(B) 25 percent of the amount by which the life insurance reserves at the end of the taxable year exceed the life insurance reserves at the end of 1958, or

(C) 50 percent of the net amount of the premiums and other consideration taken into account for the taxable year under section 809 (c)(1).

The amount so treated as subtracted, less the amount of the tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account as of the beginning of the succeeding taxable year.

(5) Reduction of policyholders surplus account for certain unused deductions.

If—

(A) an amount added to the policyholders surplus account for any taxable year increased (or created) a loss from operations for such year, and

(B) any portion of the increase (or amount created) in the loss from operations referred to in subparagraph (A) did not reduce the life insurance company taxable income for any taxable year to which such loss was carried,

the policyholders surplus account for the taxable year referred to in subparagraph (A) shall be reduced by the amount described in subparagraph (B).

(e) Special rule for certain mutualizations.

(1) In general.

For purposes of this section and section 802 (b)(3), any distribution to shareholders after December 31, 1958, in acquisition of stock pursuant to a plan of mutualization shall be treated—

(A) first, as made out of paid-in capital and paid-in surplus, to the extent thereof,

(B) thereafter, as made in two allocable parts—

(i) one part of which is made out of the other accounts referred to in subsection (a)(3), and

(ii) the remainder of which is a distribution to which subsection (a) applies.

(2) Special rules.

(A) Allocation ratio.

The part referred to in paragraph (1)(B)(i) is the amount which bears the same ratio to the amount to which paragraph (1)(B) applies as—

(i) the excess (determined as of December 31, 1958, and adjusted to the beginning of the year of the distribution as provided in subparagraph (B)) of the assets over the total liabilities, bears to

(ii) the sum (determined as of the beginning of the year of the distribution) of the excess described in clause (i), the amount in the shareholders surplus account, plus the amount in the policyholders surplus account.

(B) Adjustment for certain distrihutions.

The excess described in subparagraph (A)(i) shall be reduced by the aggregate of the prior distributions which have been treated under subsection (a)(3) as made out of accounts other than the shareholders surplus account and the policyholders surplus account.

(f) Distribution defined.

For purposes of this section, the term "distribution" includes any distribution in redemption of stock or in partial or complete liquidation of the corporation, but does not include—

(1) any distribution made by the corporation in its stock or in rights to acquire its stock;

(2) except for purposes of subsection (a)(3) and subsection (e)(2)(B), any distribution in redemption of stock issued before 1958 which at all times on and after the date of issuance and on and before the date of redemption is limited as to dividends and is callable, at the option of the issuer, at a price not in excess of 105 percent of the sum of the issue price and the amount of any contribution to surplus made by the original purchaser at the time of his purchase;

(3) any distribution after December 31, 1963, of the stock of a controlled corporation to which section 355 applies, if such controlled corporation is an insurance company subject to the tax imposed by section 831 and if—

(A) control was acquired prior to January 1, 1958, or

(B) control has been acquired after December 31, 1957—

(i) in a transaction qualifying as a reorganization under section 368(a)(1)(B), if the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the controlled corporation, or

(ii) solely in exchange for stock of the distributing corporation which stock is immediately exchanged by the controlled corporation in a transaction qualifying as a reorganization under section 368(a)(1)(A) or (C), if the controlled corporation has at all times since its organization been wholly owned by the distributing corporation and the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the corporation the assets of which have been transferred to the controlled corporation in the section 368(a)(1)(A) or (C) reorganization;

(4) any distribution after December 31, 1966, of the stock of a controlled corporation to which section 355 applies, if such distribution is made to a corporation which immediately after the distribution is in control (within the meaning of section 368(c)) of both the distributing corporation and such controlled corporation and if such controlled corporation is a life insurance company of which the distributing corporation has been in control at all times since December 31, 1957; or

(5) any distribution after December 31, 1968, of the stock of a controlled corporation to which section 355 applies, if such distribution is made to a corporation which immediately after the distribution is the owner of all the stock of all classes of both the distributing corporation and such controlled corporation and if, immediately before the

distribution, the distributing corporation had been the owner of all of the stock of all classes of such controlled corporation at all times since December 31, 1957.

Paragraphs (3), (4), and (5) shall not apply to that portion of the distribution of stock of the controlled corporation equal to the increase in the aggregate adjusted basis of such stock after December 31, 1957, except to the extent such increase results from an acquisition of stock in the controlled corporation in a transaction described in paragraph (3)(B). If any part of the increase in the aggregate adjusted basis of stock of the controlled corporation after December 31, 1957, results from the transfer (other than as part of a transaction described in paragraph (3)(B)) by the distributing corporation to the controlled corporation of property which has a fair market value in excess of its adjusted basis at the time of the transfer, paragraphs (3), (4), and (5) also shall not apply to that portion of the distribution equal to such excess.

(g) Certain distributions related to former subsidiaries.

If subsection (f)(5) applied to the distribution by a life insurance company of the stock of a corporation which was a controlled corporation—

(1) any distribution by such corporation to its shareholders (after the date of the distribution of its stock by the life insurance company), and

(2) any disposition of the stock of such corporation by the distributee corporation,

shall, for purposes of this section, be treated as a distribution to its shareholders by such life insurance company, until the amounts so treated equal the amount of the distribution of such stock which by reason of subsection (f)(5) was not included as a distribution for purposes of this section. (Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 129, and amended Pub. L. 87–790, § 3(b), Oct. 10, 1962, 76 Stat. 808; Pub. L. 87–858, § 3 (b)(4), (e), Oct. 23, 1962, 76 Stat. 1137; Pub. L. 88–571, §§ 2, 3(a), 4(a), Sept. 2, 1964, 78 Stat. 857, 859; Pub. L. 90–225, § 4 (a), (b), Dec. 27, 1967, 81 Stat. 733, 734; Pub. L. 91–172, title IX, § 907(b), Dec. 30, 1969, 83 Stat. 715.)

AMENDMENTS

1969—Subsec. (f). Pub. L. 91–172, § 907(b)(1), added par. (5) and inserted references to par. (5) in the material following par. (5).

Subsec. (g). Pub. L. 91–172, § 907(b)(2), added subsec. (g).

1967—Subsec. (f), Pub. L. 90–225 struck-out "or" at the end of par. (2), struck out the period at the end of par. (3)(B)(ii) and inserted in lieu ", or", and added par. (4), and in material following par. (4) added references to par. (4) wherever appearing, and substituted "paragraph (3)(B)." for "subparagraph (B) of such paragraph."

1964—Subsec. (a). Pub. 88–571, § 4(a)(1), eliminated definitions of "distribution." See subsec. (f) of this section.

Subsec. (b)(2)(A)(ii). Pub. L. 88–571, § 2, inserted "reduced (in the case of a taxable year beginning after December 31, 1961) by the amount referred to in clause (i)."

Subsec. (d)(5). Pub. L. 88–571, § 3(a), added par. (5).

Subsec. (f). Pub. L. 88–57I, § 4(a)(2), added subsec. (f).

1962—Subsec. (a). Pub. L. 87–858, § 3(e), added provision that "for purposes of this section, the term 'distribution' does not include any distribution before January 1, 1964, of the stock of a controlled corporation to which section 355 applies, if such controlled corporation is an insurance company subject to the tax imposed by section 831 and control has been acquired prior to January 1, 1963, in a transaction qualifying as a reorganization under section 368(a)(1)(B)."

Subsec. (c)(2). Pub. L. 87–790 substituted "accident and health insurance and group life insurance contracts" for "group life and group accident and health insurance contracts" in cl. (C).

Subsec. (c)(3)(B). Pub. L. 87–858, § 3(b)(4), substituted "802(a)" for "802(a)(1)."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 907(b) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1968, see section 907(d) of Pub. L. 91–172, set out as a note under section 805 of this title.

EFFECTIVE DATE OF 1967 AMENDMENT

Section 4(c) of Pub. L. 90–225 provided that: "The amendments made by this section [amending subsec. (f) of this section] shall apply to taxable years beginning after December 81, 1966."

EFFECTIVE DATE OF 1964 AMENDMENT

Section 3(f) of Pub. L. 88–571 provided that: "The amendments made by this section [to subsec. (d) of this section, and sections 6501, 6511, 6601 and 6611 of this title] shall apply with respect to amounts added to policyholders surplus accounts (within the meaning of section 815(c) of the Internal Revenue Code of 1954) for taxable years beginning after December 31, 1958."

Section 4(b) of Pub. L. 88–571 provided that: "The amendments made by subsection (a) [adding subsec. (f) and amending subsec. (a) of this section] shall apply to taxable years beginning after December 31, 1963."

EFFECTIVE DATE OF 1962 AMENDMENTS

Amendment of this section by Pub. L. 87–858 applicable with respect to taxable years beginning after Dec. 31, 1961, see section 3(f) of Pub. L. 87–858, set out as a note under section 801 of this title.

Amendment of subsec. (c)(2)(C) of this section by Pub. L. 87–790 applicable to taxable years beginning after Dec. 31, 1962, see section 3(c) of Pub. L. 87–790, set out as a note under section 809 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after December 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 802, 809, 819 6501, 6511, 6601, 6611 of this title.

CODIFICATION

Former section 816, act. Aug. 16, 1954, ch. 736, § 816, as added Mar. 13, 1956, ch. 83, § 2, 70 Stat. 46, which related to taxation of foreign life insurance companies, was omitted from this part by Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 112, which amended this part in its entirety. See section 819(a), (d) of this title.

SUBPART E.—MISCELLANEOUS PROVISIONS

Sec.
817. Rules relating to certain gains and losses.
818. Accounting provisions.
819. Foreign life insurance companies.
820. Optional treatment of policies reinsured under modified coinsurance contracts.

§ 817. Rules relating to certain gains and losses.

(a) Treatment of capital gains and losses, etc.

In the case of a life insurance company—

(1) in applying section 1231(a), the term "property used in the trade or business" shall be treated as including only—

(A) property used in carrying on an insurance business, of a character which is subject to the allowance for depreciation provided in

section 167, held for more than 6 months, and real property used in carrying on an insurance business, held for more than 6 months, which is not described in section 1231(b)(1) (A), (B), or (C), and

(B) property described in section 1231(b)(2), and

(2) in applying section 1221(2), the reference to property used in trade or business shall be treated as including only property used in carrying on an insurance business.

(b) Gain on property held on December 31, 1958, and certain substituted property acquired after 1958.

(1) Property held on December 31, 1958.

In the case of property held by the taxpayer on December 31, 1958, if—

(A) the fair market value of such property on such date exceeds the adjusted basis for determining gain as of such date, and

(B) the taxpayer has been a life insurance company at all times on and after December 31, 1958,

the gain on the sale or other disposition of such property shall be treated as an amount (not less than zero) equal to the amount by which the gain (determined without regard to this subsection) exceeds the difference between the fair market value on December 31, 1958, and the adjusted basis for determining gain as of such date.

(2) Certain property acquired after December 31, 1958.

In the case of property acquired after December 31, 1958, and having a substituted basis (within the meaning of section 1016(b))—

(A) for purposes of paragraph (1), such property shall be deemed held continuously by the taxpayer since the beginning of the holding period thereof, determined with reference to section 1223,

(B) the fair market value and adjusted basis referred to in paragraph (1) shall be that of that property for which the holding period taken into account includes December 31, 1958,

(C) paragraph (1) shall apply only if the property or properties the holding periods of which are taken into account were held only by life insurance companies after December 31, 1958, during the holding periods so taken into account,

(D) the difference between the fair market value and adjusted basis referred to in paragraph (1) shall be reduced (not less than zero) by the excess of (i) the gain that would have been recognized but for this subsection on all prior sales or dispositions after December 31, 1958, of properties referred to in subparagraph (C), over (ii) the gain that was recognized on such sales or other dispositions, and

(E) the basis of such property shall be determined as if the gain which would have been recognized but for this subsection were recognized gain.

(3) Property defined.

For purposes of paragraphs (1) and (2), the term "property" does not include insurance and annuity contracts (and contracts supplementary thereto) and property described in paragraph (1) of section 1221.

(c) Limitation on capital loss carryovers.

A net capital loss for any taxable year beginning before January 1, 1959, shall not be taken into account.

(d) Gain on transactions occurring prior to January 1, 1959.

For purposes of this part, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset, resulting from sales or other dispositions of property prior to January 1, 1959. Any gain after December 31, 1958, resulting from the sale or other disposition of property prior to January 1, 1959, which, but for this sentence, would be taken into account under section 1231, shall not be taken into account under section 1231 for purposes of this part.

(e) Certain reinsurance transactions in 1958.

For purposes of this part, the reinsurance in a single transaction, or in a series of related transactions, occurring in 1958, by a life insurance company of all of its insurance contracts of a particular type, through the assumption by another company or companies of all liabilities under such contracts, shall be treated as a sale of a capital asset. (Added Pub. L. 86-69, § 2(a), June 25, 1959, 73 Stat. 132.)

PRIOR PROVISIONS

A prior section 817, act Aug. 16, 1954, ch. 736, § 817, as added Mar. 13, 1956, ch. 83, § 2, 70 Stat. 46, related to denial of double deductions. See section 818(f) of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 953 of this title.

§ 818. Accounting provisions.

(a) Method of accounting.

All computations entering into the determination of the taxes imposed by this part shall be made—

(1) under an accrual method of accounting, or

(2) to the extent permitted under regulations prescribed by the Secretary or his delegate, under a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method).

Except as provided in the preceding sentence, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

(b) Amortization of premium and accrual of discount.

(1) In general.

The appropriate items of income, deductions, and adjustments under this part shall be adjusted to reflect the appropriate amortization of premium and the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness

held by a life insurance company. Such amortization and accrual shall be determined—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

(2) Special rules.

(A) Amortization of bond premium.

In the case of any bond (as defined in section 171(d)) acquired after December 31, 1957, the amount of bond premium, and the amortizable bond premium for the taxable year, shall be determined under section 171(b) as if the election set forth in section 171(c) had been made.

(B) Convertible evidences of indebtedness.

In no case shall the amount of premium on a convertible evidence of indebtedness include any amount attributable to the conversion features of the evidence of indebtedness.

(3) Exception.

For taxable years beginning after December 31, 1962, no accrual of discount shall be required under paragraph (1) on any bond (as defined in section 171(d)), except in the case of discount which is—

(A) interest to which section 103 applies, or

(B) original issue discount (as defined in section 1232(b)).

For purposes of section 805(b)(3)(A), the current earnings rate for any taxable year beginning before January 1, 1963, shall be determined as if the preceding sentence applied to such taxable year.

(c) Life insurance reserves computed on preliminary term basis.

For purposes of this part (other than section 801), at the election of the taxpayer the amount taken into account as life insurance reserves with respect to contracts for which such reserves are computed on a preliminary term basis may be determined on either of the following bases:

(1) Exact revaluation.

As if the reserves for all such contracts had been computed on a net level premium basis (using the same mortality assumptions and interest rates for both the preliminary term basis and the net level premium basis).

(2) Approximate revaluation.

The amount computed without regard to this subsection—

(A) increased by $21 per $1,000 of insurance in force (other than term insurance) under such contracts, less 2.1 percent of reserves under such contracts, and

(B) increased by $5 per $1,000 of term insurance in force under such contracts which at the time of issuance cover a period of more than 15 years, less 0.5 percent of reserves under such contracts.

If the taxpayer makes an election under either paragraph (1) or (2) for any taxable year, the basis adopted shall be adhered to in making the computations under this part (other than section 801) for the taxable year and all subsequent taxable years unless a change in the basis of computing such reserves is approved by the Secretary or his delegate, except that if, pursuant to an election made for a taxable year beginning in 1958, the basis adopted is the basis provided in paragraph (2), the taxpayer may adopt the basis provided by paragraph (1) for its first taxable year beginning after 1958.

(d) Short taxable years.

If any return of a corporation made under this part is for a period of less than the entire calendar year (referred to in this subsection as "short period"), then section 443 shall not apply in respect of such period, but—

(1) the taxable investment income and the gain or loss from operations shall be determined, under regulations prescribed by the Secretary or his delegate, on an annual basis by a ratable daily projection of the appropriate figures for the short period,

(2) that portion of the life insurance company taxable income described in paragraphs (1) and (2) of section 802(b) shall be determined on an annual basis by treating the amounts ascertained under paragraph (1) as the taxable investment income and the gain or loss from operations for the taxable year, and

(3) that portion of the life insurance company taxable income described in paragraphs (1) and (2) of section 802(b) for the short period shall be the amount which bears the same ratio to the amount ascertained under paragraph (2) as the number of days in the short period bears to the number of days in the entire calendar year.

(e) Transitional rule for changes in method of accounting.

(1) In general.

If the method of accounting required to be used in computing the taxpayer's taxes under this part for the taxable year 1958 as different from the method used in computing its taxes under this part for 1957, then there shall be ascertained the net amount of those adjustments which are determined (as of the close of 1957) to be necessary solely by reason of the change to the method required by subsection (a) in order to prevent amounts from being duplicated or omitted. The amount of the taxpayer's tax for 1957 shall be recomputed (under the law applicable to 1957, modified as provided in paragraph (4)) taking into account an amount equal to $\frac{1}{10}$ of the net amount of the adjustments determined under the preceding sentence. The amount of increase or decrease (as the case may be) referred to in paragraph (2) or (3) shall be the amount of the increase or decrease ascertained under the preceding sentence, multiplied by 10.

(2) Treatment of decrease.

For purposes of subtitle F, if the recomputation under paragraph (1) results in a decrease, the amount thereof shall be a decrease in the tax imposed for 1957; except that for purposes of computing the period of limitation on the making of refunds or the allowance of credits with respect to such overpayment, the amount of such decrease

shall be treated as an overpayment of tax for 1959. No interest shall be paid, for any period before March 16, 1960, on any overpayment of the tax imposed for 1957 which is attributable to such decrease.

(3) Treatment of increase.

(A) In general.

For purposes of subtitle F (other than sections 6016 and 6655), if the recomputation under paragraph (1) results in an increase, the amount thereof shall be treated as a tax imposed by this subsection for 1959. Such tax shall be payable in 10 equal annual installments, beginning with March 15, 1960.

(B) Special rules.

For purposes of subparagraph (A)—

(i) No interest shall be paid on any installment described in subparagraph (A) for any period before the time prescribed in such subparagraph for the payment of such installment.

(ii) Section 6152(c) (relating to proration of deficiencies to instaliments) shall apply.

(iii) In applying section 6502(a)(1) (relating to collection after assessment), the assessment of any installment described in subparagraph (A) shall be treated as made at the time prescribed by such subparagraph for the payment of such instaliment.

(iv) Except as provided in section 381(c)(22), if for any taxable year the taxpayer is not a life insurance company, the time for payment of any remaining installments described in subparagraph (A) shall be the date (determined without regard to any extension of time) for filing the return for such taxable year.

(4) Modifications of 1957 tax computation.

In recomputing the taxpayer's tax for 1957 for purposes of paragraph (1)—

(A) section 804(b) (as in effect for 1957) shall not apply with respect to any amount required to be taken into account by such paragraph, and

(B) the amount of the deduction allowed by section 805 (as in effect for 1957) shall not be reduced by reason of any amount required to be taken into account by such paragraph.

(f) Denial of double deductions.

Nothing in this part shall permit the same item to be deducted more than once under subpart B and once under subpart C.

(g) Computation on consolidated returns of policyholders' share of investment yield.

For purposes of this part, in the case of a life insurance company filing or required to file a consolidated return under section 1501 for a taxable year, the computations of the policyholders' share of investment yield under subparts B and C (including all determinations and computations incident thereto) shall be made as if such company were not filing a consolidated return. (Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 133, and amended Pub. L. 88–272, title I, § 228 (b)(1), Feb. 26, 1964, 78 Stat. 98; Pub. L. 91–688, § 1(a), Jan. 12, 1971, 84 Stat. 2072.)

PRIOR PROVISIONS

A prior section 818, act Aug. 16, 1954, ch. 736, § 818, as added Mar. 13, 1956, ch. 83, § 2, 70 Stat. 46, related to certain new insurance companies.

AMENDMENTS

1971—Subsec. (g). Pub. L. 91–688 added subsec. (g).
1964—Subsec. (b)(3). Pub. L. 88–272 added par. (3).

EFFECTIVE DATE OF 1971 AMENDMENT

Section 1(b) of Pub. L. 91–688 provided that: "The amendment made by subsection (a) [enacting subsec. (g) of this section] shall apply with respect to taxable years beginning after December 31, 1957."

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

ELECTION TO FILE SEPARATE RETURNS

Section 2 of Pub. L. 91–688 provided that:

"(a) If—

"(1) any insurance company subject to taxation under section 802 of the Internal Revenue Code of 1954 [section 802 of this title] filed a consolidated return under section 1501 of such Code [section 1501 of this title] for any taxable year beginning after December 31, 1957, and ending before March 13, 1969, and

"(2) not later than one year after the date of the enactment of this Act [Jan. 12, 1971]

"(A) such company elects (in such manner as the Secretary of the Treasury or his delegate may prescribe) to have this section apply,

"(B) such company files consents to the application of this section of all companies which at any time during any taxable year beginning after December 31, 1957, and ending before March 13, 1969, were members of the same affiliated group as such company, and

"(C) such company (and each company referred to in subparagraph (B)) files a separate return for the first taxable year beginning after December 31, 1957, for which such company filed a consolidated return and for each taxable year thereafter ending before the date of the enactment of this Act [Jan. 12, 1971], then not withstanding any law or rule of law the requirement of filing a consolidated return shall be replaced by a requirement of separate returns for each company referred to in paragraph (2)(C) for each taxable year to which paragraph (2)(C) applies with respect to such company. Paragraph (2)(C) shall not apply with respect to any company for any taxable year the allowance of a credit for which is barred on the date of the enactment of this Act [Jan. 12, 1971], by res judicata or through the operation of section 7121 or section 7122 of the Internal Revenue Code of 1954 [section 7121 or 7122 of this title].

"(b) If the making or allowance of any refund or credit, or the assessment of any deficiency, of income tax for any taxable year to which subsection (a)(2)(C) applies is prevented before the expiration of 2 years after the date of the enactment of this Act [Jan. 12, 1971] by any law or rule of law (other than sections 7121 and 7122 of such Code and other than res judicata), such refund or credit may nevertheless be made or allowed, and such deficiency may nevertheless be assessed, at any time before the expiration of such 2-year period, but only to the extent that the overpayment or deficiency is attributable to an election made under this section. No interest shall be allowed on any credit or refund described in the preceding sentence, and no interest shall be assessed with respect to any deficiency described in the preceding sentence, for any period before the day which is one year after the date of the enactment of this Act [Jan. 12, 1971]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 810, 1016, 1232 of this title.

§ 819. Foreign life insurance companies.

(a) Adjustment where surplus held in United States is less than specified minimum.

(1) In general.

In the case of any foreign corporation taxable under this part, if the minimum figure determined under paragraph (2) exceeds the surplus held in the United States, then—

(A) the amount of the policy and other contract liability requirements (determined under section 805 without regard to this subsection), and

(B) the amount of the required interest (determined under section 809(a)(2) without regard to this subsection),

shall each be reduced by an amount determined by multiplying such excess by the current earnings rate (as defined in section 805(b)(2)).

(2) Definitions.

For purposes of paragraph (1)—

(A) The minimum figure is the amount determined by multiplying the taxpayer's total insurance liabilities on United States business by—

(i) in the case of a taxable year beginning before January 1, 1959, 9 percent, and

(ii) in the case of a taxable year beginning after December 31, 1958, a percentage for such year to be determined and proclaimed by the Secretary or his delegate.

The percentage determined and proclaimed by the Secretary or his delegate under clause (ii) shall be based on such data with respect to domestic life insurance companies for the preceding taxable year as the Secretary or his delegate considers representative. Such percentage shall be computed on the basis of a ratio the numerator of which is the excess of the assets over the total insurance liabilities, and the denominator of which is the total insurance liabilities.

(B) The surplus held in the United States is the excess of the assets held in the United States over the total insurance liabilities on United States business.

For purposes of this paragraph and subsection (b) the term "total insurance liabilities" means the sum of the total reserves (as defined in section 801(c)) plus (to the extent not included in total reserves) the items referred to in paragraphs (3), (4), and (5) of section 810(c).

(3) Reduction of section 881 tax.

In the case of any foreign corporation taxable under this part, there shall be determined—

(A) the amount which would be subject to tax under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and

(B) the amount of the reduction provided by paragraph (1).

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in tax shall not exceed the increase in tax under this part by reason of the reduction provided by paragraph (1).

(b) Distributions to shareholders.

(1) In general.

In applying sections 802(b)(3) and 815 with respect to a foreign corporation the amount of the distributions to shareholders shall be determined by multiplying the total amount of the distributions to shareholders (within the meaning of section 815) of the foreign corporation by whichever of the following percentages is selected by the taxpayer for the taxable year:

(A) the percentage which the minimum figure for the taxable year (determined under subsection (a)(2)(A)) is of the excess of the assets of the company over the total insurance liabilities; or

(B) the percentage which the total insurance liabilities on United States business for the taxable year is of the company's total insurance liabilities.

(2) Distributions pursuant to certain mutualizations.

In applying section 815(e) with respect to a foreign corporation—

(A) the paid-in capital and paid-in surplus referred to in section 815(e)(1)(A) of a foreign corporation is the portion of such capital and surplus determined by multiplying such capital and surplus by the percentage selected for the taxable year under paragraph (1); and

(B) the excess referred to in section 815(e)(2)(A)(i) (without the adjustment provided by section 815(e)(2)(B)) is whichever of the following is the greater:

(i) the minimum figure for 1958 determined under subsection (a)(2)(A), or

(ii) the surplus described in subsection (a)(2)(B) (determined as of December 31, 1958).

(c) Cross reference.

For taxation of foreign corporations carrying on life insurance business within the United States, see section 842.

(Added Pub. L. 86–69, § 2(a), June 25, 1959, 73 Stat. 136, and amended Pub. L. 89–809, title I, § 104(i)(3), Nov. 13, 1966, 80 Stat. 1561.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809, § 104(i)(3)(A)—(D), struck out former subsec. (a), which rendered taxable the business of a foreign life insurance company carrying on a life insurance business within the United States in the same manner as a domestic life insurance company if, with respect to its United States business, it would qualify as a life insurance company under section 801, redesignated subsec. (b) as subsec. (a), and, in subsec. (a) as so redesignated, substituted "In the case of any foreign corporation taxable under this part" for "In the case of any company described in subsection (a)," in par. (1), "subsection (b)" for "subsection (c)" in par. (2), and added par. (3).

Subsec. (b). Pub. L. 89–809, § 104(i)(3)(A), (E)—(H), redesignated subsec. (c) as subsec. (b), and, in subsec. (b) as so redesignated, substituted "with respect to a foreign corporation" for "for purposes of subsection (a)", "foreign corporation" for "foreign life insurance company", and "subsection (a)(2)(A)" for "subsection

(b)(2)(A)" wherever appearing, and, in par. (2)(B)(ii), substituted "subsection (a)(2)(B)" for "subsection (b)(2)(B)". Former subsec. (b) redesignated as subsec. (a).

Subsec. (c). Pub. L. 89-809, § 104(1)(8)(A), (I), added subsec. (c). Former subsec. (c) redesignated as subsec. (b).

Subsec. (d). Pub. L. 89-809, § 104(1)(3)(A), struck out subsec. (d) which provided that foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this part but shall be taxable as other foreign corporations.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 4371 of this title.

§ 820. Optional treatment of policies reinsured under modified coinsurance contracts.

(a) In general.

(1) Treatment as reinsured under conventional coinsurance contract.

Under regulations prescribed by the Secretary or his delegate, an insurance or annuity policy reinsured under a modified coinsurance contract (as defined in subsection (b)) shall be treated, for purposes of this part (other than for purposes of section 801), as if such policy were reinsured under a conventional coinsurance contract.

(2) Consent of reinsured and reinsurer.

Paragraph (1) shall apply to an insurance or annuity policy reinsured under a modified coinsurance contract only if the reinsured and reinsurer consent, in such manner as the Secretary or his delegate shall prescribe by regulations—

(A) to the application of paragraph (1) to all insurance and annuity policies reinsured under such modified coinsurance contract, and

(B) to the application of the rules provided by subsection (c) and the rules prescribed under such subsection.

Such consent, once given, may not be rescinded except with the approval of the Secretary or his delegate.

(b) Definition of modified coinsurance contract.

For purposes of this section, the term "modified coinsurance contract" means an indemnity reinsurance contract under the terms of which—

(1) a life insurance company (hereinafter referred to as "the reinsurer") agrees to indemnify another life insurance company (hereinafter referred to as "the reinsured") against a risk assumed by the reinsured under the insurance or annuity policy reinsured,

(2) the reinsured retains ownership of the assets in relation to the reserve on the policy reinsured,

(3) all or part of the gross investment income derived from such assets is paid by the reinsured to the reinsurer as a part of the consideration for the reinsurance of such policy, and

(4) the reinsurer is obligated for expenses incurred, and for Federal income taxes imposed, in respect of such gross investment income.

(c) Special rules.

Under regulations prescribed by the Secretary or his delegate, in applying subsection (a)(1) with respect to any insurance or annuity policy the following rules shall (to the extent not improper under the terms of the modified coinsurance contract under which such policy is reinsured) be applied in respect of the amount of such policy reinsured:

(1) Premiums and gross investment income.

The premiums (to the extent allocable to the participation of the reinsurer therein) received for the policy reinsured shall be treated as received by the reinsurer and not by the reinsured. The gross investment income (to the extent allocable to the participation of the reinsurer therein) derived from the assets in relation to the reserve on the policy reinsured shall be treated as gross investment income of the reinsurer and not of the reinsured. The gross investment income so treated shall be considered as derived proportionately from each of the various sources of gross investment income of the reinsured.

(2) Capital gains and losses.

The gains and losses from sales and exchanges of capital assets, and gains and losses considered as gains and losses from sales and exchanges of capital assets, of the reinsured shall (to the extent of the participation therein by the reinsurer under the terms of the modified coinsurance contract) be treated as gains and losses from sales and exchanges of capital assets of the reinsurer and not of the reinsured.

(3) Reserves and assets.

The reserve on the policy reinsured shall be treated as a part of the reserves of the reinsurer and not of the reinsured, and the assets in relation to such reserve shall be treated as owned by the reinsurer and not by the reinsured.

(4) Expenses.

The expenses (to the extent reimbursable by the reinsurer) incurred with respect to the policy reinsured and with respect to the assets referred to in paragraph (3) shall be treated as incurred by the reinsurer and not by the reinsured.

(5) Dividends to policyholders.

The dividends to policyholders paid in respect of the policy reinsured shall be treated as paid by the reinsurer and not by the reinsured. For purposes of the preceding sentence, the amount of dividends to policyholders treated as paid by the reinsurer shall be the amount paid, in respect of the policy reinsured, by the reinsurer to the reinsured as reimbursement for dividends to policyholders paid by the reinsured. This paragraph shall apply also in respect of an insurance or annuity policy reinsured under a conventional coinsurance contract.

(6) Reimbursement for 1957 Federal income tax.

Any amount paid in 1958 or any subsequent year by the reinsurer to the reinsured as reimbursement for Federal income taxes imposed for

a taxable year beginning in 1957 or any preceding taxable year shall not be taken into account by the reinsured as an item under section 809(c) or by the reinsurer as a deduction under section 809(d).

(7) Rules prescribed by the Secretary.

Such other rules as may be prescribed by the Secretary or his delegate.

In applying the rules provided by paragraphs (1), (2), (3), (4), (5), and (6) and the rules prescribed under paragraph (7), an item shall be taken into account as income only once under subpart B and only once under subpart C by both the reinsured and the reinsurer, and an item shall be allowed as a deduction only once under subpart B and only once under subpart C to both the reinsured and the reinsurer. (Added Pub. L. 86-69, § 2(a), June 25, 1959, 73 Stat. 137.)

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

PART II.—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE AND CERTAIN MARINE INSURANCE COMPANIES AND OTHER THAN FIRE OR FLOOD INSURANCE COMPANIES WHICH OPERATE ON BASIS OF PERPETUAL POLICIES OR PREMIUM DEPOSITS)

Sec.
821. Tax on mutual insurance companies to which part II applies.
822. Determination of taxable investment income.
823. Determination of statutory underwriting income or loss.
824. Adjustments to provide protection against losses.
825. Unused loss deduction.
826. Election by reciprocal.

AMENDMENTS

1962—Pub. L. 87-834, § 8(a), Oct. 16, 1962, 76 Stat. 989, substituted "other than life and certain marine insurance companies and other than fire or flood insurance companies which operate on basis of perpetual policies or premium deposits" for "other than life or marine or fire insurance companies issuing perpetual policies" in the heading of Part II, "companies to which part II applies" for "companies (other than life or marine or fire insurance companies issuing perpetual policies)" in item 821, "Determination of taxable investment income" for "Determination of mutual insurance company taxable income" in item 822, and "Determination of statutory underwriting income or loss" for "Other definitions" in item 823, and added items 824-826.

§ 821. Tax on mutual insurance companies to which part II applies.

(a) Imposition of tax.

A tax is hereby imposed for each taxable year beginning after December 31, 1963, on the mutual insurance company taxable income of every mutual insurance company (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831). Such tax shall consist of—

(1) Normal tax.

A normal tax of 22 percent of the mutual insurance company taxable income, or 44 percent of the amount by which such taxable income exceeds $6,000, whichever is the lesser; plus

(2) Surtax.

A surtax on the mutual insurance company taxable income computed as provided in section 11(c) as though the mutual insurance company taxable income were the taxable income referred to in section 11(c).

(b) Mutual insurance company taxable income defined.

For purposes of this part, the term "mutual insurance company taxable income" means, with respect to any taxable year, the amount by which—

(1) the sum of—

(A) the taxable investment income (as defined in section 822(a)(1)),

(B) the statutory underwriting income (as defined in section 823(a)(1)), and

(C) the amounts required by section 824(d) to be subtracted from the protection against loss account, exceeds

(2) the sum of—

(A) the investment loss (as defined in section 822(a)(2)),

(B) the statutory underwriting loss (as defined in section 823(a)(2)), and

(C) the unused loss deduction provided by section 825(a).

(c) Alternative tax for certain small companies.

(1) Imposition of tax.

In the case of taxable years beginning after December 31, 1963, there is hereby imposed for each taxable year on the income of each mutual insurance company to which this subsection applies a tax (which shall be in lieu of the tax imposed by subsection (a)) computed as follows:

(A) Normal tax.

A normal tax of 22 percent of the taxable investment income, or 44 percent of the amount by which such taxable income exceeds $3,000, whichever is the lesser; plus

(B) Surtax.

A surtax on the taxable investment income computed as provided in section 11(c) as though the taxable investment income were the taxable income referred to in section 11(c).

(2) Gross amount received, over $150,000 but less than $250,000.

If the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is over $150,000 but less than $250,000, the tax imposed by paragraph (1) shall be reduced to an amount which bears the same proportion to the amount of the tax determined under paragraph (1) as the excess over $150,000 of such gross amount received bears to $100,000.

(3) Companies to which subsection applies.

(A) In general.

Except as provided in subparagraph (B), this subsection shall apply to every mutual insurance company (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831) which received during the taxable year

from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) a gross amount in excess of $150,000 but not in excess of $500,000.

(B) Exceptions.

This subsection shall not apply to a mutual insurance company for the taxable year if—

(i) there is in effect an election by such company made under subsection (d) to be taxable under subsection (a); or

(ii) there is any amount in the protection against loss account at the beginning of the taxable year.

(d) Election to include statutory underwriting income or loss.

(1) In general.

Any mutual insurance company which is subject to the tax imposed by subsection (c) may elect, in such manner and at such time as the Secretary or his delegate may by regulations prescribe, to be subject to the tax imposed by subsection (a).

(2) Effect of election.

If an election is made under paragraph (1), the electing company shall be subject to the tax imposed by subsection (a) (and shall not be subject to the tax imposed by subsection (c)) for the first taxable year for which such election is made and for all taxable years thereafter unless the secretary or his delegate consents to a revocation of such election.

(e) Special transitional underwriting loss.

(1) Companies to which subsection applies.

This subsection shall apply to every mutual insurance company which has been subject to the tax imposed by this section (as in effect before the enactment of this subsection) for the 5 taxable years immediately preceding January 1, 1962, and has incurred an underwriting loss for each of such 5 taxable years.

(2) Reduction of statutory underwriting income.

For purposes of this part, the statutory underwriting income of a company described in paragraph (1) for the taxable year shall be the statutory underwriting income for the taxable year (determined without regard to this subsection) reduced by the amount by which—

(A) the sum of the underwriting losses of such company for the 5 taxable years immediately preceding January 1, 1962, exceeds

(B) the total amount by which the company's statutory underwriting income was reduced by reason of this subsection for prior taxable years.

(3) Underwriting loss defined.

For purposes of this subsection, the term "underwriting loss" means statutory underwriting loss, computed without any deduction under section 824(a) and without any deduction under section 832(c)(11).

(4) Years to which snbsection applies.

This subsection shall apply with respect to any taxable year beginning after December 31, 1962, and before January 1, 1968, for which the taxpayer is subject to the tax imposed by subsection (a).

(f) Cross references.

(1) For exemption from tax of certain mutual insurance companies, see section 501(c)(15).

(2) For alternative tax in case of capital gains, see section 1201(a).

(3) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842.

(Aug. 16, 1954, ch. 736, 68A Stat. 260; Mar. 30, 1955, ch. 18, § 2, 69 Stat. 14; Mar. 13, 1956, ch. 83, § 3(a)(1), (2), 70 Stat. 47; Mar. 29, 1956, ch. 115 § 2, 70 Stat. 66; Mar. 29, 1957, Pub. L. 85–12, § 2, 71 Stat. 9; June 30, 1958, Pub. L. 85–475, § 2, 72 Stat. 259; June 30, 1959, Pub. L. 86–75, § 2, 73 Stat. 157; June 30, 1960, Pub. L. 86–564, title II, § 201, 74 Stat. 290; June 30, 1961, Pub. L. 87–72, § 2, 75 Stat. 193; June 28, 1962, Pub. L. 87–508, § 2, 76 Stat. 114; Oct. 16, 1962, Pub. L. 87–834, § 8(a), 76 Stat. 989; June 29, 1963 Pub. L. 88–52, § 2, 77 Stat. 72; Feb. 26, 1964, Pub. L. 88–272, title I, § 123(a), 78 Stat. 29; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(i)(4), 80 Stat. 1562.)

AMENDMENTS

1966—Subsec. (e). Pub. L. 89–809, § 104(i)(4(A), struck out former subsec. (e) dealing with foreign mutual insurance companies not carrying on an insurance business within the United States and redesignated subsec. (f) as subsec. (e).

Subsec. (f). Pub. L. 89–809, § 104(i)(4)(A), (B), redesignated subsec. (g) as subsec. (f) and, in subsec. (f) as so redesignated, added item (3). Former subsec. (f) redesignated as subsec. (e).

Subsec. (g). Pub. L. 89–809, § 104(i)(4)(A), redesignated subsec. (g) as subsec. (f). Former subsec. (f) redesignated as subsec. (e).

1964—Subsec. (a). Pub. L. 88–272, § 123(a)(1), substituted "December 31, 1963" for "December 31, 1962", provisions setting a normal tax of 22% of the mutual insurance company taxable income, or 44% of the amount such income exceeds $6,000, whichever is the lesser, for provisions taxing 30% of such income, or 60% of the amount it exceeded $6,000, whichever was the lesser, for taxable years beginning before July 1, 1964, and 25% of such income, or 50% of the amount it exceeded $6,000, whichever was the lesser, for taxable years beginning after June 30, 1964, in par. (1), and in par. (2), "on the mutual insurance company taxable income computed as provided in section 11(c) as though the mutual insurance company taxable income were the taxable income referred to in section 11(c)" for "of 22 percent of the mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax exempt interest) in excess of $25,000."

Subsec. (c)(1). Pub. L. 88–272, § 123(a)(2), substituted "December 31, 1963" for "December 31, 1962", provisions setting a normal tax of 22% of the taxable investment income, or 44% of the amount such income exceeds $3,000, whichever is the lesser, for provisions taxing 30% of such income, or 60% of the amount it exceeded $3,000, whichever was the lesser, for taxable years beginning before July 1, 1964, and 25% of such income, or 50% of the amount it exceeded $3,000, whichever was the lesser, for taxable years beginning after June 30, 1964, and in par. (B), "on the taxable investment income computed as provided in section 11(c) as though the taxable investment income were the taxable income referred to in section 11(c)" for "of 22 percent of the taxable investment income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of $25,000."

1963—Subsec. (a)(1). Pub. L. 88–52 substituted "July 1, 1964" for "July 1, 1963" and "June 30, 1964" for "June 30, 1963", wherever appearing.

Subsec. (c)(1)(A). Pub. L. 88–52 substituted "July 1, 1964" for "July 1, 1963" and "June 30, 1964" for June 30, 1963", wherever appearing.

1962—Subsec. (a). Pub. L. 87–834 excluded flood insurance companies subject to the tax imposed by section 831 of this title, eliminated provisions which excluded

mutual insurance companies which are interinsurers or reciprocal underwriters, and substituted provisions authorizing a normal tax, in the case of taxable years beginning before July 1, 1963, of 30 percent of the taxable income, or 60 percent of the amount by which such taxable income exceeds $6,000, whichever is lesser, and in the case of taxable years beginning after June 30, 1963, of 25 percent of the taxable income, or 50 percent of the amount by which such taxable income exceeds $6,000, whichever is less, for provisions which imposed a normal tax, in the case of taxable years beginning before July 1, 1962, of 30 percent of the taxable income, or 60 percent of the amount by which such taxable income exceeds $3,000, whichever is the lesser, and in the case of taxable years beginning after June 30, 1962, of 25 percent of the taxable income, or 50 percent of the amount by which such taxable income exceeds $3,000, whichever is the lesser, and if for the taxable year the gross amount of income from the items described in section 822(b) (other than par. (1)(D) thereof) and net premiums, minus dividends to policyholders, minus the interest which under section 103 is excluded from gross income, exceeds $75,000, a tax equal to 1 percent of the amount so computed, or 2 percent of the excess of the amount so computed over $75,000, whichever is the lesser.

Subsec. (a)(1)(A). Pub. L. 87–508 substituted "July 1, 1963" for "July 1, 1962" and "June 30, 1963" for "June 30, 1962", wherever appearing.

Subsec. (b). Pub. L. 87–834 substituted provisions defining "mutual insurance company taxable income" for provisions which imposed a tax on mutual insurance companies which are interinsurers or reciprocal underwriters.

Subsec. (b)(1). Pub. L. 87–503 substituted "July 1, 1963" for "July 1, 1962" and "June 30, 1963" for "June 30, 1962", wherever appearing.

Subsec. (c). Pub. L. 87–834 amended subsection generally to read as above set forth. Prior to such amendment, subsection read as follows: "If the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is over $75,000 but less than $125,000, the tax imposed by subsection (a) or subsection (b), whichever applies, shall be reduced to an amount which bears the same proportion to the amount of the tax determined under such subsection as the excess over $75,000 of such gross amount received bears to $50,000."

Subsec. (d). Pub. L. 87–834 added subsec. (d) and redesignated former subsec. (d) as (e).

Subsec. (e). Pub. L. 87–834 redesignated former subsec. (d) as (e) and included flood insurance companies subject to the tax imposed by section 831 within the exception clause. Former subsec. (e) redesignated (g)(2).

Subsec. (f). Pub. L. 87–834 added subsec. (f).

Subsec. (g). Pub. L. 87–834 added subsec. (g). Provisions of subsec. (g)(2) were formerly contained in subsec. (e) of this section.

1961—Subsec. (a)(1)(A). Pub. L. 87–72 substituted "July 1, 1962" for "July 1, 1961" and "June 30, 1962" for "June 30, 1961", wherever appearing.

Subsec. (b)(1). Pub. L. 87–72 substituted "July 1, 1962" for "July 1, 1961" and "June 30, 1962" for "June 30, 1961", wherever appearing.

1960—Subsec. (a)(1)(A). Pub. L. 86–564 substituted "July 1, 1961" for "July 1, 1960" and "June 30, 1961" for "June 30, 1960" wherever appearing.

Subsec. (b)(1). Pub. L. 86–564 substituted "July 1, 1961" for "July 1, 1960" and "June 30, 1961" for "June 30, 1960" wherever appearing.

1959—Subsec. (a)(1)(A). Pub. L. 86–75 substituted "July 1, 1960" for "July 1, 1959" and "June 30, 1960" for "June 30, 1959" wherever appearing.

Subsec. (b)(1). Pub. L. 86–75 substituted "July 1, 1960" for "July 1, 1959" wherever appearing.

1958—Subsec. (a) (1) (A). Pub. L. 85–475 substituted "July 1, 1959" for "July 1, 1958" and "June 30, 1959" for "June 30, 1958" wherever appearing.

Subsec. (b) (1). Pub. L. 85–475 substituted "July 1, 1959" for "July 1, 1958" and "June 30, 1959" for "June 30, 1958" wherever appearing.

1957—Subsec. (a) (1) (A). Pub. L. 85–12 substituted "July 1, 1958" for "April 1, 1957" and "June 30, 1958" for "March 31, 1957" wherever appearing.

Subsec. (b) (1). Pub. L. 85–12 substituted "July 1, 1958" for "April 1, 1957" and "June 30, 1958" for "March 31, 1957" wherever appearing.

1956—Subsec. (a) (1) (A). Act Mar. 29, 1956, substituted "April 1, 1957" for "April 1, 1956" and "March 31, 1957" for "March 31, 1956" wherever appearing.

Subsec. (a) (2). Act Mar. 13, 1956, § 3 (a) (1), substituted "the items described in section 822(b) (other than paragraph (1) (D) thereof)" for "interest, dividends, rents,".

Subsec. (b) (1). Act Mar. 29, 1956, substituted "April 1, 1957" for "April 1, 1956" and "March 31, 1957" for "March 31, 1956" wherever appearing.

Subsec. (c). Act Mar. 13, 1956, § 3 (a) (2), substituted "the items described in section 822 (b) (other than paragraph (1) (D) thereof)" for "interest, dividends, rents,".

1955—Subsec. (a) (1) (A). Act Mar. 80, 1955, substituted "April 1, 1956" for "April 1, 1955" and "March 31, 1956" for "March 31, 1955" wherever appearing.

Subsec. (b)(1). Act. Mar. 30, 1955, substituted "April 1, 1956" for "April 1, 1955" and "March 31, 1956" for March 31, 1955" wherever appearing.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Section 8(h) of Pub. L. 87–834 provided that: "The amendments made by this section [adding sections 823–826 of this title, amending this section and sections 501, 822, 831, 832, 841, 1016 and 1201 of this title, and redesignating former section 823 of this title as section 822(f) of this title] (other than by subsection (f) [adding subsec. (c) of section 831 of this title]) shall apply with respect to taxable years beginning after December 31, 1962."

EFFECTIVE DATE OF 1956 AMENDMENT

Section 6 of act Mar. 13, 1956, provided that: "The amendments made by this Act [to part I, of this subchapter as it existed prior to June 25, 1959 and to this section and sections 316(b)(1), 501(c)(15), 594(a)(2), 822(b), (c)(3), (6), (8), (9), (d)(1), (e), 832(b)(4), (c)(5), (8), 841, 842, 843, 891, 1201(a), 1504(b)(2), and 4371(2) of this title] shall apply only to taxable years beginning after December 31, 1954."

SHORT TITLE

Congress in enacting amendments to part I of this subchapter as it existed prior to June 25, 1959 and to this section and sections 316(b)(1), 501(c)(15), 594(a)(2), 822(b), (c) (3), (6), (8), (9), (d)(1), (e), 832(b)(4), (c) (5), (8), 841, 842, 891, 1201(a), 1504(b)(2), and 4371(2) of this title, and adding section 843 of this title, provided by section 1 of act Mar. 13, 1956, that they shall be popularly known as the "Life Insurance Company Tax Act for 1955".

CROSS REFERENCES

Alternative tax, see section 1201 of this title.

Burial or funeral benefit insurance company as taxable under this section or section 831, see section 801 of this title.

Consolidated returns, includible corporation defined to mean insurance companies taxable under this section, see section 1504 of this title.

Credit for foreign taxes, see section 841 of this title.

Dividends defined in distributions by corporations, see section 316 of this title.

Doubling tax rates on citizens and corporations of certain foreign countries, see section 891 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 243, 801, 822, 823, 824, 825, 826, 831, 841, 891, 1201, 1504, 1563, 4914 of this title.

§ 822. Determination of taxable investment income.

(a) Definitions.

For purposes of this part—

(1) The term "taxable investment income" means the gross investment income, minus the deductions provided in subsection (c).

(2) The term "investment loss" means the amount by which the deductions provided in subsection (c) exceed the gross investment income.

(b) Gross investment income.

For purposes of subsection (a), the term "gross investment income" means the sum of the following:

(1) The gross amount of income during the taxable year from—

(A) interest, dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,

(C) the alteration or termination of any instrument or agreement described in subparagraph (B), and

(D) gains from sales or exchanges of capital assets to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses).

(2) The gross income during the taxable year from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

(c) Deductions.

In computing taxable investment income, the following deductions shall be allowed:

(1) Tax-free interest.

The amount of interest which under section 103 is excluded for the taxable year from gross income.

(2) Investment expenses.

Investment expenses paid or accrued during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which taxable investment income (computed without any deduction for investment expenses allowed by this paragraph, for tax-free interest allowed by paragraph (1), or for partially tax-exempt interest and dividends received allowed by paragraph (7)), exceeds 3¾ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

(3) Real estate expenses.

Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

(4) Depreciation.

The depreciation deduction allowed by section 167.

(5) Interest paid or accrued.

All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from taxation under this subtitle.

(6) Capital losses.

Capital losses to the extent provided in subchapter P (sec. 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of the items described in subsection (b) (other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the taxable investment income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deduction provided in section 242 for partially tax-exempt interest); or

(B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(7) Special deductions.

The special deductions allowed by part VIII (except section 248) of subchapter B (sec. 241 and following, relating to partially tax-exempt interest and to dividends received). In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for

purposes of this paragraph, the reference in such section to "taxable income" shall be treated as a reference to "taxable investment income".

(8) Trade or business deductions.

The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner; except that for purposes of this paragraph—

(A) any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account, and

(B) the deduction for net operating losses provided in section 172 shall not be allowed.

(9) Depletion.

The deduction allowed by section 611 (relating to depletion).

(d) Other applicable rules.

(1) Rental value of real estate.

The deduction under subsection (c) (3) or (4) on account of any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 821 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this paragraph) as the rental value of the space not so occupied bears to the rental value of the entire property.

(2) Amortization of premium and accrual of discount.

The gross amount of income during the taxable year from interest, the deduction provided in subsection (c)(1), and the deduction allowed by section 242 (relating to partially tax-exempt interest) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. Such amortization and accrual shall be determined—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

For taxable years beginning after December 31, 1962, no accrual of discount shall be required under this paragraph on any bond (as defined in section 171(d)).

(3) Double deductions.

Nothing in this part shall permit the same item to be deducted more than once.

(e) Definitions.

For purposes of this part—

(1) Net premiums.

The term "net premiums" means gross premiums (including deposits and assessments) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends on the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (2).

(2) Dividends to policyholders.

The term "dividends to policyholders" means dividends and similar distributions paid or declared to policyholders. For purposes of the preceding sentence, the term "paid or declared" shall be construed according to the method regularly employed in keeping the books of the insurance company.

(Aug. 16, 1954, ch. 736, 68A Stat. 261; Mar. 13, 1956, ch. 83, § 3(a) (3)—(8), 70 Stat. 47, 48; Oct. 16, 1962, Pub. L. 87-834, § 8(b), 76 Stat. 991; Feb. 26, 1964, Pub. L. 88-272, title II, § 228 (b)(2), 78 Stat. 99; Nov. 13, 1966, Pub. L. 89-809, title I, § 104(i)(5), 80 Stat. 1562.)

AMENDMENTS

1966—Subsec. (e). Pub. L. 89-809 struck out former subsec. (e) dealing with foreign mutual insurance companies other than life or marine and redesignated subsec. (f) as subsec. (e).

Subsec. (f). Pub. L. 89-809, redesignated subsec. (g) as subsec. (f). Former subsec. (f) redesignated as subsec. (e).

1964—Subsec. (d)(2). Pub. L. 88-272 provided that for taxable years beginning after Dec. 31, 1962, no accrual of discount shall be required under par. (2) on any bond.

1962—Pub. L. 87-834, § 8(b)(1), substituted "Determination of taxable investment income" for "Determination of mutual insurance company taxable income" in the section catchline.

Subsec. (a). Pub. L. 87-834, § 8(b)(1), defined "taxable investment income" and "investment loss" for purposes of this part, and eliminated provisions which defined "mutual insurance company taxable income" for purposes of section 821 of this title, which provisions are now contained in section 821(b) of this title.

Subsec. (c). Pub. L. 87-834, § 8(b)(2), (3), substituted "taxable investment income" for "mutual insurance company taxable income" in the opening provisions and in pars. (2) and (6)(A), and inserted sentence in par. (7) providing that in applying section 246(b) (relating to limitations on aggregate amount of deductions for dividends received) for purposes of par. (7), the reference in such section to "taxable income" shall be treated as a reference to "taxable investment income."

Subsec. (e). Pub. L. 87-834, § 8(b)(2), substituted "taxable investment income" for "mutual insurance company taxable income."

Subsec. (f). Pub. L. 87-834, § 8(b)(4), added subsec. (f). Provisions of subsec. (f) were formerly contained in section 823 of this title.

1956—Subsec. (b). Act Mar. 13, 1956, § 3(a)(3), principally included royalties, and the income from a trade or business other than the insurance business carried on by the insurance company in "gross investment income."

Subsec. (c). Act Mar. 13, 1956, § 3(a)(4), (5), (6), clarified the deduction for real estate expenses in par. (3), substituted in par. (6) "the sum of the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums received. In the application of section 1212" for "the sum of interest, dividends, rents, and net premiums received. In the application of section 1211", and inserted pars. (8) and (9).

Subsec. (d)(1). Act Mar. 13, 1956, § 3(a)(7), substituted "subsection (c)(3) or (4)" for "subsection (e)(3) or (4)".

Subsec. (e). Act Mar. 13, 1956, § 3(a)(8), substituted "items described in subsection (b) (other than paragraph (1)(D) thereof" for "interest, dividends, rents,".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsecs. (a), (c) and (e) of this section, and addition of subsec. (f) of this section, by Pub. L. 87-834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87-834, set out as a note under section 821 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956 applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 501, 821, 822, 832, 841 of this title.

§ 823. Determination of statutory underwriting income or loss.

(a) In general.

For purposes of this part—

(1) The term "statutory underwriting income" means the amount by which—

(A) the gross income which would be taken into account in computing taxable income under section 832 if the taxpayer were subject to the tax imposed by section 831, reduced by the gross investment income, exceeds

(B) the sum of (i) the deductions which would be taken into account in computing taxable income if the taxpayer were subject to the tax imposed by section 831, reduced by the deductions provided in section 822(c), plus (ii) the deductions provided in subsection (c) and section 824(a).

(2) The term "statutory underwriting loss" means the excess of the amount referred to in paragraph (1)(B) over the amount referred to in paragraph (1)(A).

(b) Modifications.

In applying subsection (a)—

(1) Net operating loss deduction.

Except as provided by section 844, the deduction for net operating losses provided in section 172 shall not be allowed.

(2) Interinsurers.

In the case of a mutual insurance company which is an interinsurer or reciprocal underwriter—

(A) there shall be allowed as a deduction the increase for the taxable year in savings credited to subscriber accounts, or

(B) there shall be included as an item of gross income the decrease for the taxable year in savings credited to subscriber accounts.

For purposes of the preceding sentence, the term "savings credited to subscriber accounts" means such portion of the surplus as is credited to the individual accounts of subscribers before the 16th day of the third month following the close of the taxable year, but only if the company would be obligated to pay such amount promptly to such subscriber if he terminated his contract at the close of the company's taxable year. For purposes of determining his taxable income, the subscriber shall treat any such savings credited to his account as a dividend paid or declared.

(c) Special deduction for small company having gross amount of less than $1,100,000.

(1) In general.

If the gross amount received during the taxable year by a taxpayer subject to the tax imposed by section 821(a) from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not equal or exceed $1,100,000, then in determining the statutory underwriting income or loss for the taxable year there shall be allowed an additional deduction of $6,000; except that if such gross amount exceeds $500,000, such additional deduction shall be equal to 1 percent of the amount by which $1,100,000 exceeds such gross amount.

(2) Limitation.

The amount of the deduction allowed under paragraph (1) shall not exceed the statutory underwriting income for the taxable year, computed without regard to any deduction under this subsection or section 824(a).

(Added Pub. L. 87-834, § 8(c), Oct. 16, 1962, 76 Stat. 992, and amended Pub. L. 91-172, title IX, § 907(c)(2)(B), Dec. 30, 1969, 83 Stat. 717.)

PRIOR PROVISIONS

A prior section 823, act Aug. 16, 1954, ch. 736, 68A Stat. 263, which defined "net premiums" and "dividends to policyholders", was redesignated section 822(f) of this title by section 8(b)(4) of Pub. L. 87-834.

AMENDMENTS

1969—Subsec. (b)(1). Pub. L. 91-172 provided that section 844 of this title be excepted from the nondeduction operating loss provision of section 172 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable with respect to losses incurred in taxable year beginning after Dec. 31, 1962, but not affecting any tax liability for any taxable year beginning before Jan. 1, 1967, see section 907(d) of Pub. L. 91-172, set out as a note under section 805 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87-834, set out as a note under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 821 of this title.

§ 824. Adjustments to provide protection against losses.

(a) Allowance of deduction.

(1) In general.

In determining the statutory underwriting income or loss for any taxable year there shall be allowed as a deduction the sum of—

(A) an amount equal to 1 percent of the losses incurred during the taxable year (as determined under section 832(b)(5)), plus

(B) an amount equal to 25 percent of the underwriting gain for the taxable year, plus

(C) if the concentrated windstorm, etc., premium percentage for the taxable year exceeds 40 percent, an amount determined by applying so much of such percentage as exceeds 40 percent to the underwriting gain for the taxable year.

For purposes of this paragraph, the term "underwriting gain" means statutory underwriting income, computed without any deduction under this subsection.

(2) Special rule for companies having coucentrated windstorm, etc., risks.

For purposes of paragraph (1)(C), the term "concentrated windstorm, etc., premium percentage" means, with respect to any taxable year, the percentage obtained by dividing—

(A) the amount of the premiums earned on insurance contracts during the taxable year (as defined in section 832(b)(4)), to the extent attributable to insuring against losses arising, either in any one State or within 200 miles of any fixed point selected by the taxpayer, from windstorm, hail, flood, earthquake, or similar hazards, by

(B) the amount of the premiums earned on insurance contracts during the taxable year (as so defined).

(b) Protection against loss account.

Each insurance company subject to the tax imposed by section 821(a) for any taxable year shall, for purposes of this part, establish and maintain a protection against loss account.

(c) Additions to account.

There shall be added to the protection against loss account for each taxable year an amount equal to the amount allowable as a deduction for the taxable year under subsection (a)(1).

(d) Subtractions.

(1) Annual subtractions.

After applying subsection (c), there shall be subtracted for the taxable year from the protection against loss account—

(A) first, an amount equal to the excess (if any) of the deduction allowed under subsection (a) for the taxable year over the underwriting gain (within the meaning of subsection (a)(1)) for the taxable year,

(B) then, the amount (if any) by which—

(i) the sum of the investment loss for such year and the statutory underwriting loss (reduced by the amount referred to in subparagraph (A)) for such year, exceeds

(ii) the sum of the statutory underwriting income for such taxable year and the taxable investment income for such taxable year,

(C) next (in the order in which the losses occurred), amounts equal to the unused loss carryovers to such year,

(D) next, any amount remaining which was added to the account for the fifth preceding taxable year, minus one-half of the amount remaining in the account for such taxable year which was added by reason of subsection (a)(1)(B), and

(E) finally, the amount by which the total amount in the account exceeds which ever of the following is the greater:

(i) 10 percent of premiums earned on insurance contracts during the taxable year (as defined in section 832(b)(4)) less dividends to policyholders (as defined in section 832(c)(11)), or

(ii) the total amount in the account at the close of the preceding taxable year.

(2) Rules for ceiling on protection against loss account.

For purposes of paragraph (1)(E), the total amount in the account shall be determined—

(A) after the application of this section without regard to paragraph (1)(E), and

(B) without taking into consideration amounts remaining in the account which were added, with respect to all taxable years, by reason of subsection (a)(1)(C).

(3) Priorities.

The amounts required to be subtracted from the protection against loss account—

(A) under subparagraphs (A), (B), and (C) of paragraph (1) shall be subtracted—

(i) first (on a first-in, first-out, basis) from amounts in the account with respect to the five preceding taxable years and the taxable year, and

(ii) then from amounts in the account with respect to earlier years,

(B) under subparagraph (E) of paragraph (1) shall be subtracted only from amounts in the account with respect to the taxable year, and

(C) under paragraphs (A), (B), (C), and (E) of paragraph (1) shall, if the amount to be subtracted from the total amounts in the account with respect to any taxable year is less than such total, be subtracted from each of the amounts (referred to in subsection (a)(1)) in the account with respect to such year in the proportion which each bears to such total.

(4) Terminatiou of taxability under section 821.

If the taxpayer is not subject to tax under section 821 for any taxable year, the entire amount in the account at the close of the preceding taxable year shall be subtracted from the account in such preceding taxable year.

(5) Election to subtract amount from accouut.

(A) A taxpayer may elect for any taxable year for which it is subject to tax under section 821 (a) to subtract from its protection against loss account any amount which, but for the application of this subparagraph, would be in such account as of the close of such taxable year.

(B) The election provided by subparagraph (A) for any taxable year shall be made (in such manner and in such form as the Secretary or his delegate may by regulations prescribe) after the close of such taxable year and not later than the time prescribed by law for filing the return (including extensions thereof) for the taxable year following such taxable year. Such an election, once made, may not be revoked.

(Added Pub. L. 87–834, § 8(c), Oct. 16, 1962, 76 Stat. 993.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87–834, set out as a note under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 821, 823, 825, 826 of this title.

§ 825. Unused loss deduction.

(a) Amount of deduction.

For purposes of this part, the unused loss deduction for the taxable year shall be an amount equal to the unused loss carryovers or carrybacks to the taxable year.

(b) Unused loss defined.

For purposes of this part, the term "unused loss" means, with respect to any taxable year, the amount (if any) by which—

(1) the sum of the statutory underwriting loss and the investment loss, exceeds

(2) the sum of—

(A) the taxable investment income,

(B) the statutory underwriting income, and

(C) the amounts required by section 824(d) to be subtracted from the protection against loss account.

(c) Loss year defined.

For purposes of this part, the term "loss year" means, with respect to any company subject to the tax imposed by section 821(a), any taxable year in which the unused loss (as defined in subsection (b)) of such taxpayer is more than zero.

(d) Years to which carried.

The unused loss for any loss year shall be—

(1) an unused loss carryback to each of the 3 taxable years preceding the loss year, and

(2) an unused loss carryover to each of the 5 taxable years following the loss year.

(e) Amount of carrybacks and carryovers.

The entire amount of the unused loss for any loss year shall be carried to the earliest of the taxable years to which such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess (if any) of the amount of such loss over the sum of the offsets (as defined in subsection (f)) for each of the prior taxable years to which such loss may be carried.

(f) Offset defined.

For purposes of subsection (e), the term "offset" means with respect to any taxable year(hereinafter referred to as the "offset year")—

(1) in the case of an unused loss carryback from the loss year to the offset year, the mutual insurance company taxable income for the offset year; or

(2) in the case of an unused loss carryover from the loss year to the offset year, an amount equal to the sum of—

(A) the amount required to be subtracted from the protection against loss account under section 824(d)(1)(C) for the offset year, plus

(B) the mutual insurance company taxable income for the offset year.

For purposes of paragraphs (1) and (2)(B), the mutual insurance company taxable income for the offset year shall be determined without regard to any unused loss carryback or carryover from the loss year or any taxable year thereafter.

(g) Limitations.

For purposes of this part, an unused loss shall not be carried—

(1) to or from any taxable year beginning before January 1, 1963,

(2) except as provided by section 844, to or from any taxable year for which the insurance company is not subject to the tax imposed by section 821(a), nor

(3) except as provided by section 844, to any taxable year if, between the loss year and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by section 821(a).

(Added Pub. L. 87–834, § 8(c), Oct. 16, 1962, 76 Stat. 995, and amended Pub. L. 91–172, title IX, § 907(c)(2)(C), (D), Dec. 30, 1969, 83 Stat. 717.)

AMENDMENTS

1969—Subsec. (g)(2), (3). Pub. L. 91–172 provided that section 844 of this title be excepted from the nonallowable carryover provisions of this section.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 907(c)(2)(C), (D) of Pub. L. 91–172 applicable with respect to losses incurred in taxable year beginning after Dec. 31, 1962, but not affecting any tax liability for any taxable year beginning before Jan. 1, 1967, see section 907(d) of Pub. L. 91–172, set out as a note under section 805 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87–834, set out as a note under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 821, 844 of this title.

§ 826. Election by reciprocal.

(a) In general.

Except as otherwise provided in this section, any mutual insurance company which is an interinsurer or reciprocal underwriter (hereinafter in this section referred to as a "reciprocal") subject to the taxes imposed by section 821(a) may, under regulations prescribed by the Secretary or his delegate, elect to be subject to the limitation provided in subsection (b). Such election shall be effective for the taxable year for which made and for all succeeding taxable years, and shall not be revoked except with the consent of the Secretary or his delegate.

(b) Limitation.

The deduction for amounts paid or incurred in the taxable year to the attorney-in-fact by a reciprocal making the election provided in subsection (a) shall be limited to, but in no case increased by, the deductions of the attorney-in-fact allocable, in accordance with regulations prescribed by the Secretary or his delegate, to the income received by the attorney-in-fact from the reciprocal.

(c) Exception.

An election may not be made by a reciprocal under subsection (a) unless the attorney-in-fact of such reciprocal—

(1) is subject to the taxes imposed by section 11 (b) and (c);

(2) consents in such manner as the Secretary or his delegate shall prescribe by regulations to make available such information as may be re-

quired during the period in which the election provided in subsection (a) is in effect, under regulations prescribed by the Secretary or his delegate;

(3) reports the income received from the reciprocal and the deductions allocable thereto under the same method of accounting under which the the reciprocal reports deductions for amounts paid to the attorney-in-fact; and

(4) files its return on the calendar year basis.

(d) Special rule.

In applying section 824(d)(1)(D), any amount which was added to the protection against loss account by reason of an election under this section shall be treated as having been added by reason of section 824(a)(1)(A).

(e) Credit.

Any reciprocal electing to be subject to the limitation provided in subsection (b) shall be credited with so much of the tax paid by the attorney-in-fact as is attributable, under regulations prescribed by the Secretary or his delegate, to the income received by the attorney-in-fact from the reciprocal in such taxable year.

(f) Surtax exemption denied.

Any increase in taxable income of a reciprocal attributable to the limitation provided in subsection (b) shall be taxed without regard to the surtax exemption provided in section 821(a)(2).

(g) Adjustment for refund.

If for any taxable year an attorney-in-fact is allowed a credit or refund for taxes paid with respect to which credit or refund to the reciprocal resulted under subsection (e), the taxes of such reciprocal for such taxable year shall be properly adjusted under regulations prescribed by the Secretary or his delegate.

(h) Taxes of attorney-in-fact unaffected.

Nothing in this section shall increase or decrease the taxes imposed by this chapter on the income of the attorney-in-fact. (Added Pub. L. 87-834, § 8(c), Oct. 16, 1962, 76 Stat. 996.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87-834, set out as a note under section 821 of this title.

PART III.—OTHER INSURANCE COMPANIES

Sec.
831. Tax on insurance companies (other than life or mutual), mutual marine insurance companies, and certain mutual fire or flood insurance companies.
832. Insurance company taxable income.

AMENDMENTS

1962—Pub. L. 87-834, § 8(g)(4)(C), Oct. 16, 1962, 76 Stat. 999, substituted "and certain mutual fire or flood insurance companies" for "and mutual fire insurance companies issuing perpetual policies" in item 831.

§ 831. Tax on insurance companies (other than life or mutual), mutual marine insurance companies, and certain mutual fire or flood insurance companies.

(a) Imposition of tax.

Taxes computed as provided in section 11 shall be imposed for each taxable year or the taxable income of—

(1) every insurance company (other than a life or mutual insurance company),

(2) every mutual marine insurance company, and

(3) every mutual fire or flood insurance company—

(A) exclusively issuing perpetual policies, or

(B) whose principal business is the issuance of policies for which the premium deposits are the same, regardless of the length of the term for which the policies are written, if the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy.

(b) Election for multiple line company to be taxed on total income.

(1) In general.

Any mutual insurance company engaged in writing marine, fire, and casualty insurance which for any 5-year period beginning after December 31, 1941, and ending before January 1, 1962, was subject to the tax imposed by section 831 (or the tax imposed by corresponding provisions of prior law) may elect, in such manner and at such time as the Secretary or his delegate may by regulations prescribe, to be subject to the tax imposed by section 831, whether or not marine insurance is its predominant source of premium income.

(2) Effect of election.

If an election is made under paragraph (1), the electing company shall (in lieu of being subject to the tax imposed by section 821) be subject to the tax imposed by this section for taxable years beginning after December 31, 1961. Such election shall not be revoked except with the consent of the Secretary or his delegate.

(c) Cross references.

(1) For alternative tax in case of capital gains, see section 1201(a).

(2) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842.

(Aug. 16, 1954, ch. 736, 68A Stat 264; Oct. 16, 1962, Pub. L. 87-834, § 8(e)(1), (f), (g)(4)(B), 76 Stat. 997-999; Nov. 13, 1966, Pub. L. 89-809, title I, § 104(i)(6), 80 Stat. 1562.)

AMENDMENTS

1966—Subsec. (b). Pub. L. 89-809, § 104(i)(6)(A), struck out subsec. (b) which excepted foreign insurance companies other than life or mutual insurance companies, foreign mutual marine insurance companies, and foreign mutual fire insurance companies not carrying on an insurance business within the United States and provided that they would be taxable as other foreign corporations and redesignated subsec. (c) as subsec. (b).

Subsec. (c). Pub. L. 89-809, § 104(i)(6)(B), redesignated subsec. (d) as subsec. (c) and, in subsec. (c) as so redesignated, added item (2). Former subsec. (c) redesignated as subsec. (b).

Subsec. (d). Pub. L. 89-809, § 104(i)(6)(B), redesignated subsec. (d) as subsec. (c).

1962—Pub. L. 87-834, § 8(g)(4)(B), substituted "and certain mutual fire or flood insurance companies" for "and mutual fire insurance companies issuing perpetual policies" in the section catchline.

Subsec. (a). Pub. L. 87-834, § 8(e)(1), included flood insurance companies, and substituted provisions authorizing imposition of the tax on those companies whose principal business is the issuance of policies for which the premium deposits are the same, regardless of the

length of the term for which the policies are written, if the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy for provisions which authorized imposition of tax on those companies which issued policies for which the sole premium charged is a single deposit which (except for such deduction of underwriting costs as may be provided) is refundable on cancellation or expiration of the policy.

Subsec. (c). Pub. L. 87–834, § 8(f), added subsec. (c) and redesignated former subsec. (c) as (d).

Subsec. (d). Pub. L. 87–834, § 8(f), redesignated former subsec. (c) as (d).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (a) of this section by Pub. L. 87–834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87–834, set out as a note under section 821 of this title.

CROSS REFERENCES

Alternative tax, see section 1201 of this title.

Burial or funeral benefit insurance company as taxable under this section or section 821, see section 801(f) of this title.

Consolidated returns, see section 1503 of this title.

Doubling of tax rates on citizens and corporations of certain foreign countries, see section 891 of this title.

Tax on mutual insurance companies to which part II applies, see section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 801, 815, 821, 823, 832, 841, 891, 1201, 4914 of this title.

§ 832. Insurance company taxable income.

(a) Definition of taxable income.

In the case of an insurance company subject to the tax imposed by section 831, the term "taxable income" means the gross income as defined in subsection (b) (1) less the deductions allowed by subsection (c).

(b) Definitions.

In the case of an insurance company subject to the tax imposed by section 831—

(1) Gross income.

The term "gross income" means the sum of—

(A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners,

(B) gain during the taxable year from the sale or other disposition of property, and

(C) all other items constituting gross income under subchapter B, except that, in the case of a mutual fire insurance company described in section 831(a)(3)(A), the amount of single deposit premiums paid to such company shall not be included in gross income,

(D) in the case of a mutual fire or flood insurance company described in section 831(a)(3)(B), an amount equal to 2 percent of the premiums earned on insurance contracts during the taxable year with respect to policies described in section 831(a)(3)(B) after deduction of premium deposits returned or credited during the same taxable year; and

(E) in the case of a company which writes mortgage guaranty insurance, the amount required by subsection (e)(5) to be subtracted from the mortgage guaranty account.

(2) Investment income.

The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows: To all interest, dividends, and rents received during the taxable year, add interest, dividends, and rents due and accrued at the end of the taxable year, and deduct all interest, dividends, and rents due and accrued at the end of the preceding taxable year.

(3) Underwriting income.

The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred.

(4) Premiums earned.

The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

(A) From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance.

(B) To the result so obtained, add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year.

For purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 801 (b), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 831 and not qualifying as a life insurance company under section 801. For purposes of this subsection, unearned premiums of mutual fire or flood insurance companies described in section 831(a)(3)(B) means (with respect to the policies described in section 831(a)(3)(B)) the amount of unabsorbed premium deposits which the company would be obligated to return to its policyholders at the close of the taxable year if all of its policies were terminated at such time; and the determination of such amount shall be based on the schedule of unabsorbed premium deposit returns for each such company then in effect. Premiums paid by the subscriber of a mutual flood insurance company referred to in paragraph (3) of section 831(a) shall be treated, for purposes of computing the taxable income of such subscriber, in the same manner as premiums paid by a policyholder to a mutual fire insurance company referred to in such paragraph (3).

(5) Losses incurred.

The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

(A) To losses paid during the taxable year, add salvage and reinsurance recoverable out-

standing at the end of the preceding taxable year and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year.

(B) To the result so obtained, add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year.

(6) Expenses incurred.

The term "expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows: To all expenses paid during the taxable year, add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the taxable income subject to the tax imposed by section 831, there shall be deducted from expenses incurred (as defined in this paragraph) all expenses incurred which are not allowed as deductions by subsection (c).

(c) Deductions allowed.

In computing the taxable income of an insurance company subject to the tax imposed by section 831, there shall be allowed as deductions:

(1) all ordinary and necessary expenses incurred, as provided in section 162 (relating to trade or business expenses);

(2) all interest, as provided in section 163;

(3) taxes, as provided in section 164;

(4) losses incurred, as defined in subsection (b) (5) of this section;

(5) capital losses to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders in their capacity as such, losses paid, and expenses paid over the sum of the items described in section 822 (b) (other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the taxable income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deductions provided in section 242 for partially tax-exempt interest); or

(B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders;

(6) debts in the nature of agency balances and bills receivable which become worthless within the taxable year;

(7) the amount of interest earned during the taxable year which under section 103 is excluded from gross income;

(8) the depreciation deduction allowed by section 167 and the deduction allowed by section 611 (relating to depletion);

(9) charitable, etc., contributions, as provided in section 170;

(10) deductions (other than those specified in this subsection) as provided in part VI of subchapter B (sec. 161 and following, relating to itemized deductions for individuals and corporations) and in part I of subchapter D (sec. 401 and following, relating to pension, profit-sharing, stock bonus plans, etc.);

(11) dividends and similar distributions paid or declared to policyholders in their capacity as such, except in the case of a mutual fire insurance company described in section 831(a)(3)(A). For purposes of the preceding sentence, the term "dividends and similar distributions" includes amounts returned or credited to policyholders on cancellation or expiration of policies described in section 831(a)(3)(B). For purposes of this paragraph, the term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company;

(12) the special deductions allowed by part VIII of subchapter B (sec. 241 and following, relating to partially tax-exempt interest and to dividends received); and

(13) in the case of a company which writes mortgage guaranty insurance, the deduction allowed by subsection (e).

(d) Double deductions.

Nothing in this section shall permit the same item to be deducted more than once.

(e) Special deduction and income account.

In the case of taxable years beginning after December 31, 1966, of a company which writes mortgage guaranty insurance—

(1) Additional deduction.

There shall be allowed as a deduction for the taxable year, if bonds are purchased as required by paragraph (2), the sum of—

(A) an amount representing the amount required by State law or regulation to be set aside in a reserve for mortgage guaranty insurance losses resulting from adverse economic cycles; and

(B) an amount representing the aggregate of amounts so set aside in such reserve for the 8 preceding taxable years to the extent such amounts were not deducted under this paragraph in such preceding taxable years,

except that the deduction allowable for the taxable year under this paragraph shall not exceed the taxable income for the taxable year computed without regard to this paragraph or to any carry-

back of a net operating loss. For purposes of this paragraph, the amount required by State law or regulation to be so set aside in any taxable year shall not exceed 50 percent of premiums earned on insurance contracts (as defined in subsection (b)(4)) with respect to mortgage guaranty insurance for such year. For purposes of this subsection, all amounts shall be taken into account on a first-in-time basis. The computation and deduction under this section of losses incurred (including losses resulting from adverse economic cycles) shall not be affected by the provisions of this subsection. For purposes of this subsection, the terms "preceding taxable years" and "preceding taxable year" shall not include taxable years which began before January 1, 1967.

(2) Purchase of bonds.

The deduction under paragraph (1) shall be allowed only to the extent that tax and loss bonds are purchased in an amount equal to the tax benefit attributable to such deduction, as determined under regulations prescribed by the Secretary or his delegate, on or before the date that any taxes (determined without regard to this subsection) due for the taxable year for which the deduction is allowed are due to be paid, as if no election to make installment payments under section 6152 is made. If a deduction would be allowed but for the fact that tax and loss bonds were not timely purchased, such deduction shall be allowed to the extent such purchases are made within a reasonable time, as determined by the Secretary or his delegate, if all interest and penalties, computed as if this sentence did not apply, are paid.

(3) Mortgage guaranty account.

Each company which writes mortgage guaranty insurance shall, for purposes of this part, establish and maintain a mortgage guaranty account.

(4) Additions to account.

There shall be added to the mortgage guaranty account for each taxable year an amount equal to the amount allowed as a deduction for the taxable year under paragraph (1).

(5) Subtractions from account and inclusion in gross income.

After applying paragraph (4), there shall be subtracted for the taxable year from the mortgage guaranty account and included in gross income—

(A) the amount (if any) remaining which was added to the account for the tenth preceding taxable year, and

(B) the excess (if any) of the aggregate amount in the mortgage guaranty account over the aggregate amount in the reserve referred to in paragraph (1)(A). For purposes of determining such excess, the aggregate amount in the mortgage guaranty account shall be determined after applying subparagraph (A), and the aggregate amount in the reserve referred to in paragraph (1)(A) shall be determined by disregarding any amounts remaining in such reserve added for taxable years beginning before January 1, 1967,

(C) an amount (if any) equal to the net operating loss for the taxable year computed without regard to this subparagraph, and

(D) any amount improperly subtracted from the account under subparagraph (A), (B), or (C) to the extent that tax and loss bonds were redeemed with respect to such amount.

If a company liquidates or otherwise terminates its mortgage guaranty insurance business and does not transfer or distribute such business in an acquisition of assets referred to in section 381(a), the entire amount remaining in such account shall be subtracted. Except in the case where a company transfers or distributes its mortgage guaranty insurance in an acquisition of assets referred to in section 381(a), if the company is not subject to the tax imposed by section 831 for any taxable year, the entire amount in the account at the close of the preceding taxable year shall be subtracted from the account in such preceding taxable year. (Aug. 16, 1954, ch. 736, 68A Stat. 264; Mar. 13, 1956, ch. 83, § 3(b), 70 Stat. 48; Oct. 16, 1962, Pub. L. 87-834, § 8(e)(2—5), 76 Stat. 997, 998; Feb. 26, 1964, Pub. L. 88-272, title II, § 228(c), 78 Stat. 99; Nov. 13, 1966, Pub. L. 89-809, title I, § 104(i)(7), 80 Stat. 1562; Jan. 2, 1968, Pub. L. 90-240, § 5(a)—(c), 81 Stat. 776, 777.)

AMENDMENTS

1968—Subsec. (b)(1). Pub. L. 90-240, § 5(a), added subpar. (E).

Subsec. (c). Pub. L. 90-240, § 5(b), added par. (13).

Subsec. (e). Pub. L. 90-240, § 5(c), added subsec. (e).

1966—Subsec. (d). Pub. L. 89-809 struck out subsec. (d) having reference to the taxable income of foreign insurance companies other than life or mutual and foreign mutual marine and redesignated subsec. (e) as subsec. (d).

Subsec. (e). Pub. L. 89-809 redesignated subsec. (e) as subsec. (d).

1964—Subsec. (c)(10). Pub. L. 88-272 inserted the reference to part I of subchapter D.

1962—Subsec. (b)(1)(C). Pub. L. 87-834, § 8(e)(3), (5), substituted "section 831(a)(3)(A)" for "section 831(a)."

Subsec. (b)(1)(D). Pub. L. 87-834, §8(e)(5), added subsec. (b)(1)(D).

Subsec. (b)(4). Pub. L. 87-834, § 8(e)(2), inserted provisions defining unearned premiums of mutual fire or flood insurance companies, and which require premiums paid by the subscriber of a mutual flood insurance company to be treated, for purposes of computing the taxable income of such subscriber, in the same manner as premiums paid by a policyholder to a mutual fire insurance company referred to in par. (3) of section 831(a) of this title.

Subsec. (c)(11). Pub. L. 87-834, § 8(e)(4), substituted "section 831(a)(3)(A)" for "section 831(a)", and inserted the definition of "dividends and similar distributions."

1956—Subsec. (b)(4). Act Mar. 13, 1956, § 3(b)(1), substituted "section 801(b)" for "section 806".

Subsec. (c). Act Mar. 13, 1956, § 3(b)(2), (3), substituted "the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received. In the application of section 1212" for "interest, dividends, rents, and net premiums received. In the application of section 1211" in par. (5), and authorized the deduction for depletion in par. (8).

EFFECTIVE DATE OF 1968 AMENDMENT

Section 5(e) of Pub. L. 90-240 provided that: "The amendments made by subsections (a), (b), (c), and (d) [amending this section and section 381(c)(22) of this title] shall apply to taxable years beginning after December 31, 1966, except that so much of section 832(e)(2) of the Internal Revenue Code of 1954 [subsec. (e)(2) of this section] (as added by the amendment made by sub-

section (c)) as provides for payment of interest and penalties for failure to make a timely purchase of tax and loss bonds shall not apply with respect to any period during which such bonds are not available for purchase."

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 228(d) of Pub. L. 88–272, set out as a note under section 809 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsecs. (b) (1), (4) and (c)(11) of this section by Pub. L. 87–834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87–834, set out as a note under section 821 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956, applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

TREATMENT AS UNEARNED PREMIUMS OF ADDITIONS TO RESERVES REQUIRED BY STATE LAW OR REGULATIONS FOR MORTGAGE GUARANTY INSURANCE LOSSES

Section 5(g) of Pub. L. 90–240 provided that:

"(1) In the case of taxable years beginning before 1967, a company shall treat additions to a reserve, required by State law or regulations for mortgage guaranty insurance losses resulting from adverse economic cycles, as unearned premiums for purposes of section 832(b)(4) of the Internal Revenue Code of 1954 [subsec. (b)(4) of this section], but the amount so treated as unearned premiums in a taxable year shall not exceed 50 percent of premiums earned on insurance contracts (as defined in section 832 (b)(4) of such Code [subsec. (b)(4) of this section]), determined without regard to amounts added to the reserve, with respect to mortgage guaranty insurance for such year. The amount of unearned premiums at the close of 1966 shall be determined without regard to the preceding sentence for the purpose of applying section 832(b) (4) of such Code [subsec. (b)(4) of this section[to 1967. Additions to such a reserve shall not be treated as unearned premiums for any taxable year beginning after 1966.

"(2) If a mortgage guaranty insurance company made additions to a reserve which were so treated as unearned premiums described in paragraph (1), such company, in taxable years beginning after 1966, shall include in gross income (in addition to the items specified in section 832 (b)(1) of such Code [subsec. (b)(1) of this section]) the sum of the following amounts until there is included in gross income an amount equal to the aggregate additions to the reserve described in paragraph (1) for taxable years beginning before 1967:

"(A) an amount (if any) equal to the excess of losses incurred (as defined in section 832(b)(5) of such Code [subsec. (b)(5) of this section[) for the taxable year over 35 percent of premiums earned on insurance contracts during the taxable year (as defined in section 832(b)(4) of such Code [subsec. (b)(4) of this section]), determined without regard to amounts added to the reserve referred to in paragraph (1), with respect to mortgage guaranty insurance,

"(B) the amount (if any) remaining which was added to the reserve for the tenth preceding taxable year, and

"(C) the excess (if any) of—

"(i) the aggregate of amounts so treated as unearned premiums for all taxable years beginning before 1967 less the total of the amounts included in gross income under this paragraph for prior taxable years and the amounts included in gross income under subparagraphs (A) and (B) for the taxable year, over

"(ii) the aggregate of the additions made for taxable years beginning before 1967 which remain in the reserve at the close of the taxable year.

Amounts shall be taken into account on a first-in-time basis. For purposes of section 832(e) of such Code [subsec. (e) of this section[and this paragraph, if part of the reserve is reduced under State law or regulation, such reduction shall first apply to the extent of amounts added to the reserve for taxable years beginning before 1967, and only then to amounts added thereafter.

"(3) The provisions of this subsection shall apply to taxable years beginning after December 31, 1956."

CROSS REFERENCES

Consolidated returns, see section 1504 of this title.

Credit on foreign taxes, see section 841 of this title.

Dividends defined in distributions by corporations, see section 316 of this title.

Personal holding company income, see section 543 of this title.

Tax imposed on corporations, see section 11 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 543, 821, 823, 824, 841, 844, 953, 4914, 6511 of this title; title 31 section 757c–3.

PART IV.—PROVISIONS OF GENERAL APPLICATION

Sec.
841. Credit for foreign taxes.
842. Foreign corporations carrying on insurance business.
843. Annual accounting period.
844. Special loss carryover rules.

AMENDMENTS

1969—Pub. L. 91–172, title IX, § 907(c)(2)(A), Dec. 30, 1969, 83 Stat. 717, added item 844.

1966—Pub. L. 89–809, title I, § 104(i)(2), Nov. 13, 1966, 80 Stat. 1561, substituted "Foreign corporations carrying on insurance business" for "Computation of gross income" in item 842.

1956—Act Mar. 13, 1956, ch. 83, § 4 (b), 70 Stat. 49, added item 843.

§ 841. Credit for foreign taxes.

The taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 802, 821, or 831, to the extent provided in the case of a domestic corporation in section 901 (relating to foreign tax credit). For purposes of the preceding sentence (and for purposes of applying section 906 with respect to a foreign corporation subject to tax under this subchapter), the term "taxable income" as used in section 904 means—

(1) in the case of the tax imposed by section 802, the life insurance company taxable income (as defined in section 802(b)),

(2) in the case of the tax imposed by section 821(a), the mutual insurance company taxable income (as defined in section 821(b)); and in the case of the tax imposed by section 821(c), the taxable investment income (as defined in section 822(a)), and

(3) in the case of the tax imposed by section 831, the taxable income (as defined in section 832(a)).

(Aug. 16, 1954, ch. 736, 68A Stat. 267; Mar. 13, 1956, ch. 83, § 5(4), 70 Stat. 49; June 25, 1959, Pub. L. 86–69, § 3(b), 73 Stat. 139; Oct. 16, 1962, Pub. L. 87–834, § 8(g)(1), 76 Stat. 998; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(i)(8), 80 Stat. 1562.)

AMENDMENTS

1966—Pub. L. 89-809 substituted "For purposes of the preceding sentence (and for purposes of applying section 906 with respect to a foreign corporation subject to tax under this subchapter), the term "taxable income" as used in section 904" for "For purposes of the preceding sentence, the term 'taxable income' as used in section 904".

1962—Pub. L. 87-834 added par. (2) and redesignated former par. (2) as (3).

1959—Pub. L. 86-69 eliminated a reference to section 811 of this title in the first sentence, and substituted "section 802, the life insurance company taxable income (as defined in section 802(b)), and" for "section 802 or 811, the net investment income (as defined in section 803(c))" in par. (1).

1956—Act Mar. 13, 1956, inserted references to section 811.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-809 with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of section by Pub. L. 87-834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87-834, set out as a note under section 821 of this title.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86-69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956 applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

§ 842. Foreign corporations carrying on insurance business.

If a foreign corporation carrying on an insurance business within the United States would qualify under part I, II, or III of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such corporation shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. With respect to the remainder of its income, which is from sources within the United States, such a foreign corporation shall be taxable as provided in section 881. (Aug. 16, 1954, ch. 736, 68A Stat. 267; Mar. 13, 1956, ch. 83, § 5(5), 70 Stat. 49; June 25, 1959, Pub. L. 86-69, § 3(f)(1), 73 Stat. 140; Nov. 13, 1966, Pub. L. 89-809, title I, § 104(i)(1), 80 Stat. 1561.)

AMENDMENTS

1966—Pub. L. 89-809 substituted provisions covering the taxability of foreign corporations that are carrying on an insurance business within the United States which would qualify under part I, II, or III of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation for provisions that the gross income of insurance companies subject to the tax imposed by section 802 or 831 shall not be determined in the manner provided in part I of subchapter N (relating to determination of sources of income).

1959—Pub. L. 86-69 eliminated reference to section 811.

1956—Act Mar. 13, 1956, inserted reference to section 811.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-809 with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment of section by Pub. L. 86-69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956 applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1442 of this title.

§ 843. Annual accounting period.

For purposes of this subtitle, the annual accounting period for each insurance company subject to a tax imposed by this subchapter shall be the calendar year. (Added Mar. 13, 1956, ch. 83, § 4(a), 70 Stat. 48.)

EFFECTIVE DATE

Section as applicable not only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

§ 844. Special loss carryover rules.

(a) General rule.

If an insurance company—

(1) is subject to the tax imposed by part I, II, or III of this subchapter for the taxable year, and

(2) was subject to the tax imposed by a different part of this subchapter for a prior taxable year beginning after December 31, 1962,

then any operations loss carryover under section 812, unused loss carryover under section 825, or net operating loss carryover under section 172, as the case may be, arising in such prior taxable year shall be included in its operations loss deduction under section 812(a), unused loss deduction under section 825(a), or net operating loss deduction under section 832(c)(10), as the case may be.

(b) Limitation.

The amount included under section 812(a), 825(a), or 832(c)(10), as the case may be, by reason of the application of subsection (a) shall not exceed the amount that would have constituted the loss carryover under such section if for all relevant taxable years such company had been subject to the tax imposed by the part referred to in subsection (a)(1) rather than the part referred to in subsection (a)(2). For purposes of applying the preceding sentence—

(1) in the case of a mutual insurance company which becomes a stock insurance company, an amount equal to 25 percent of the deduction under section 832(c)(11) (relating to dividends to policyholders) shall not be allowed, and

(2) section 812(b)(1)(A)(iii) (relating to additional years to which losses may be carried by new life insurance companies) shall not apply.

(c) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section. (Added Pub. L. 91-172, title IX, § 907(c)(1), Dec. 30, 1969, 83 Stat. 716.)

EFFECTIVE DATE

Section applicable with respect to losses incurred in taxable years beginning after Dec. 31, 1962, but not affecting any tax liability for any taxable year beginning before Jan. 1, 1967, see section 907(d) of Pub. L. 91–172, set out as a note under section 805 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 809, 823, 825 of this title.

Subchapter M.—Regulated Investment Companies and Real Estate Investment Trusts

Part
I.—Regulated investment companies.
II.—Real estate investment trusts.

PART I.—REGULATED INVESTMENT COMPANIES

Sec.
851. Definition of regulated investment company.
852. Taxation of regulated investment companies and their shareholders.
853. Foreign tax credit allowed to shareholders.
854. Limitations applicable to dividends received from regulated investment company.
855. Dividends paid by regulated investment company after close of taxable year.

AMENDMENTS

1960—Pub. L. 86–779, § 10(b)(1), Sept. 14, 1960, 74 Stat. 1008, added "and Real Estate Investment Trusts" to the Subchapter M heading, Part I and Part II designations thereunder and Part I designation preceding table of sections numbered 851 to 855.

§ 851. Definition of regulated investment company.

(a) General rule.

For purposes of this subtitle, the term "regulated investment company" means any domestic corporation (other than a personal holding company as defined in section 542)—

(1) which, at all times during the taxable year, is registered under the Investment Company Act of 1940, as amended (54 Stat. 789; 15 U. S. C. 80 a–1 to 80b–2) either as a management company or as a unit investment trust, or

(2) which is a common trust fund or similar fund excluded by section 3 (c) (3) of such Act (15 U.S.C. 80a–3(c)) from the definition of "investment company" and is not included in the definition of "common trust fund" by section 584 (a).

(b) Limitations.

A corporation shall not be considered a regulated investment company for any taxable year unless—

(1) it files with its return for the taxable year an election to be a regulated investment company or has made such election for a previous taxable year which began after December 31, 1941;

(2) at least 90 percent of its gross income is derived from dividends, interests, and gains from the sale or other disposition of stock or securities;

(3) less than 30 percent of its gross income is derived from the sale or other disposition of stock or securities held for less than 3 months; and

(4) at the close of each quarter of the taxable year—

(A) at least 50 percent of the value of its total assets is represented by—

(i) cash and cash items (including receivables), Government securities and securities of other regulated investment companies, and

(ii) other securities for purposes of this calculation limited, except and to the extent provided in subsection (e), in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the taxpayer and to not more than 10 percent of the outstanding voting securities of such issuer, and

(B) not more than 25 percent of the value of its total assets is invested in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary or his delegate, to be engaged in the same or similar trades or businesses or related trades or businesses.

(c) Rules applicable to suhsection (b) (4).

For purposes of subsection (b) (4) and this subsection—

(1) In ascertaining the value of the taxpayer's investment in the securities of an issuer, for the purposes of subparagraph (B), there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer, as determined under regulations prescribed by the Secretary or his delegate.

(2) The term "controls" means the ownership in a corporation of 20 percent or more of the total combined voting power of all classes of stock entitled to vote.

(3) The term "controlled group" means one or more chains of corporations connected through stock ownership with the taxpayer if—

(A) 20 percent or more of the total combined voting power of all classes of stock entitled to vote of each of the corporations (except the taxpayer) is owned directly by one or more of the other corporations, and

(B) the taxpayer owns directly 20 percent or more of the total combined voting power of all classes of stock entitled to vote, of at least one of the other corporations.

(4) The term "value" means, with respect to securities (other than those of majority-owned subsidiaries) for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the board of directors, except that in the case of securities of majority-owned subsidiaries which are investment companies such fair value shall not exceed market value or asset value, whichever is higher.

(5) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

(d) Determination of status.

A corporation which meets the requirements of subsections (b) (4) and (c) at the close of any quar-

ter shall not lose its status as a regulated investment company because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A corporation which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

(e) Investment companies furnishing capital to development corporations.

(1) General rule.

If the Securities and Exchange Commission determines, in accordance with regulations issued by it, and certifies to the Secretary or his delegate not earlier than 60 days prior to the close of the taxable year of a registered management company, that such investment company is principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, such investment company may, in the computation of 50 percent of the value of its assets under subparagraph (A) of subsection (b) (4) for any quarter of such taxable year, include the value of any securities of an issuer, whether or not the investment company owns more than 10 percent of the outstanding voting securities of such issuer, the basis of which, when added to the basis of the investment company for securities of such issuer previously acquired, did not exceed 5 percent of the value of the total assets of the investment company at the time of the subsequent acquisition of securities. The preceding sentence shall not apply to the securities of an issuer if the investment company has continuously held any security of such issuer (or of any predecessor company of such issuer as determined under regulations prescribed by the Secretary or his delegate) for 10 or more years preceding such quarter of such taxable year.

(2) Limitation.

The provisions of this subsection shall not apply at the close of any quarter of a taxable year to an investment company if at the close of such quarter more than 25 percent of the value of its total assets is represented by securities of issuers with respect to each of which the investment company holds more than 10 percent of the outstanding votmg securities of such issuer and in respect of each of which or any predecessor thereof the investment company has continuously held any security for 10 or more years preceding such quarter unless the value of its total assets so represented is reduced to 25 percent or less within 30 days after the close of such quarter.

(3) Determination of status.

For purposes of this subsection, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the date of the first acquisition of any security in such corporation or any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and an investment company shall be considered at any date to be furnishing capital to any company whose securities it holds if within 10 years prior to such date it has acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or predecessor thereof. For purposes of the certification under this subsection, the Securities and Exchange Commission shall have authority to issue such rules, regulations and orders, and to conduct such investigations and hearings, either public or private, as it may deem appropriate.

(4) Definitions.

The terms used in this subsection shall have the same meaning as in subsections (b) (4) and (c) of this section.

(f) Certain unit investment trusts.

For purposes of this title—

(1) A unit investment trust (as defined in the Investment Company Act of 1940)—

(A) which is registered under such Act and issues periodic payment plan certificates (as defined in such Act) in one or more series,

(B) substantially all of the assets of which, as to all such series, consist of (i) securities issued by a single management company (as defined in such Act) and securities acquired pursuant to subparagraph (C), or (ii) securities issued by a single other corporation, and

(C) which has no power to invest in any other securities except securities issued by a single other management company, when permitted by such Act or the rules and regulations of the Securities and Exchange Commission,

shall not be treated as a person.

(2) In the case of a unit investment trust described in paragraph (1)—

(A) each holder of an interest in such trust shall, to the extent of such interest, be treated as owning a proportionate share of the assets of such trust;

(B) the basis of the assets of such trust which are treated under subparagraph (A) as being owned by a holder of an interest in such trust shall be the same as the basis of his interest in such trust; and

(C) in determining the period for which the holder of an interest in such trust has held the assets of the trust which are treated under subparagraph (A) as being owned by him, there

shall be included the period for which such holder has held his interest in such trust.

This subsection shall not apply in the case of a unit investment trust which is a segregated asset account under the insurance laws or regulations of a State. (Aug. 16, 1954, ch. 736, 68A Stat. 268; Sept. 3, 1958, Pub. L. 85–886, title I, § 38, 72 Stat. 1638; Dec. 30, 1969, Pub. L. 91–172, title IX, § 908(a), 83 Stat. 717.)

AMENDMENTS

1969—Subsec. (f). Pub. L. 91–172 added subsec. (f).

1958—Subsec. (e)(1). Pub. L. 85–866, § 38(a), substituted in the first sentence "not earlier than 60 days" for "not less than 60 days".

Subsec. (e)(2). Pub. L. 85–866, § 38(b), substituted "issuer" for "issues".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 908(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [adding subsec. (f) of this section] shall apply to taxable years of unit investment trusts ending after December 31, 1968, and to taxable years of holders of interests in such trusts ending with or within such taxable years of such trusts. The enactment of this section shall not be construed to result in the realization of gain or loss by any unit investment trust or by any holder of an interest in a unit investment trust."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsecs. (e) (1) and (e) (2) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 11, 401, 853, 1212, 1247 of this title.

§ 852. Taxation of regulated investment companies and their shareholders.

(a) Requirements applicable to regulated investment companies.

The provisions of this part (other than subsection (c) of this section) shall not be applicable to a regulated investment company for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equals or exceeds 90 percent of its investment company taxable income for the taxable year (determined without regard to subsection (b) (2) (D)), and

(2) the investment company complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of its outstanding stock.

(b) Method of taxation of companies and shareholders.

(1) Imposition of normal tax and surtax on regulated investment companies.

There is hereby imposed for each taxable year upon the investment company taxable income of every regulated investment company a normal tax and surtax computed as provided in section 11, as though the investment company taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such investment company for the taxable year (computed without regard to capital gains dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) Investment company taxable income.

The investment company taxable income shall be the taxable income of the regulated investment company adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The net operating loss deduction provided in section 172 shall not be allowed.

(C) The deductions for corporations provided in part VIII (except section 248) in subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(D) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends.

(E) The taxable income shall be computed without regard to section 443 (b) (relating to computation of tax on change of annual accounting period).

(3) Capital gains.

(A) Imposition of tax.

There is hereby imposed for each taxable year in the case of every regulated investment company a tax, determined as provided in section 1201(a), on the excess, if any, of the net long-term capital gain over the sum of—

(i) the net short-term capital loss, and

(ii) the deduction for dividends paid (as defined in section 561) determined with reference to capital gains dividends only.

(B) Treatment of capital gain dividends by shareholders.

A capital gain dividend shall be treated by the shareholders as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) Definition of capital gain dividend.

For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the company as a capital gain dividend in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including capital gains dividends paid after the close of the taxable year described in section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. For purpcses of subparagraph (A) (ii), the deduction for dividends paid shall, in the case of a taxable year beginning before January 1, 1975, first be made from the amount subject to tax in accordance with section 1201(a) (1) (B), to the extent thereof, and then from the

amount subject to tax in accordance with section 1201(a)(1)(A).

(D) Treatment by shareholders of undistributed capital gains.

(i) Every shareholder of a regulated investment company at the close of the company's taxable year shall include, in computing his long-term capital gains in his return for his taxable year in which the last day of the company's taxable year falls, such amount as the company shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 45 days after close of its taxable year, but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in subparagraph (A) which he would have received if all of such amount had been distributed as capital gain dividends by the company to the holders of such shares at the close of its taxable year.

(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax imposed by subparagraph (A) on the amounts required by this subparagraph to be included in respect of such shares in computing his long-term capital gains for that year; and such shareholder shall be allowed credit or refund, as the case may be, for the tax so deemed to have been paid by him.

(iii) The adjusted basis of such shares in the hands of the shareholder shall be increased, with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by 75 percent of so much of such amounts as equals the amount subject to tax in accordance with section 1201(a)(1)(A) and by 70 percent (72 percent in the case of a taxable year beginning after December 31, 1969, and before January 1, 1971) of so much of such amounts as equals the amount subject to tax in accordance with section 1201(a)(1)(B) or (2).

(iv) In the event of such designation the tax imposed by subparagraph (A) shall be paid by the regulated investment company within 30 days after close of its taxable year.

(v) The earnings and profits of such regulated investment company, and the earnings and profits of any such shareholder which is a corporation, shall be appropriately adjusted in accordance with regulations prescribed by the Secretary or his delegate.

(4) Loss on sale or exchange of stock held less than 31 days.

If—

(A) under subparagraph (B) or (D) of paragraph (3) a shareholder of a regulated investment company is required, with respect to any share, to treat any amount as a long-term capital gain, and

(B) such share is held by the taxpayer for less than 31 days,

then any loss on the sale or exchange of such share shall, to the extent of the amount described in subparagraph (A) of this paragraph, be treated as loss from the sale or exchange of a capital asset held for more than 6 months. For purposes of this paragraph, the rules of section 246 (c) (3) shall apply in determining whether any share of stock has been held for less than 31 days; except that "30 days" shall be substituted for the number of days specified in subparagraph (B) of section 246 (c) (3).

(c) Earnings and profits.

The earnings and profits of a regulated investment company for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year. For purposes of this subsection, the term "regulated investment company" includes a domestic corporation which is a regulated investment company determined without regard to the requirements of subsection (a).

(d) Distributions in redemption of interests in unit investment trusts.

In the case of a unit investment trust—

(1) which is registered under the Investment Company Act of 1940 and issues periodic payment plan certificates (as defined in such Act), and

(2) substantially all of the assets of which consist of securities issued by a management company (as defined in such Act),

section 562(c) (relating to preferential dividends) shall not apply to a distribution by such trust to a holder of an interest in such trust in redemption of part of all of such interest, with respect to the net capital gain of such trust attributable to such redemption. (Aug. 16, 1954, ch. 736, 68A Stat. 271; July 11, 1956, ch. 573, § 2(a), 70 Stat. 530; Sept. 2, 1958, Pub. L. 85-866, title I, §§ 39(a), 101(a), (b), 72 Stat. 1638, 1674; Sept. 14, 1960, Pub. L. 86-779, § 10(b)(2),(3), 74 Stat. 1009; Feb. 26, 1964, Pub. L. 88-272, title II, § 229(a) (1), (2), (b), 78 Stat. 99; Dec. 30, 1969, Pub. L. 91-172, title V, § 511(c)(2), 83 Stat. 637.)

REFERENCES IN TEXT

The Investment Company Act of 1940, referred to in subsec. (d), is classified to section 80a-1 et seq. of Title 15, Commerce and Trade.

AMENDMENTS

1969—Subsec. (b)(3)(A). Pub. L. 91-172, § 511(c)(2)(A), substituted "determined as provided in section 1201(a), on" for "of 25 percent of."

Subsec. (b)(3)(C). Pub. L. 91-172, § 511(c)(2)(B), added provision requiring for the purposes of the deduction for capital gains dividends paid the deduction shall, in the case of a taxable year beginning before Jan. 1, 1975, first be made from the amount subject to tax in accordance with section 1201(a)(1)(B), to the extent thereof, and then from the amount subject to tax in accordance with section 1201(a)(1)(A).

Subsec. (b)(3)(D). Pub. L. 91-172, § 511(c)(2)(C), (D), struck out "of 25 percent" in cl. (ii), substituted reference in cl. (iii) to the increase of the adjusted basis of shares in the hands of the shareholder, with respect to the amounts required by this subpar., by 75 percent of so much of such amounts as equals the amount subject to tax in accordance with section 1201(a)(1)(A) and by 70 percent (72 percent in the case of a taxable year beginning after Dec. 31, 1969, and before Jan. 1, 1971) of so much of such amounts as equals the amount subject to tax in accordance with section 1201(a)(1)(B) or (2), for reference to the increase of the adjusted basis of shares in

the hand of the shareholder by 75 percent of the amounts required by this subpar. to be included in computing his long-term capital gains.

1964—Subsec. (b)(3) (C), (D)(1). Pub. L. 88–272, § 229(a)(1), (2), substituted "45 days" for "30 days" in pars. (C) and (D)(1).

Subsec. (d). Pub. L. 88–272, § 229(b), added subsec. (d).

1960—Subsec. (a). Pub. L. 86–779, § 10(b)(2), substituted "this part" for "this subchapter."

Subsec. (b)(3)(C). Pub. L. 86–779, § 10(b)(3), substituted "For purposes of this part, a capital gain dividend is" for "A capital gain dividend means."

1958—Subsec. (a). Pub. L. 85–866, § 101(a), inserted "(other than subsection (c) of this section)".

Subsec. (b)(4). Pub. L. 85–866, § 39 (a), added subsec. (b)(4).

Subsec. (c). Pub. L. 85–866, § 101 (b), added sentence defining regulated investment company.

1956—Subsec. (b) (3) (D). Act July 11, 1956, added subsec. (b)(3)(D).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 511(d) of Pub. L. 91–172, set out as a note under section 1201 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Section 229(c) of Pub. L. 88–272 provided that: "The amendments made by subsection (a) [to subsec. (b) of this section, and sections 853, 854(b)(2), and 855 of this title] shall apply to taxable years of regulated investment companies ending on or after the date of the enactment of this Act [Feb. 26, 1964]. The amendment made by subsection (b) [adding subsec. (d) of this section] shall apply to taxable years of regulated investment companies ending after December 31, 1963."

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 39 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [adding subsec. (b)(4) of this section] shall apply with respect to taxable years ending after December 31, 1957, but only with respect to shares of stock acquired after December 31, 1957."

Section 101 (c) of Pub. L. 85–866 provided that: "The amendments made by this section [to subsecs. (a) and (c) of this section] shall apply with respect to taxable years of regulated investment companies beginning on or after March 1, 1958."

EFFECTIVE DATE OF 1956 AMENDMENT

Section 2 (b) of act July 11, 1956, provided that amendment adding subpar. (D) to subsec. (b) (3) should apply only with respect to taxable years of regulated investment companies beginning after Dec. 31, 1956.

CROSS REFERENCES

Doubling of tax rate on citizens and corporations of certain foreign countries, see section 891 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 51, 58, 853, 854, 891, 1562 of this title.

§ 853. Foreign tax credit allowed to shareholders.

(a) General rule.

A regulated investment company—

(1) more than 50 percent of the value (as defined in section 851 (c) (4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations, and

(2) which meets the requirements of section 852 (a) for the taxable year,

may, for such taxable year, elect the application of this section with respect to income, war profits, and excess profits taxes described in section 901 (b)(1), which are paid by the investment company during such taxable year to foreign countries and possessions of the United States.

(b) Effect of election.

If the election provided in subsection (a) is effective for a taxable year—

(1) the regulated investment company—

(A) shall not, with respect to such taxable year, be allowed a deduction under section 164 (a) or a credit under section 901 for taxes to which subsection (a) is applicable, and

(B) shall be allowed as an addition to the dividends paid deduction for such taxable year the amount of such taxes;

(2) each shareholder of such investment company shall—

(A) include in gross income and treat as paid by him his proportionate share of such taxes, and

(B) treat as gross income from sources within the respective foreign countries and possessions of the United States, for purposes of applying subpart A of part III of subchapter N, the sum of his proportionate share of such taxes and the portion of any dividend paid by such investment company which represents income derived from sources within foreign countries or possessions of the United States.

(c) Notice to shareholders.

The amounts to be treated by the shareholder, for purposes of subsection (b) (2), as his proportionate share of—

(1) taxes paid to any foreign country or possession of the United States, and

(2) gross income derived from sources within any foreign country or possession of the United States,

shall not exceed the amounts so designated by the company in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year.

(d) Manner of making election and notifying shareholders.

The election provided in subsection (a) and the notice to shareholders required by subsection (c) shall be made in such manner as the Secretary or his delegate may prescribe by regulations.

(e) Cross references.

(1) For treatment by shareholders of taxes paid to foreign countries and possessions of the United States, see section 164 (a) and section 901.

(2) For definition of foreign corporation, see section 7701 (a) (5).

(Aug. 16, 1954, ch. 736, 68A Stat. 272; Feb. 26, 1964, Pub. L. 88–272, title II, § 229(a)(3), 78 Stat. 99.)

AMENDMENTS

1964—Subsec. (c). Pub. L. 88–272 substituted "45 days" for "30 days."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years of regulated investment companies ending on or after Feb. 26, 1964, see section 229(c) of Pub. L. 88–272, set out as a note under section 852 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 855 of this title.

§ 854. Limitations applicable to dividends received from regulated investment company.

(a) Capital gain dividend.

For purposes of section 116 (relating to an exclusion for dividends received by individuals) and section 243 (relating to deductions for dividends received by corporations), a capital gain dividend (as defined in section 852(b)(3)) received from a regulated investment company shall not be considered as a dividend.

(b) Other dividends.

(1) General rule.

In the case of a dividend received from a regulated investment company (other than a dividend to which subsection (a) applies)—

(A) if such investment company meets the requirements of section 852 (a) for the taxable year during which it paid such dividend; and

(B) the aggregate dividends received by such company during such taxable year are less than 75 percent of its gross income,

then, in computing the exclusion under section 116 and the deduction under section 243, there shall be taken into account only that portion of the dividend which bears the same ratio to the amount of such dividend as the aggregate dividends received by such company during such taxable year bear to its gross income for such taxable year.

(2) Notice to shareholders.

The amount of any distribution by a regulated investment company which may be taken into account as a dividend for purposes of the exclusion under section 116 and the deduction under section 243 shall not exceed the amount so designated by the company in a written notice to its shareholders mailed not later than 45 days after the close of its taxable year.

(3) Definitions.

For purposes of this subsection—

(A) The term "gross income" does not include gain from the sale or other disposition of stock or securities.

(B) The term "aggregate dividends received" includes only dividends received from domestic corporations other than dividends described in section 116 (b) (relating to dividends excluded from gross income). In determining the amount of any dividend for purposes of this subparagraph, the rules provided in section 116 (c) (relating to certain distributions) shall apply.

(Aug. 16, 1954, ch. 736, 68A Stat. 273; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 201(d)(8)—(10), 229(a)(4), 78 Stat. 32, 99.)

AMENDMENTS

1964—Subsec. (a). Pub. L. 88–272, § 201(d)(8), deleted "section 34(a) (relating to credit for dividends received by individuals)," preceding "section 116."

Subsec. (b). Pub. L. 88–272, §§ 201(d)(9), (10), 229(a)(4), substituted "45 days" for "30 days" in par. (2), and deleted "the credit under section 34(a)," preceding "the exclusion" in par. (1), and "the credit under section 34," preceding "the exclusion" in par. (2).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsecs. (a), (b) (1), (2), by Pub. L. 88–272, applicable to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

Amendment of subsec. (b)(2) by Pub. L. 88–272 applicable to taxable years of regulated investment companies ending on or after Feb. 26, 1964, see section 229(c) of Pub. L. 88–272, set out as a note under section 852 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 116, 243 of this title.

§ 855. Dividends paid by regulated investment company after close of taxable year.

(a) General rule.

For purposes of this chapter, if a regulated investment company—

(1) declares a dividend prior to the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and

(2) distributes the amount of such dividend to shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration,

the amount so declared and distributed shall, to the extent the company elects in such return in accordance with regulations prescribed by the Secretary or his delegate, be considered as having been paid during such taxable year, except as provided in subsections (b), (c) and (d).

(b) Receipt by shareholder.

Amounts to which subsection (a) is applicable shall be treated as received by the shareholder in the taxable year in which the distribution is made.

(c) Notice to shareholders.

In the case of amounts to which subsection (a) is applicable, any notice to shareholders required under this part with respect to such amounts shall be made not later than 45 days after the close of the taxable year in which the distribution is made.

(d) Foreign tax election.

If an investment company to which section 853 is applicable for the taxable year makes a distribution as provided in subsection (a) of this section, the shareholders shall consider the amounts described in section 853 (b) (2) allocable to such distribution as paid or received, as the case may be, in the taxable year in which the distribution is made. (Aug. 16, 1954, ch. 736, 68A Stat. 274; Sept. 14, 1960, Pub. L. 86–779, § 10(b)(2), 74 Stat. 1009; Feb. 26, 1964, Pub. L. 88–272, title II, § 229(a)(5), 78 Stat. 99.)

AMENDMENTS

1964—Subsec. (c). Pub. L. 88–272 substituted "45 days" for "30 days."

1960—Subsec. (c). Pub. L. 86–779 substituted "this part" for "this subchapter."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years of regulated investment companies ending on or after Feb. 26, 1964, see section 229(c) of Pub. L. 88–272, set out as a note under section 852 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 852 of this title.

PART II.—REAL ESTATE INVESTMENT TRUSTS

Sec.
856. Definition of real estate investment trust.
857. Taxation of real estate investment trusts and their beneficiaries.
858. Dividends paid by real estate investment trust after close of taxable year.

AMENDMENTS

1960—Pub. L. 86–779, § 10(a), Sept. 14, 1960, 74 Stat. 1003, added Part II analysis.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 116 of this title.

§ 856. Definition of real estate investment trust.

(a) In general.

For purposes of this subtitle, the term "real estate investment trust" means an unincorporated trust or an unincorporated association—

(1) which is managed by one or more trustees;

(2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;

(3) which (but for the provisions of this part) would be taxable as a domestic corporation;

(4) which does not hold any property primarily for sale to customers in the ordinary course of its trade or business;

(5) the beneficial ownership of which is held by 100 or more persons;

(6) which would not be a personal holding company (as defined in section 542) if all of its adjusted ordinary gross income (as defined in section 543(b)(2)) constituted personal holding company income (as defined in section 543); and

(7) which meets the requirements of subsection (c).

(b) Determination of status.

The conditions described in paragraphs (1) to (4), inclusive, of subsection (a) must be met during the entire taxable year, and the condition described in paragraph (5) must exist during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months.

(c) Limitations.

A trust or association shall not be considered a real estate investment trust for any taxable year unless—

(1) it files with its return for the taxable year an election to be a real estate investment trust or has made such election for a previous taxable year which began after December 31, 1960;

(2) at least 90 percent of its gross income is derived from—

(A) dividends;

(B) interest;

(C) rents from real property;

(D) gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property); and

(E) abatements and refunds of taxes on real property;

(3) at least 75 percent of its gross income is derived from—

(A) rents from real property;

(B) interest on obligations secured by mortgages on real property or on interests in real property;

(C) gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property);

(D) dividends or other distributions on, and gain from the sale or other disposition of, transferable shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part; and

(E) abatements and refunds of taxes on real property;

(4) less than 30 percent of its gross income is derived from the sale or other disposition of—

(A) stock or securities held for less than 6 months; and

(B) real property (including interests in real property) not compulsorily or involuntarily converted within the meaning of section 1033, held for less than 4 years; and

(5) at the close of each quarter of the taxable year—

(A) at least 75 percent of the value of its total assets is represented by real estate assets, cash and cash items (including receivables), and Government securities; and

(B) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)) for purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the trust and to not more than 10 percent of the outstanding voting securities of such issuer.

A real estate investment trust which meets the requirements of this paragraph at the close of any quarter shall not lose its status as a real estate investment trust because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A real estate investment trust which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a real estate investment trust if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

(6) For purposes of this part—

(A) The term "value" means, with respect to securities for which market quotations are readily available, the market value of such securities;

and with respect to other securities and assets, fair value as determined in good faith by the trustees, except that in the case of securities of real estate investment trusts such fair value shall not exceed market value or asset value, whichever is higher.

(B) The term "real estate assets" means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part.

(C) The term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon and leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

(D) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

(d) Rents from real property defined.

For purposes of paragraphs (2) and (3) of subsection (c), the term "rents from real property" includes rents from interests in real property but does not include—

(1) any amount received or accrued, directly or indirectly, with respect to any real property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales);

(2) any amount received or accrued directly or indirectly from any person if the real estate investment trust owns, directly or indirectly—

(A) in the case of any person which is a corporation, stock of such person possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total number of shares of all classes of stock of such person; or

(B) in the case of any person which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person; and

(3) any amount received or accrued, directly or indirectly, with respect to any real property, if the real estate investment trust furnishes or renders services to the tenants of such property, or manages or operates such property, other than through an independent contractor from whom the trust itself does not derive or receive any income. For purposes of this paragraph, the term "independent contractor" means—

(A) a person who does not own, directly or indirectly, more than 35 percent of the shares, or certificates of beneficial interest, in the real estate investment trust, or

(B) a person, if a corporation, not more than 35 percent of the total combined voting power of whose stock (or 35 percent of the total shares of all classes of whose stock), or, if not a corporation, not more than 35 percent of the interest in whose assets or net profits is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the trust.

For purposes of paragraphs (2) and (3), the rules prescribed by section 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person; except that "10 percent" shall be substituted for "50 percent" in subparagraph (C) of sections 318(a)(2) and 318(a)(3). (Added Pub. L. 86–779, § 10(a), Sept. 14, 1960, 74 Stat. 1004, and amended Pub. L. 88–272, title II, § 225(k)(4), Feb. 26, 1964, 78 Stat. 94; Pub. L. 88–554, § 4(b)(4), Aug. 31, 1964, 78 Stat. 763.)

REFERENCES IN TEXT

The Investment Company Act of 1940, as amended, referred to in subsec. (c)(6)(D), is classified to section 80a–1 et seq. of Title 15, Commerce and Trade.

AMENDMENTS

1964—Subsec. (a)(6). Pub. L. 88–272 substituted "adjusted ordinary gross income (as defined in section 543(b)(2))" for "gross income."

Subsec. (d). Pub. L. 88–554 inserted the reference to subparagraph (C) of section 318(a)(3) of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Amendment of section by section 4 of Pub. L. 88–554 effective Aug. 31, 1964, except that for purposes of sections 302 and 304 of this title, such amendments shall not apply to distributions in payment for stock acquisitions or redemptions, if such acquisitions or redemptions occurred before Aug. 31, 1964, see section 4(c) of Pub. L. 88–554 set out as a note under section 318 of this title.

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272 set out as a note under section 316 of this title.

EFFECTIVE DATE

Section 10(k) of Pub. L. 86–779 provided that: "The amendments made by this section [adding sections 856–858 and amending sections 11(d)(3), 34(c), 116(b), 243(c), 318(b), 443(d), 852 (a), (b)(3)(c), 855(c) and 1504(b)(6) of this title] shall apply with respect to taxable years of real estate investment trusts beginning after December 31, 1960."

CROSS REFERENCES

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1212 of this title.

§ 857. Taxation of real estate investment trusts and their beneficiaries.

(a) Requirements applicable to real estate investment trusts.

The provisions of this part (other than subsection (d) of this section) shall not apply to a real estate investment trust for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equals or exceeds 90 percent of its real estate investment trust taxable income for the taxable year (determined without regard to subsection (b)(2)(C)), and

(2) the real estate investment trust complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust.

(b) Method of taxation of real estate investment trusts and holders of shares or certificates of beneficial interest.

(1) Imposition of normal tax and surtax on real estate investment trusts.

There is hereby imposed for each taxable year on the real estate investment trust taxable income of every real estate investment trust a normal tax and surtax computed as provided in section 11, as though the real estate investment trust taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such real estate investment trust for the taxable year (computed without regard to capital gains dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) Real estate investment trust taxable income.

For purposes of this part, the term "real estate investment trust taxable income" means the taxable income of the real estate investment trust, adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(C) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends.

(D) The taxable income shall be computed without regard to section 443(b) (relating to computation of tax on change of annual accounting period).

(E) The net operating loss deduction provided in section 172 shall not be allowed.

(3) Capital gains.

(A) Imposition of tax.

There is hereby imposed for each taxable year in the case of every real estate investment trust a tax, determined as provided in section 1201(a), on the excess, if any, of the net long-term capital gain over the sum of—

(i) the net short-term capital loss; and

(ii) the deduction for dividends paid (as defined in section 561) determined with reference to capital gains dividends only.

(B) Treatment of capital gain dividends by shareholders.

A capital gain dividend shall be treated by the shareholders or holders of beneficial interests as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) Definition of capital gain dividend.

For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders or holders of beneficial interests at any time before the expiration of 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the trust (including capital gain dividends paid after the close of the taxable year described in section 858) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. For purposes of subparagraph (A)(ii), in the case of a taxable year beginning before January 1, 1975, the deduction for dividends paid shall first be made from the amount subject to tax in accordance with section 1201(a)(1)(B), to the extent thereof, and then from the amount subject to tax in accordance with section 1201(a)(1)(A).

(4) Loss on sale or exchange of stock held less than 31 days.

If—

(A) under subparagraph (B) of paragraph (3) a shareholder of, or a holder of a beneficial interest in, a real estate investment trust is required, with respect to any share or beneficial interest, to treat any amount as a long-term capital gain, and

(B) such share or interest is held by the taxpayer for less than 31 days,

then any loss on the sale or exchange of such share or interest shall, to the extent of the amount described in subparagraph (A) of this paragraph, be treated as loss from the sale or exchange of a capital asset held for more than 6 months. For purposes of this paragraph, the rules of section 246(c)(3) shall apply in determining whether any share of stock or beneficial interest has been held for less than 31 days; except that "30 days" shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

(c) Restrictions applicable to dividends received from real estate investment trusts.

For purposes of section 116 (relating to an exclusion for dividends received by individuals) and section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

(d) Earnings and profits.

The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year. For purposes of this subsection, the term "real estate investment trust" includes a domestic unincorporated trust or association which is a real estate investment trust determined without regard to the requirements of subsection (a). (Added Pub. L. 86-779, § 10(a), Sept. 14, 1960, 74 Stat. 1006, and

amended Pub. L. 88–272, title II, § 201(d)(11), Feb. 26, 1964, 78 Stat. 32, Pub. L. 91–172, title V, § 511(c)(3), Dec. 30, 1969, 83 Stat. 637.)

AMENDMENTS

1969—Subsec. (b)(3)(A). Pub. L. 91–172, § 511 (c)(3)(A), substituted "determined as provided in section 1201(a), on" for "of 25 percent of."

Subsec. (b)(3)(C). Pub. L. 91–172, § 511(c)(3)(B), added provision requiring for the purposes of the deduction for capital gains dividends paid, in the case of a taxable year beginning before Jan. 1, 1975, the deduction for dividends paid shall first be made from the amount subject to tax in accordance with section 1201(a)(1)(B), to the extent thereof, and then from the amount subject to tax in accordance with section 1201(a)(1)(A).

1964—Subsec. (c). Pub. L. 88–272 deleted "section 34(a) (relating to credit for dividends received by individuals)," preceding "section 116."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 511(d) of Pub. L. 91–172, set out as a note under section 1201 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 58, 1562 of this title.

§ 858. Dividends paid by real estate investment trust after close of taxable year.

(a) General rule.

For purposes of this part, if a real estate investment trust—

(1) declares a dividend before the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and

(2) distributes the amount of such dividend to shareholders or holders of beneficial interests in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration,

the amount so declared and distributed shall, to the extent the trust elects in such return in accordance with regulations prescribed by the Secretary or his delegate, be considered as having been paid during such taxable year, except as provided in subsections (b) and (c).

(b) Receipt by shareholder.

Amounts to which subsection (a) applies shall be treated as received by the shareholder or holder of a beneficial interest in the taxable year in which the distribution is made.

(c) Notice to shareholders.

In the case of amounts to which subsection (a) applies, any notice to shareholders or holders of beneficial interests required under this part with respect to such amounts shall be made not later than 30 days after the close of the taxable year in which the distribution is made. (Added Pub. L. 86–779, § 10(a), Sept. 14, 1960, 74 Stat. 1008.)

EFFECTIVE DATE

Section applicable with respect to taxable years of real estate investment trusts beginning after Dec. 31, 1960, see section 10(k) of Pub. L. 86–779, set out as a note under section 856 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 857 of this title.

Subchapter N.—Tax Based on Income From Sources Within or Without the United States

Part

I. Determination of sources of income.
II. Nonresident aliens and foreign corporations.
III. Income from sources without the United States.

SUBCHAPTER REFERRED TO IN OTHER SECTIONS

This subchapter is referred to in section 555 of this title.

PART I.—DETERMINATION OF SOURCES OF INCOME

Sec.

861. Income from sources within the United States.
862. Income from sources without the United States.
863. Items not specified in section 861 or 862.
864. Definitions.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 306 of this title.

§ 861. Income from sources within the United States.

(a) Gross income from sources within United States.

The following items of gross income shall be treated as income from sources within the United States:

(1) Interest.

Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—

(A) interest on amounts described in subsection (c) received by a nonresident alien individual or a foreign corporation, if such interest is not effectively connected with the conduct of a trade or business within the United States,

(B) interest received from a resident alien individual or a domestic corporation, when it is shown to the satisfaction of the Secretary or his delegate that less than 20 percent of the gross income from all sources of such individual or such corporation has been derived from sources within the United States, as determined under the provisions of this part, for the 3-year period ending with the close of the taxable year of such individual or such corporation preceding the payment of such interest, or for such part of such period as may be applicable,

(C) interest received from a foreign corporation (other than interest paid or credited by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business), when it is shown to the satisfaction of the Secretary or his delegate that less than 50 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable

year preceding the payment of such interest (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States,

(D) in the case of interest received from a foreign corporation (other than interest paid or credited by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business), 50 percent or more of the gross income of which from all sources for the 3-year period ending with the close of its taxable year preceding the payment of such interest (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States, an amount of such interest which bears the same ratio to such interest as the gross income of such foreign corporation for such period which was not effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources,

(E) income derived by a foreign central bank of issue from bankers' acceptances, and

(F) interest on deposits with a foreign branch of a domestic corporation or a domestic partnership, if such branch is engaged in the commercial banking business.

(2) Dividends.

The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 931, and other than a corporation less than 20 percent of whose gross income is shown to the satisfaction of the Secretary or his delegate to have been derived from sources within the United States, as determined under the provisions of this part, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

(B) from a foreign corporation unless less than 50 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period which was effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources; but dividends (other than dividends for which a deduction is allowable under section 245(b)) from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent (and only to the extent) exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends, or

(C) from a foreign corporation to the extent that such amount is required by section 243(d) (relating to certain dividends from foreign corporations) to be treated as dividends from a domestic corporation which is subject to taxation under this chapter, and to such extent subparagraph (B) shall not apply to such amount.

(3) Personal services.

Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if—

(A) the labor or services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

(B) such compensation does not exceed $3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under a contract with—

(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporaton.

(4) Rentals and royalties.

Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property.

(5) Sale of real property.

Gains, profits, and income from the sale of real property located in the United States.

(6) Sale of personal property.

Gains, profits, and income derived from the purchase of personal property without the United States (other than within a possession of the United States) and its sale within the United States.

(b) Taxable income from sources within United States.

From the items of gross income specified in subsection (a) as being income from sources within the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

(c) Interest on deposits, etc.

For purposes of subsection (a)(1)(A), the amounts described in this subsection are—

(1) deposits with persons carrying on the banking business,

(2) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deductible under section 591 (determined without regard to section 265) in computing the taxable income of such institutions, and

(3) amounts held by an insurance company under an agreement to pay interest thereon. Effective with respect to amounts paid or credited after December 31, 1975, subsection (a)(1)(A) and this subsection shall cease to apply.

(d) Special rules for application of paragraphs (1)(B), (1)(C), (1)(D), and (2)(B) of subsection (a).

(1) New entities.

For purposes of paragraphs (1)(B), (1)(C), (1)(D), and (2)(B) of subsection (a), if the resident alien individual, domestic corporation, or foreign corporation, as the case may be, has no gross income from any source for the 3-year period (or part thereof) specified, the 20 percent test or the 50 percent test, as the case may be, shall be applied with respect to the taxable year of the payor in which payment of the interest or dividends, as the case may be, is made.

(2) Transition rule.

For purposes of paragraphs (1)(C), (1)(D), and (2)(B) of subsection (a), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States.

(Aug. 16, 1954, ch. 736, 68A Stat. 275; Sept. 14, 1960, Pub. L. 86-779, § 3(b), 74 Stat. 998; Oct. 16, 1962, Pub. L. 87-834, § 9(c), 76 Stat. 1001; Nov. 13, 1966, Pub. L. 89-809, title I, § 102(a)(1)—(3), (b), (c), 80 Stat. 1541—1543; Dec. 30, 1969, Pub. L. 91-172, title IV, § 435(a), 83 Stat. 625.)

AMENDMENTS

1969—Subsec. (a)(1). Pub. L. 91-172, § 435(a)(1), struck out "after December 31, 1972," following "interest paid or credited" in parenthetical material following "interest received from a foreign corporation" in subpars. (C) and (D).

Subsec. (c)(3). Pub. L. 91-172, § 435(a)(2), substituted "1975" for "1972".

1966—Subsec. (a)(1)(A). Pub. L. 89-809, § 102(a)(1)(A), substituted "interest on amounts described in subsection (c) received by a nonresident alien individual or a foreign corporation, if such interest is not effectively connected with the conduct of a trade or business within the United States" for "interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States."

Subsec. (a)(1)(B). Pub. L. 89-809, § 102(a)(2), eliminated interest received from a resident foreign corporation, and substituted "gross income from all sources of such individual or such corporation" for "gross income of such resident payor or domestic corporation", and "taxable year of such individual or such corporation" for "taxable year of such payor."

Subsec. (a)(1)(C). Pub. L. 89-809, § 102(a)(2), added subsec. (a)(1)(C), and redesignated former subsec. (a)(1)(C) as (a)(1)(E).

Subsec. (a)(1)(D). Pub. L. 89-809, § 102(a)(2), added subsec. (a)(1)(D).

Subsec. (a)(1)(E). Pub. L. 89-809, § 102(a)(2), redesignated former subsec. (a)(1)(C) as (a)(1)(E).

Subsec. (a)(1)(F). Pub. L. 89-809, § 102(a)(2), added subsec. (a)(1)(F).

Subsec. (a)(2)(B). Pub. L. 89-809, § 102(b), substituted "50 percent of the gross income from all sources" for "50 percent of the gross income", "effectively connected with the conduct of a trade or business within the United States" for "derived from sources within the United States as determined from the provisions of this part", and "ratio to such dividends as the gross income of the corporation for such period which was effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources" for "ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States bears to its gross income from all sources" and inserted "(other than dividends for which a deduction is allowable under section 245(b))" after "dividends" and "(and only to the extent)" after "extent".

Subsec. (a)(3)(C)(ii). Pub. L. 89-809, § 102(c), inserted "an individual who is a citizen or resident of the United States, a domestic partnership, or" before "a domestic corporation" and "individual, partnership, or" after "United States by such".

Subsec. (c). Pub. L. 89-809, § 102(a)(1)(B), added subsec. (c).

Subsec. (d). Pub. L. 89-809, § 102(a)(3), added subsec. (d).

1962—Subsec. (a)(2)(B). Pub. L. 87-834 substituted "to the extent exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends" for "to the extent exceeding the amount of the deduction allowable under section 245 in respect of such dividends."

1960—Subsec. (a)(2)(C). Pub. L. 86-779 added subpar. (C).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 435(a)(1) of Pub. L. 91-172 provided in part that the amendments to subsec. (a)(1)(C), (D), by section 435(a)(1) of Pub. L. 91-172, were effective with respect to amounts paid or credited after Dec. 31, 1969.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 102(e) of Pub. L. 89-809 provided that:

"(1) The amendments made by subsections (a), (c), and (d) [amending subsec. (a)(1)(A), (a)(1)(B) and (a)(3)(C)(ii) of this section and 895 of this title, redesignating subsec. (a)(1) (C) and (F) and subsecs. (c) and (d) of this section and section 864 (b) and (c) of this title] shall apply with respect to taxable years beginning after December 31, 1966; except that in applying section 864(c)(4)(B)(iii) of the Internal Revenue Code of 1954 [section 864(c)(4)(B)(ii) of this title] (as added by subsection (d)) with respect to a binding contract entered into on or before February 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account.

"(2) The amendments made by subsection (b) [amending subsec. (a)(2)(B) of this section] shall apply with respect to amounts received after December 31, 1966."

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (a)(2)(B) of this section by Pub. L. 87-834 applicable in respect of any distribution received by a domestic corporation after Dec. 31, 1964, and in respect of any distribution received by a domestic corporation before Jan. 1, 1965, in a taxable year of such corporation beginning after Dec. 31, 1962, but only to the extent that such distribution is made out of the accumulated profits of a foreign corporation for a taxable year (of such foreign corporation) beginning after Dec. 31, 1962, see section 9(e) of Pub. L. 87-834, set out as a note under section 902 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–779 applicable to dividends received after Dec. 31, 1959, in taxable years ending after such date, see section 3(c) of Pub. L. 86–779, set out as a note under section 243 of this title.

SHORT TITLE

Section 101 of Pub. L. 89–809 provided that: "This title [adding sections 877, 896, 906, 981, 2107, 2108, and 6683 of this title, amending this section and sections 1, 11, 116, 154, 245, 301, 512, 542, 543, 545, 819, 821, 822, 831, 832, 841, 842, 864, 871, 872, 873, 874, 875, 881, 882, 884, 894, 895, 901, 904, 911, 931, 932, 952, 953, 1248, 1249, 1441, 1442, 1461, 2014, 2101, 2102, 2104, 2105, 2106, 2501, 2511, 3401, 6015, 6016, 6018, 6501, 6513, and 7701 of this title, redesignating former section 877 as 878 repealing section 1493, and enacting provisions set out as notes under this section and sections 11, 871, 874, 894, 901, 904, 931, 2101, 2501, and 6501 of this title] may be cited as the 'Foreign Investors Tax Act of 1966'."

CONFORMITY OF AMENDMENTS MADE BY FOREIGN INVESTORS TAX ACT OF 1966 WITH TREATY OBLIGATIONS OF THE UNITED STATES.

Section 110 of Pub. L. 89–809 provided that: "No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States. For purposes of the preceding sentence, the extension of a benefit provided by any amendment made by this title shall not be deemed to be contrary to a treaty obligation of the United States." See Short Title note under this section for list of sections affected by Title I of Pub. L. 89–809.

CROSS REFERENCES

Income from sources without the United States—
Generally, see section 901 et seq. of this title.
Determination of source, see section 862 of this title.
Items not specified in section 861 or 862, see section 863 of this title.
Personal holding companies defined, exception if a foreign corporation with gross income from sources within United States, see section 542 (c) (7) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 638, 862, 863, 864, 2104, 2105, 4948 of this title.

§ 862. Income from sources without the United States.

(a) Gross income from sources without United States.

The following items of gross income shall be treated as income from sources without the United States:

(1) interest other than that derived from sources within the United States as provided in section 861 (a) (1);

(2) dividends other than those derived from sources within the United States as provided in section 861 (a) (2);

(3) compensation for labor or personal services performed without the United States;

(4) rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties;

(5) gains, profits, and income from the sale of real property located without the United States; and

(6) gains, profits, and income derived from the purchase of personal property within the United States and its sale without the United States.

(b) Taxable income from sources without United States.

From the items of gross income specified in subsection (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as taxable income from sources without the United States. (Aug. 16, 1954, ch. 736, 68A Stat. 276.)

CROSS REFERENCES

Income from sources within the United States, see section 861 of this title.
Income from sources without the United States, see section 901 et seq. of this title.
Items not specified in section 861 or 862, see section 863 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 638, 863, 864 of this title.

§ 863. Items not specified in section 861 or 862.

(a) Allocation under regulations.

Items of gross income, expenses, losses, and deductions, other than those specified in sections 861 (a) and 862 (a), shall be allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary or his delegate. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the taxable income therefrom) the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

(b) Income partly from within and partly from without the United States.

In the case of gross income derived from sources partly within and partly without the United States, the taxable income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income; and the portion of such taxable income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Secretary or his delegate. Gains, profits, and income—

(1) from transportation or other services rendered partly within and partly without the United States,

(2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, or

(3) derived from the purchase of personal property within a possession of the United States and its sale within the United States,

shall be treated as derived partly from sources within and partly from sources without the United States. (Aug. 16, 1954, ch. 736, 68A Stat. 277.)

§ 864. Definitions.

(a) Sale, etc.

For purposes of this part, the word "sale" includes "exchange"; the word "sold" includes "exchanged"; and the word "produced" includes "created", "fabricated", "manufactured", "extracted", "processed", "cured", or "aged".

(b) Trade or business within the United States.

For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include—

(1) Performance of personal services for foreign employer.

The performance of personal services—

(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

(2) Trading in securities or commodities.

(A) Stocks and securities.

(i) In general.

Trading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent.

(ii) Trading for taxpayer's own account.

Trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities, or in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) or 543(b)(1)(C) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

(B) Commodities.

(i) In general.

Trading in commodities through a resident broker, commission agent, custodian, or other independent agent.

(ii) Trading for taxpayer's own account.

Trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in commodities.

(iii) Limitation.

Clauses (i) and (ii) shall apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

(C) Limitation.

Subparagraphs (A)(i) and (B)(i) shall apply only if, at no time during the taxable year, the taxpayer has an office or other fixed place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

(c) Effectively connected income, etc.

(1) General rule.

For purposes of this title—

(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), and (4) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Except as provided in section 871(d) or sections 882 (d) and (e), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

(2) Periodical, etc., income from sources within United States—factors.

In determining whether income from sources within the United States of the types described in section 871(a)(1) or section 881(a), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or

business. In applying this paragraph and paragraph (4), interest referred to in section 861 (a)(1)(A) shall be considered income from sources within the United States.

(3) Other income from sources within United States.

All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

(4) Income from sources without United States.

(A) Except as provided in subparagraphs (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale of such property) derived in the active conduct of such trade or business;

(ii) consists of dividends or interest, or gain or loss from the sale or exchange of stock or notes, bonds, or other evidences of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stocks or securities for its own account; or

(iii) is derived from the sale (without the United States) through such office or other fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale.

(C) In the case of a foreign corporation taxable under part I of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

(D) No income from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

(ii) is subpart F income within the meaning of section 952(a).

(5) Rules for application of paragraph (4)(B).

For purposes of subparagraph (B) of paragraph (4)—

(A) in determining whether a nonresident alien individual or a foreign corporation has an office or other fixed place of business, an office or other fixed place of business of an agent shall be disregarded unless such agent (i) has the authority to negotiate and conclude contracts in the name of the nonresident alien individual or foreign corporation and regularly exercises that authority or has a stock of merchandise from which he regularly fills orders on behalf of such individual or foreign corporation, and (ii) is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business,

(B) income, gain, or loss shall not be considered as attributable to an office or other fixed place of business within the United States unless such office or fixed place of business is a material factor in the production of such income, gain, or loss and such office or fixed place of business regularly carries on activities of the type from which such income, gain, or loss is derived, and

(C) the income, gain, or loss which shall be attributable to an office or other fixed place of business within the United States shall be the income, gain, or loss property allocable thereto, but, in the case of a sale described in clause (iii) of such paragraph, the income which shall be treated as attributable to an office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale were made in the United States.

(Aug. 16, 1954, ch. 736, 68A Stat. 278; Nov. 13, 1966, Pub. L. 89-809, title I, § 102(d), 80 Stat. 1544.)

AMENDMENTS

1966—Pub. L. 89-809 designated existing provisions as subsec. (a) and added subsecs. (b) and (c).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89-809 applicable with respect to taxable years beginning after Dec. 31, 1966, except that in applying section 864(c)(4)(B)(iii) of this title with respect to a binding contract entered into on or before Feb. 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account, see section 102(e)(1) of Pub. L. 89-809, set out as a note under section 861 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 871 of this title.

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart
A. Nonresident alien individuals.
B. Foreign corporations.
C. Miscellaneous provisions.

SUBPART A.—NONRESIDENT ALIEN INDIVIDUALS

Sec.
871. Tax on nonresident alien individuals.
872. Gross income.
873. Deductions.
874. Allowance of deductions and credits.
875. Partnerships; beneficiaries of estates and trusts.
876. Alien residents of Puerto Rico.
877. Expatriation to avoid tax.
878. Foreign educational, charitable, and certain other exempt organizations.

AMENDMENTS

1966—Pub. L. 89-809, title I, § 103(e)(2), (f)(2), Nov. 13, 1966, 80 Stat. 1551, 1552, inserted "; beneficiaries of estates and trusts" in item 875, added item 877, and redesignated former item 877 as 878.

§ 871. Tax on nonresident alien individuals.

(a) Income not connected with United States business—30 percent tax.

(1) Income other than capital gains.

There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as—

(A) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

(B) gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235 made on or before October 4, 1966,

(C) in the case of bonds or other evidences of indebtedness issued after September 28, 1965, amounts which under section 1232 are considered as gains from the sale or exchange of property which is not a capital asset, and

(D) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under subsection (e),

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

(2) Capital gains of aliens present in the United States 183 days or more.

In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

(b) Income connected with United States business—graduated rate of tax.

(1) Imposition of tax.

A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 1 or 1201(b) on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

(2) Determination of taxable income.

In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

(c) Participants in certain exchange or training programs.

For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15)(F) or (J)), shall be treated as a nonresident alien individual engaged in trade or business within the United States, and any income described in section 1441(b) (1) or (2) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States.

(d) Election to treat real property income as income connected with United States business.

(1) In general.

A nonresident alien individual who during the taxable year derives any income—

(A) from real property held for the production of income and located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of such real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

(B) which, but for this subsection, would not be treated as income which is effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (b)(1) whether or not such individual is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

(2) Election after revocation.

If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year before the 5th taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary or his delegate consents to such new election.

(3) Form and time of election and revocation.

An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary or his delegate may by regulations prescribe.

(e) Gains from sale or exchange of certain intangible property.

For purposes of subsection (a)(1)(D), and for purposes of sections 881(a)(4), 1441(b), and 1442(a)—

(1) Payments treated as contingent on use, etc.

If more than 50 percent of the gain for any taxable year from the sale or exchange of any patent, copyright, secret process or formula, good will, trademark, trade brand, franchise, or other like property, or of any interest in any such property, is from payments which are contingent on the productivity, use, or disposition of such property or interest, all of the gain for the taxable year from the sale or exchange of such property or interest shall be treated as being from payments which are contingent on the productivity, use, or disposition of such property or interest.

(2) Source rule.

In determining whether gains described in subsection (a)(1)(D) and section 881(a)(4) are received from sources within the United States, such gains shall be treated as rentals or royalties for the use of, or privilege of using, property or an interest in property.

(f) Certain annuities received under qualified plans.

For purposes of this section, gross income does not include any amount received as an annuity under a qualified annuity plan described in section 403(a)(1), or from a qualified trust described in section 401(a) which is exempt from tax under section 501(a), if—

(1) all of the personal services by reason of which such annuity is payable were either (A) personal services performed outside the United States by an individual who, at the time of performance of such personal services, was a nonresident alien, or (B) personal services described in section 864(b)(1) performed within the United States by such individual, and

(2) at the time the first amount is paid as such annuity under such annuity plan, or by such trust, 90 percent or more of the employees for whom contributions or benefits are provided under such annuity plan, or under the plan or plans of which such trust is a part, are citizens or residents of the United States.

(g) Cross references.

(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4).

(2) For taxation of nonresident alien individuals who are expatriated United States citizens, see section 877.

(3) For doubling of tax on citizens of certain foreign countries, see section 891.

(4) For adjustment of tax in case of nationals or residents of certain foreign countries, see section 896.

(5) For withholding of tax at source on nonresident alien individuals, see section 1441.

(6) For the requirement of making a declaration of estimated tax by certain nonresident alien individuals, see section 6015(i).

(Aug. 16, 1954, ch. 736, 68A Stat. 278; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 40 (a), 41 (a), 72 Stat. 1638, 1639; Apr. 22, 1960, Pub. L. 86–437, § 2(b), 74 Stat. 79; Sept. 21, 1961, Pub. L. 87–256, § 110(b), 75 Stat. 535; Feb. 26, 1964, Pub. L. 88–272, title I, § 113(b), title II, § 201(d)(12), 78 Stat. 24, 32; Nov. 18, 1966, Pub. L. 89–809, title I, § 103(a)(1), 80 Stat. 1547.)

REFERENCES IN TEXT

Section 101(a)(15) of the Immigration and Nationality Act, as amended, referred to in subsec. (c), is classified to section 1101(a)(15) of Title 8, Aliens and Nationality.

AMENDMENTS

1966—Subsecs. (a), (b). Pub. L. 89–809 consolidated the substance of former subsecs. (a)—(c) and, as part of the consolidation, revised the overall income tax treatment of nonresident alien individuals by substituting provisions dividing their income for tax purposes into two basic groups according to whether or not the income is effectively connected with a United States trade or business for provisions calling for different tax treatment based upon whether or not they are, or are not, engaged in a trade or business in the United States, with a further breakdown of those not engaged in trade or business in the United States as to whether their income is over or under $21,200.

Subsec. (c). Pub. L. 89–809 redesignated former subsec. (d) as subsec. (c) and, in subsec. (c) as so redesignated, added provisions that any income described in section 1441(b) (1) or (2) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States. Substance of former subsec. (c) revised and incorporated into subsecs. (a) and (b).

Subsec. (d). Pub. L. 89–809 added subsec. (d). Former subsec. (d) redesignated as subsec. (c) and amended.

Subsec. (e). Pub. L. 89–809 added subsec. (e). Former subsec. (e) redesignated as subsec. (g) and amended.

Subsec. (f). Pub. L. 89–809 added subsec. (f).

Subsec. (g). Pub. L. 89–809 redesignated former subsec. (e) as subsec. (g) and, in subsec. (g) as so redesignated, added pars. (2) and (4)—(6) while redesignating former pars. (1) and (2) as (3) and (1) respectively.

1964—Subsec. (a). Pub. L. 88–272, § 113(b)(2), substituted "30 percent tax" for "and gross income of not more than $15,400" in the subsection catchline.

Subsec. (b). Pub. L. 88–272, §§ 113(b)(1), (3), 201(d)(12), substituted "$19,000 in the case of a taxable year beginning in 1964 or more than $21,200 in the case of a taxable year beginning after 1964" for "$15,400", "the credit under section 35" for "the sum of the credits under sec-

tions 34 and 35" in the text, and "Regular tax" for "and gross income of more than $15,400" in the subsection catchline.

1961—Subsec. (d). Pub. L. 87–256 added subsec. (d) and redesignated former subsec. (d) as (e).

Subsec. (e). Pub. L. 87–256 redesignated former subsec. (d) as (e).

1960—Subsec. (d). Pub. L. 86–437 substituted "Cross references" for "Doubling of tax" in subsection catchline, and added the cross reference to section 402(a)(4).

1958—Subsec. (a) (1). Pub. L. 85–866, § 40 (a), inserted "section 403 (a) (2)," after "section 402 (a) (2),".

Subsec. (b) Pub. L. 85–866, § 41 (a), added last par. covering former provisions of par. (3), which was deleted by the amendment, and containing new provisions with references to credits under section 34 and 35 and exclusion under section 116 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 103(n) of Pub. L. 89–809 provided that:

"(1) The amendments made by this section (other than the amendments made by subsections (h), (i), and (k)) [amending this section and sections 1, 116, 154, 872, 873, 874, 875, 932, 6015, and 7701 of this title, redesignating section 877 as 873 and adding section 877 of this title and repealing section 1493 of this title] shall apply with respect to taxable years beginning after December 31, 1966.

"(2) The amendments made by subsection (h) [amending section 1441 of this title] shall apply with respect to payments made in taxable years of recipients beginning after December 31, 1966.

"(3) The amendments made by subsection (i) [amending section 1461 of this title] shall apply with respect to payments occurring after December 31, 1966.

"(4) The amendments made by subsection (k) [amending section 3401 of this title] shall apply with respect to remuneration paid after December 31, 1966."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (b) by section 113(b)(1) of Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

Amendment of subsec. (b) by section 201(d)(12) of Pub. L. 88–272, which substituted "the credit under section 35" for the "sum of the credits under sections 34 and 35," applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

EFFECTIVE DATE OF 1961 AMENDMENT

Amendment of section by Pub. L. 87–256 applicable to taxable years beginning after Dec. 31, 1961, see section 110(h)(1) of Pub. L. 87–256, set out as a note under section 117 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of subsec. (d) of this section by Pub. L. 86–437 applicable only with respect to taxable years beginning after Dec. 31, 1959, see section 3 of Pub. L. 86–437, set out as a note under section 402 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 40 (c) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (a) (1) of this section] shall apply only with respect to taxable years ending after the date of the enactment of this Act [Sept. 2, 1958]. The amendments made by subsection (b) [to section 1441 (b), (c) (5) of this title] shall take effect on the day following the date of the enactment of this Act [Sept. 2, 1958]."

Section 41 (c) of Pub. L. 85–866 provided that: "The amendments made by this section [to subsec. (b) of this section and section 35 (c), (d) of this title] shall apply only with respect to taxable years beginning after December 31, 1957."

CROSS REFERENCES

Consent dividends, nonresident aliens and foreign corporations, see section 565 (e) of this title.

Dispositions of certain stock, source of gain, see section 306 (f) of this title.

Income tax returns, persons required to make returns of income, see section 6012 of this title.

Judicial proceedings, production of records in case of foreign corporations, foreign trusts or estates and nonresident alien individuals, see section 7456 (b) of this title.

Partial exclusion of dividends received by individuals, certain nonresident aliens ineligible for exclusion, see section 116 (d) of this title.

Retirement income, nonresident alien ineligible for credit, see section 37 (h) of this title.

Standard deduction for individuals, nonresident alien as ineligible, see section 142 (b) (1) of this title.

Time for filing income tax returns, nonresident aliens and foreign corporations, see section 6072 (c) of this title.

Withholding tax on—

Foreign corporations, see section 1442 of this title.

Nonresident aliens, see section 1441 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 2, 5, 35, 51, 116, 306, 864, 873, 877, 881, 882, 891, 906, 1441, 1442, 6012 of this title.

§ 872. Gross income.

(a) General rule.

In the case of a nonresident alien individual, gross income includes only—

(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

(b) Exclusions.

The following items shall not be included in gross income of a nonresident alien individual, and shall be exempt from taxation under this subtitle:

(1) Ships under foreign flag.

Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) Aircraft of foreign registry.

Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(3) Compensation of participants in certain exchange or training programs.

Compensation paid by a foreign employer to a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended. For purposes of this paragraph, the term "foreign employer" means—

(A) a nonresident alien individual, foreign partnership, or foreign corporation, or

(B) an office or place of business maintained in a foreign country or in a possession of the United States by a domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States.

(4) Certain bond income of residents of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

Income derived by a nonresident alien individual from a series E or series H United States savings bond, if such individual acquired such

bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

(Aug. 16, 1954, ch. 736, 68A Stat. 280; Sept. 21, 1961, Pub. L. 87–256, § 110(c), 75 Stat. 536; Nov. 13, 1966, Pub. L. 89–809, title I, § 103(b), 80 Stat. 1550.)

REFERENCES IN TEXT

Section 101(a)(15) of the Immigration and Nationality Act, as amended, referred to in subsec. (b)(3), is classified to section 1101(a)(15) of Title 8, Aliens and Nationality.

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809, § 103(b)(1), limited the inclusion of gross income which is derived from sources within the United States to such income which is not effectively connected with the conduct of a trade or business within the United States and added provision including gross income without the limitation as to source which is effectively connected with the conduct of a trade or business within the United States.

Subsec. (b)(3)(B). Pub. L. 89–809, § 103(b)(2), substituted "by a domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States" for "by a domestic corporation".

Subsec. (b)(4). Pub. L. 89–809, § 102(b)(3), added par. (4).

1961—Subsec. (b). Pub. L. 87–256 added par. (3).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

EFFECTIVE DATE OF 1961 AMENDMENT

Amendment of section by Pub. L. 87–256 applicable to taxable years beginning after Dec. 31, 1961, see section 110(h)(1) of Pub. L. 87–256, set out as a note under section 117 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 877 of this title.

§ 873. Deductions.

(a) General rule.

In the case of a nonresident alien individual, the deductions shall be allowed only for purposes of section 871(b) and (except as provided by subsection (b)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

(b) Exceptions.

The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

(1) Losses.

The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property located within the United States.

(2) Charitable contributions.

The deduction for charitable contributions and gifts allowed by section 170.

(3) Personal exemption.

The deduction for personal exemptions allowed by section 151, except that in the case of a nonresident alien individual who is not a resident of a contiguous country only one exemption shall be allowed under section 151.

(c) Cross references.

(1) For disallowance of standard deduction, see section 142(b)(1).

(2) For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

(Aug. 16, 1954, ch. 736, 68A Stat. 280; Nov. 13, 1966, Pub. L. 89–809, title I, § 103(c)(1), 80 Stat. 1550.)

AMENDMENTS

1966—Pub. L. 89–809 substituted "connected with income which is effectively connected with the conduct of a trade or business within the United States" for "connected with income from sources within the United States" in subsec. (a), deleted provisions relating to the deduction of losses not connected with a trade or business but incurred in transactions entered into for profit in subsec. (b), made the casualty loss deduction available even if the property giving rise to the loss is not effectively connected with the conduct of a trade or business in the United States if the property is located in this country, made the charitable contribution deduction available even though not related to the trade or business, and added subsec. (c)(2) making a cross reference to section 906(b)(1) for rule that certain foreign taxes are not to be taken into account in determining deduction or credit.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 877, 906 of this title.

§ 874. Allowance of deductions and credits.

(a) Return prerequisite to allowance.

A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided by sections 31 and 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline, special fuels, and lubricating oil.

(b) Tax withheld at source.

The benefit of the deduction for exemptions under section 151 may, in the discretion of the Secretary or his delegate, and under regulations prescribed by the Secretary or his delegate, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

(c) Foreign tax credit.

Except as provided in section 906, a nonresident alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901. (Aug. 16, 1954, ch. 736, 68A Stat. 281; June 21, 1965, Pub. L. 89–44, title VIII, § 809(d)(3), 79 Stat.

167; Nov. 13, 1966, Pub. L. 89–809, title I, §§ 103(d), 106(a)(3), 80 Stat. 1551, 1569; May 21, 1970, Pub. L. 91–258, title II, § 207(d)(1), 84 Stat. 248.)

AMENDMENTS

1970—Subsec. (a). Pub. L. 91–258 included provision against construction of subsec. (a) to deny credit provided by section 39 for certain uses of special fuels.

1966—Subsec. (a). Pub. L. 89–809, § 103(d), struck out "of his total income received from all sources in the United States" following "true and accurate return".

Subsec. (c). Pub. L. 89–809, § 106(a)(3), substituted "Foreign tax credit" for "Foreign tax credit not allowed" as the subsection heading and inserted reference to an exception provided in section 906.

1965—Subsec. (a). Pub. L. 89–44 inserted "or the credit provided by section 39 for certain uses of gasoline and lubricating oil" before the period at the end.

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91–258 effective on July 1, 1970, see section 211(a) of Pub. L. 91–258, set out as a note under section 4041 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsec. (a) by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

Section 106(a)(6) of Pub. L. 89–809 provided that: "The amendments made by this subsection [adding sections 901(b)(4) and 906 of this title and amending subsec. (c) of this section] shall apply with respect to taxable years beginning after Dec. 31, 1966. In applying section 904 of the Internal Revenue Code of 1954 [section 904 of this title] with respect to section 906 of such Code [section 906 of this title], no amount may be carried from or to any taxable year beginning before Jan. 1, 1967, and no such year shall be taken into account."

EFFECTIVE DATE OF 1965 AMENDMENT

Amendment of subsec. (a) by Pub. L. 89–44 applicable to taxable years beginning on or after July 1, 1965, see section 809(f) of Pub. L. 89–44, set out as a note under section 6420 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1441, 1451 of this title.

§ 875. Partnerships; beneficiaries of estates and trusts.

For purposes of this subtitle—

(1) a nonresident alien individual or foreign corporation shall be considered as being engaged in a trade or business within the United States if the partnership of which such individual or corporation is a member is so engaged, and

(2) a nonresident alien individual or foreign corporation which is a beneficiary of an estate or trust which is engaged in any trade or business within the United States shall be treated as being engaged in such trade or business within the United States.

(Aug. 16, 1954, ch. 736, 68A Stat. 281; Nov. 13, 1966, Pub. L. 89–809, title I, § 103(e)(1), 80 Stat. 1551.)

AMENDMENTS

1966—Pub. L. 89–809 designated existing provisions as par. (1), substituted reference to nonresident alien individuals or foreign corporations for reference simply to nonresident alien individuals in par. (1) as so designated, and added par. (2).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

§ 876. Alien residents of Puerto Rico.

(a) No application to certain alien residents of Puerto Rico.

This subpart shall not apply to an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, and such alien shall be subject to the tax imposed by section 1.

(b) Cross reference.

For exclusion from gross income of income derived from sources within Puerto Rico, see section 933.

(Aug. 16, 1954, ch. 736, 68A Stat. 281.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 901 of this title.

§ 877. Expatriation to avoid tax.

(a) In general.

Every nonresident alien individual who at any time after March 8, 1965, and within the 10-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871.

(b) Alternative tax.

A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1 or section 1201(b), except that—

(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (c) of this section), and

(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as provided under regulations prescribed by the Secretary or his delegate.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deduction (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section.

(c) Special rules of source.

For purposes of subsection (b), the following items of gross income shall be treated as income from sources within the United States:

(1) Sale of property.

Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

(2) Stock or debt obligations.

Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

(d) Exception for loss of citizenship for certain causes.

Subsection (a) shall not apply to a nonresident alien individual whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

(e) Burden of proof.

If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual. (Added Pub. L. 89–809, title I, § 103(f)(1), Nov. 13, 1966, 80 Stat. 1551.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 2, 116, 894 of this title.

§ 878. Foreign educational, charitable, and certain other exempt organizations.

For special provisions relating to foreign educational, charitable, and other exempt organizations, see sections 512(a) and 4948.

(Aug. 16, 1954, ch. 736, 68A Stat. 282, formerly § 877, renumbered § 878, Nov. 13, 1966, Pub. L. 89–809, title I, § 103(f)(1), 80 Stat. 1551, and amended Dec. 30, 1969, Pub. L. 91–172, title I, § 101(j)(20), 83 Stat. 528.)

AMENDMENTS

1969—Pub. L. 91–172 substituted provisions requiring reference to organizations in sections 512(a) and 4948 for provisions requiring reference to trusts in section 512(a), and struck out reference to unrelated business income.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 101(k)(2)(B) of Pub. L. 91–172, set out as a note under section 4940 of this title.

SUBPART B.—FOREIGN CORPORATIONS

Sec.
881. Tax on income of foreign corporations not connected with United States business.
882. Tax on income of foreign corporations connected with United States business.
883. Exclusions from gross income.
884. Cross references.

AMENDMENTS

1966—Pub. L. 89–809, title I, § 104(b)(3), Nov. 13, 1966, 80 Stat. 1557, substituted "Tax on income of foreign corporations not connected with United States business" for "Tax on foreign corporations not engaged in business in United States" in item 881, and "Tax on income of foreign corporations connected with United States business" for "Tax on resident foreign corporations" in item 882.

§ 881. Tax on income of foreign corporations not connected with United States business.

(a) Imposition of tax.

There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as—

(1) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

(2) gains described in section 631 (b) or (c),

(3) in the case of bonds or other evidences of indebtedness issued after September 28, 1965, amounts which under section 1232 are considered as gains from the sale or exchange of property which is not a capital asset, and

(4) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under section 871(e),

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

(b) Doubling of tax.

For doubling of tax on corporations of certain foreign countries, see section 891.

(Aug. 16, 1954, ch. 736, 68A Stat. 282; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(a), 80 Stat. 1555.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809 substantially revised the income tax treatment of foreign corporations, substituted the concept of amounts received from sources within the United States by foreign corporations but not effectively connected with the conduct of a trade or business within the United States for the concept of amounts received from sources within the United States by foreign corporations not engaged in trade or business within the United States as the amount upon which the existing 30 percent levy should be imposed, and added contingent income received from the sale of patents and other intangibles and amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange of bonds or other evidences of indebtedness issued after Sept. 28, 1965, to the specified types of fixed or determinable income.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

CROSS REFERENCES

Consent dividends, nonresident aliens and foreign corporations, see section 565 (e) of this title.

Corporate organizations, foreign corporations, see section 367 of this title.

Credit for corporate stockholder in foreign corporation, see section 902 of this title.

Distributions by corporations, source of gain when dispositions of certain stock, see section 306 (f) of this title.

Dividends received from certain foreign corporations, see section 245 of this title.

Income from sources within the United States, see section 861 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 306, 819, 842, 864, 871, 891, 906, 1442, 1563, 6016, 6154 of this title.

§ 882. Tax on income of foreign corporations connected with United States business.

(a) Normal tax and surtax.

(1) Imposition of tax.

A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

(2) Determination of taxable income.

In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

(b) Gross income.

In the case of a foreign corporation, gross income includes only—

(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

(c) Allowance of deductions and credits.

(1) Allocation of deductions.

(A) General rule.

In the case of a foreign corporation, the deductions shall be allowed only for purposes of subsection (a) and (except as provided by subparagraph (B)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

(B) Charitable contributions.

The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income which is effectively connected with the conduct of a trade or business within the United States.

(2) Deductions and credits allowed only if return filed.

A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. The preceding sentence shall not apply for purposes of the tax imposed by section 541 (relating to personal holding company tax), and shall not be construed to deny the credit provided by section 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.

(3) Foreign tax credit.

Except as provided by section 906, foreign corporations shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(4) Cross reference.

For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906 (b)(1).

(d) Election to treat real property income as income connected with United States business.

(1) In general.

A foreign corporation which during the taxable year derives any income—

(A) from real property located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

(2) Election after revocation, etc.

Paragraphs (2) and (3) of section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871(d).

(e) Interest on United States obligations received by banks organized in possessions.

In the case of a corporation created or organized in, or under the law of, a possession of the United States which is carrying on the banking business in a possession of the United States, interest on obligations of the United States shall—

(1) for purposes of this subpart, be treated as income which is effectively connected with the conduct of a trade or business within the United States, and

(2) shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year.

(f) Returns of tax by agent.

If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent. (Aug. 16, 1954, ch. 736, 68A Stat. 282; Nov. 13, 1966, Pub. L. 89-809, title I, § 104(b)(1), 80 Stat. 1555.)

AMENDMENTS

1966—Pub. L. 89–809 substantially revised the income tax treatment of foreign corporations, introduced the concept of taxable income effectively connected with the conduct of a trade or business within the United States into provisions dealing with the imposition of tax, substituted a concept of gross income that included gross income derived from sources within the United States not effectively connected with the conduct of a trade or business within the United States and gross income effectively connected with the conduct of a trade or business within the United States for a concept of gross income that included only gross income from sources within the United States, and inserted provisions for an election to treat real property income as income connected with United States business, treatment of interest on United States obligations received by banks organized in possessions, and the returns of tax by agents, and added cross reference to section 906(b)(1).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 11, 864, 906, 1442 of this title.

§ 883. Exclusions from gross income.

(a) Income of foreign corporations from ships and aircraft.

The following items shall not be included in gross income of a foreign corporation, and shall be exempt from taxation under this subtitle:

(1) Ships under foreign flag.

Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) Aircraft of foreign registry.

Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(b) Earnings derived from communications satellite System.

The earnings derived from the ownership or operation of a communications satellite system by a foreign entity designated by a foreign government to participate in such ownership or operation shall be exempt from taxation under this subtitle, if the United States, through its designated entity, participates in such system pursuant to the Communications Satellite Act of 1962 (47 U.S.C. 701 and following). (Aug. 16, 1954, ch. 736, 68A Stat. 283; Oct. 22, 1968, Pub. L. 90–622, § 1(a), 82 Stat. 1311.)

AMENDMENTS

1968—Subsec. (a). Pub. L. 90–622 denominated existing provisions as subsec. (a) and added the subsec. catchline "Income of foreign corporations from ships and aircraft".

Subsec. (b). Pub. L. 90–622 added subsec. (b).

EFFECTIVE DATE OF 1968 AMENDMENT

Section 1(b) of Pub. L. 90–622 provided that: "The amendment made by subsection (a) [adding subsec. (b) to this section] shall apply with respect to taxable years beginning after December 31, 1966."

§ 884. Cross references.

(1) For special provisions relating to foreign corporations carrying on an insurance business within the United States, see section 842.

(2) For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section 864(b).

(3) For adjustment of tax in case of corporations of certain foreign countries, see section 896.

(4) For allowance of credit against the tax in case of a foreign corporation having income effectively connected with the conduct of a trade or business within the United States, see section 906.

(5) For withholding at source of tax on income of foreign coroporations, see section 1442.

(Aug. 16, 1954, ch. 736, 68A Stat. 283; Nov. 13, 1966, Pub. L. 89–809, title I, § 104(m)(1), 80 Stat. 1563; Dec. 30, 1969, Pub. L. 91–172, title I, § 101(j)(21), 83 Stat. 528.)

AMENDMENTS

1969—Par. (1). Pub. L. 91–172 redesignated former par. (2) as par. (1). Former par. (1) referring to section 512 (a) was stricken.

Pars. (2)–(5). Pub. L. 91–172 redesignated former pars. (3), (4), (5) and (6) as pars. (2), (3), (4) and (5).

1966—Par. (1). Pub. L. 89–809 redesignated former par. (4) as par. (1). Former par. (1) redesignated as par (6).

Par. (2). Pub. L. 89–809 redesignated former par. (3) as par. (2) and, in par. (2) as so redesignated, substituted "foreign corporations carrying on an insurance business within the United States, see section 842" for "foreign insurance companies, see subchapter L (sec. 801 and following". Former par. (2) redesignated as par. (3).

Par. (3). Pub. L. 89–809 redesignated former par. (2) as par. (3) and, in par. (3) as so redesignated, substituted "section 864(b) for "section 871(c)". Former par. (3) redesignated as par. (2).

Pars. (4), (5). Pub. L. 89–809 added pars. (4) and (5). Former par. (4) redesignated as par. (1).

Par. (6). Pub. L. 89–809 redesignated former par. (1) as par. (6).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 101(k)(2)(B) of Pub. L. 91–172, set out as a note under section 4940 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

SUBPART C.—MISCELLANEOUS PROVISIONS

Sec.
891. Doubling of rates of tax on citizens and corporations of certain foreign countries.
892. Income of foreign governments and of international organizations.
893. Compensation of employees of foreign governments or international organizations.
894. Income affected by treaty.
895. Income derived by a foreign central bank of issue from obligations of the United States or from bank deposits.
896. Adjustment of tax on nationals, residents, and corporations of certain foreign countries.

AMENDMENTS

1966—Pub. L. 89–809, title I, §§ 102(a)(4)(B), 105(c), Nov. 13, 1966, 80 Stat. 1543, 1565, substituted "affected by treaty" for "exempt under treaty" in item 894, inserted "or from bank deposits" in item 895, and added item 896.

1961—Pub. L. 87–29, § 1(b), May 4, 1961, 75 Stat. 64, added item 895.

§ 891. Doubling of rates of tax on citizens and corporations of certain foreign countries.

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 802, 821, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be

doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B). Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made. (Aug. 16, 1954, ch. 736, 68A Stat. 283; Mar. 13, 1956, ch. 83, § 5(6), 70 Stat. 49; June 25, 1959, Pub. L. 86–69, § 3(f)(1), 73 Stat. 140.)

AMENDMENTS

1959—Pub. L. 86–69 eliminated reference to section 811.

1956—Act Mar. 13, 1956, inserted reference to section 811.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86–69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out a note under section 801 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956, as applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 821 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 5, 12 of this title.

§ 892. Income of foreign governments and of international organizations.

The income of foreign governments or international organizations received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments or by international organizations, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments or international organizations, or from any other source within the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle. (Aug. 16, 1954, ch. 736, 68A Stat. 284.)

§ 893. Compensation of employees of foreign governments or international organizations.

(a) Rule for exclusion.

Wages, fees, or salary of any employee of a foreign government or of an international organization (including a consular or other officer, or a nondiplomatic representative), received as compensation for official services to such government or international organization shall not be included in gross income and shall be exempt from taxation under this subtitle if—

(1) such employee is not a citizen of the United States, or is a citizen of the Republic of the Philippines (whether or not a citizen of the United States); and

(2) in the case of an employee of a foreign government, the services are of a character similar to those performed by employees of the Government of the United States in foreign countries; and

(3) in the case of an employee of a foreign government, the foreign government grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country.

(b) Certificate by Secretary of State.

The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries. (Aug. 16, 1954, ch. 736, 68A Stat. 284.)

§ 894. Income affected by treaty.

(a) Income exempt under treaty.

Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

(b) Permanent establishment in United States.

For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or a foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. This subsection shall not apply in respect of the tax computed under section 877(b). (Aug. 16, 1954, ch. 736, 68A Stat. 284; Nov. 13, 1966, Pub. L. 89–809, title I, § 105(a), 80 Stat. 1563.)

AMENDMENTS

1966—Pub. L. 89–809 designated existing provisions as subsec. (a) added subsec. (b) and substituted "affected by treaty" for "exempt under treaty" in the section catchline.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 105(d) of Pub. L. 89–809 provided that: "The amendments made by this section (other than subsections (d) and (f)) [amending this section and adding section 896 of this title] shall apply with respect to taxable years beginning after December 31, 1966."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 643, 819 of this title.

§ 895. Income derived hy a foreign central bank of issue from ohligations of the United States or from hank deposits.

Income derived by a foreign central bank of issue from obligations of the United States or of any agency or instrumentality thereof (including beneficial interests, participations, and other instruments issued under section 302(c) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717)) which are owned by such foreign central bank of issue, or derived from interest on deposits with persons carrying on the banking business, shall not be included in gross income and shall be

exempt from taxation under this subtitle unless such obligations or deposits are held for, or used in connection with, the conduct of commercial banking functions or other commercial activities. For purposes of the preceding sentence the Bank for International Settlements shall be treated as a foreign central bank of issue. (Added Pub. L. 87–29, § 1(a), May 4, 1961, 75 Stat. 64, and amended Pub. L. 89–809, title I, § 102(a)(4)(A), Nov. 13, 1966, 80 Stat. 1543.)

AMENDMENTS

1966—Pub. L. 89–809 exempted income derived from obligations of agencies or instrumentalities of the United States, and income derived from interest on deposits with persons carrying on the banking business, inserted parenthetical phrase "(including beneficial interests, participations, and other instruments issued under section 302(c) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717))," and inserted sentence requiring the Bank for International Settlements to be treated as a foreign central bank of issue.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, except that in applying section 864(c)(4)(B)(iii) of this title with respect to a binding contract entered into on or before Feb. 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account, see section 102(e)(1) of Pub. L. 89–809, set out as a note under section 861 of this title.

EFFECTIVE DATE

Section 1(c) of Pub. L. 87–29 provided that: "The amendments made by subsections (a) and (b) [adding this section and amending analysis preceding section 891 of this title] shall be effective with respect to income received in taxable years beginning after December 31, 1960."

§ 896. Adjustment of tax on nationals, residents, and corporations of certain foreign countries.

(a) Imposition of more burdensome taxes by foreign country.

Whenever the President finds that—

(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the United States not residents of such foreign country or domestic corporations are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country,

(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

(3) it is in the public interest to apply pre-1967 tax provisions in accordance with the provisions of this subsection to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter and chapter 3 on or after the date of enactment of this section.

(b) Imposition of discriminatory taxes by foreign country.

Whenever the President finds that—

(1) under the laws of any foreign country, citizens of the United States or domestic corporations (or any class of such citizens or corporations) are, with respect to any item of income, being subjected to a higher effective rate of tax than are nationals, residents, or corporations of such foreign country (or a similar class of such nationals, residents, or corporations) under similar circumstances;

(2) such foreign country, when requested by the United States to do so, has not acted to eliminate such higher effective rate of tax; and

(3) it is in the public interest to adjust, in accordance with the provisions of this subsection, the effective rate of tax imposed by this subtitle on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations),

the President shall proclaim that the tax on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations) shall, for taxable years beginning after such proclamation, be adjusted so as to cause the effective rate of tax imposed by this subtitle on such similar income to be substantially equal to the effective rate of tax imposed by such foreign country on such item of income of citizens of the United States or domestic corporations (or such class of citizens or corporations). In implementing a proclamation made under this subsection, the effective rate of tax imposed by this subtitle on an item of income may be adjusted by the disallowance, in whole or in part, of any deduction, credit, or exemption which would otherwise be allowed with respect to that item of income or by increasing the rate of tax otherwise applicable to that item of income.

(c) Alleviation of more burdensome or discriminatory taxes.

Whenever the President finds that—

(1) the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that citizens of the United States not residents of such foreign country or domestic corporations are no longer subject to more burdensome taxes on the item of income derived by such citizens or corporations from sources within such foreign country, or

(2) the laws of any foreign country with respect to which the President has made a proclamation under subsection (b) have been modified so that citizens of the United States or domestic corporations (or any class of such citizens or corporations) are no longer subject to a higher effective rate of tax on the item of income,

he shall proclaim that the tax imposed by this subtitle on the similar income of nationals, residents, or corporations of such foreign country shall, for

any taxable year beginning after such proclamation, be determined under this subtitle without regard to such subsection.

(d) Notification of Congress required.

No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

(e) Implementation by regulations.

The Secretary or his delegate shall prescribe such regulations as he deems necessary or appropriate to implement this section. (Added Pub. L. 89–809, title I, § 105(b), Nov. 13, 1966, 80 Stat. 1563.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1966, see section 105(d) of Pub. L. 89–809, set out as a note under section 894 of this title.

PART III.—INCOME FROM SOURCES WITHOUT THE UNITED STATES

Subpart
A. Foreign tax credit.
B. Earned income of citizens of United States.
C. Western Hemisphere trade corporations.
D. Possessions of the United States.
E. China Trade Act corporations.
F. Controlled foreign corporations.
G. Export trade corporations.
H. Income of certain nonresident United States citizens subject to foreign community property laws.

AMENDMENTS

1966—Pub. L. 89–809, title I, § 105(e)(2), Nov. 13, 1966, 80 Stat. 1567, added the heading of subpart H.

1962—Pub. L. 87–834, § 12(b)(3), Oct. 16, 1962, 76 Stat. 1031, added the headings of subparts F and G.

SUBPART A.—FOREIGN TAX CREDIT

Sec.
901. Taxes of foreign countries and of possessions of United States.
902. Credit for corporate stockholder in foreign corporation.
903. Credit for taxes in lieu of income, etc., taxes.
904. Limitation on credit.
905. Applicable rules.
906. Nonresident alien individuals and foreign corporations.

AMENDMENTS

1966—Pub. L. 89–809, title I, § 106(a)(2), Nov. 13, 1966, 80 Stat. 1569, added item 906.

§ 901. Taxes of foreign countries and of possessions of United States.

(a) Allowance of credit.

If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 56 (relating to minimum tax for tax preferences), against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries) or under section 1351 (relating to recoveries of foreign expropriation losses), or against the personal holding company tax imposed by section 541.

(b) Amount allowed.

Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) Citizens and domestic corporations.

In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) Resident of the United States or Puerto Rico.

In the case of a resident of the United States and in the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) Alien resident of the United States or Puerto Rico.

In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any foreign country; and

(4) Nonresident alien individuals and foreign corporations.

In the case of any nonresident alien individual not described in section 876 and in the case of any foreign corporation, the amount determined pursuant to section 906; and

(5) Partnerships and estates.

In the case of any individual described in paragraph (1), (2), (3), or (4), who is a member of a partnership or a beneficiary of an estate or trust, the amount of his proportionate share of the taxes (described in such paragraph) of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(c) Similar credit required for certain alien residents.

Whenever the President finds that—

(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit for any such taxes paid or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b)(3),

(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

(3) it is in the public interest to allow the credit under subsection (b)(3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country,

the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b)(3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit.

(d) Corporations treated as foreign.

For purposes of this subpart, the following corporations shall be treated as foreign corporations:

(1) a corporation entitled to the benefits of section 931, by reason of receiving a large percentage of its gross income from sources within a possession of the United States; and

(2) a corporation organized under the China Trade Act, 1922 (15 U. S. C., chapter 4), and entitled to the deduction provided in section 941.

(e) Foreign taxes on mineral income.

(1) Reduction in amount allowed.

Notwithstanding subsection (b), the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or possession of the United States with respect to foreign mineral income from sources within such country or possession which would (but for this paragraph) be allowed under such subsection shall be reduced by the amount (if any) by which—

(A) the amount of such taxes (or, if smaller, the amount of the tax which would be computed under this chapter with respect to such income determined without the deduction allowed under section 613), exceeds

(B) the amount of the tax computed under this chapter with respect to such income.

(2) Foreign mineral income defined.

For purposes of paragraph (1), the term "foreign mineral income" means income derived from the extraction of minerals from mines, wells, or other natural deposits, the processing of such minerals into their primary products, and the transportation, distribution, or sale of such minerals or primary products. Such term includes, but is not limited to—

(A) dividends received from a foreign corporation in respect of which taxes are deemed paid by the taxpayer under section 902, to the extent such dividends are attributable to foreign mineral income, and

(B) that portion of the taxpayer's distributive share of the income of partnerships attributable to foreign mineral income.

(f) Cross reference.

(1) For deductions of income, war profits, and excess profits taxes paid to a foreign country or a possession of the United States, see sections 164 and 275.

(2) For right of each partner to make election under this section, see section 703 (b).

(3) For right of estate or trust to the credit for taxes imposed by foreign countries and possessions of the United States under this section, see section 642 (a) (2).

(4) For reduction of credit for failure of a United States person to furnish certain information with respect to a foreign corporation controlled by him, see section 6038.

(Aug. 16, 1954, ch. 736, 68A Stat. 285; Sept. 14, 1960, Pub. L. 86–780, § 3(a), (b), 74 Stat. 1013; Oct. 16, 1962, Pub. L. 87–834, §§ 9(d)(3), 12(b)(1), 76 Stat. 1001, 1031; Feb. 26, 1964, Pub. L. 88–272, title II, § 207(b)(7), 78 Stat. 42; Apr. 8, 1966, Pub. L. 89–384, § 1(c)(2), 80 Stat. 102; Nov. 13, 1966, Pub. L. 89–809, title I, § 106(a)(4), (5), (b)(1), (2), 80 Stat. 1569; Dec. 30, 1969, Pub. L. 91–172, title III, § 301(b)(9), title V, § 506(a), 83 Stat. 585, 634.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 301(b)(9), inserted in last sentence "against the tax imposed by section 56 (relating to minimum tax for tax preferences)," after "not be allowed".

Subsec. (e). Pub. L. 91–172, § 506(a), added subsec. (e). Former subsec. (e) redesignated (f).

1966—Subsec. (a). Pub. L. 89–384 added the additional tax imposed under section 1351 (relating to recoveries of foreign expropriation losses) to the list of taxes against which the foreign tax credit may not be allowed.

Subsec. (b)(3). Pub. L. 89–809, § 106(b)(1), struck out provisions which made the allowance of the credit dependent upon whether the foreign country of which the alien resident was a citizen or subject, in imposing such taxes, allowed a similar credit to citizens of the United States residing in such country.

Subsec. (b)(4). Pub. L. 89–809, § 106(a)(4), added subsec. (a)(4). Former subsec. (a)(4) redesignated as (a)(5).

Subsec. (b)(5). Pub. L. 89–809, § 106(a) (4), (5), redesignated former subsec. (b)(4) as (b)(5) and, in subsec. (b)(5) as so redesignated, inserted reference to paragraph (4).

Subsec. (c). Pub. L. 89–809, § 106(b)(2), added subsec. (c). Former subsec. (c) redesignated as (d).

Subsecs. (d), (e). Pub. L. 89–809, § 106(b)(2), redesignated former subsecs. (c) and (d) as (d) and (e), respectively.

1964—Subsec. (d)(1). Pub. L. 88–272 inserted the reference to section 275.

1962—Subsec. (a). Pub. L. 87–834, § 12(b)(1), substituted "sections 902 and 960" for "section 902."

Subsec. (d)(4). Pub. L. 87–834, § 9(d)(3), added subsec. (d)(4).

1960—Subsec. (a). Pub. L. 86–780, § 3 (a), (b), inserted "applicable" preceding "limitation" and substitued "Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year" for "Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund of the tax against which the credit is allowable."

Subsec. (b). Pub. L. 86–780, § 3(b), inserted "applicable" preceding "limitation."

EFFECTIVE DATE OF 1969 AMENDMENT

Section 506(c) of Pub L. 91–172 provided that: "The amendments made by this section [amending this section and section 904 of this title] shall apply with respect to taxable years beginning after December 31, 1969."

Amendment of subsec. (a) of this section by section 301(b)(9) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1966 AMENDMENTS

Amendment of subsec. (a) by Pub. L. 89–384 applicable with respect to amounts received after December 31, 1964, in respect of foreign expropriation losses (as defined in section 1351(b) of this title) sustained after December 31, 1958, see section 2 of Pub. L. 89–384, set out as a note under section 1351 of this title.

Addition of par. (4) of subsec. (b), redesignation of former par. (4) as par. (5), and amendment of par. (5) as so redesignated by section 106(a) (4), (5) of Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 106(a)(6) of Pub. L. 89–809, set out as a note under section 874 of this title.

Section 106(b)(4) of Pub. L. 89–809 provided that: "The amendments made by this subsection (other than paragraph (3)) [amending par. (3) of subsec. (b), adding subsec. (c), and redesignating former subsecs. (c) and (d) as (d) and (e) respectively] shall apply with

respect to taxable years beginning after December 31, 1966. The amendment made by paragraph (3) [amending section 2014(a) and adding section 2014(h) of this title] shall apply with respect to estates of decedents dying after the date of enactment of this Act [November 13, 1966]."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88-272 applicable to taxable years beginning after Dec. 31, 1963, see section 207(c) of Pub. L. 88-272, set out as a note under section 164 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment of subsec. (a) of this section by Pub. L. 87-834 applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. 87-834, set out as a note under section 821 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of subsecs. (a) and (b) by section 3(a) of Pub. L. 86-780 applicable to taxable years beginning after Dec. 31, 1960, and amendment of subsec. (a) by section 3(b) of Pub. L. 86-780 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 4 of Pub. L. 86-780, set out as a note under section 904 of this title.

ECONOMICALLY LESS DEVELOPED COUNTRIES

Designation of certain foreign countries as economically less developed countries, see Ex. Ord. No. 11071, Dec. 27, 1962, 27 F.R. 12875, set out as a note under section 955 of this title.

CROSS REFERENCES

Credit for foreign taxes, see section 841 of this title.

Disallowance of foreign tax credit, see section 942 of this title.

Foreign tax credit, applicable rules, see section 905 of this title.

Income from sources within possessions of the United States, foreign tax credit, see section 931 (g) of this title.

Investment companies, foreign tax credit allowed to shareholder, see section 853 of this title.

Limitations, special rules relating to foreign tax credit, see section 6511 (d) (3) of this title.

Nonresident aliens, foreign tax credit not allowed, see section 874 (c) of this title.

Partners and partnerships, taxes paid or accrued to foreign countries and possessions of the United States, see section 702 (a) (6) of this title.

Tax on resident foreign corporations, foreign tax credit, see section 882 (4) of this title.

Taxes of foreign countries and possessions of the United States, see sections 33 and 515 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 33, 243, 275, 515, 642, 702, 703, 841, 853, 874, 882, 905, 906, 931, 1247, 1503, 6038 of this title.

§ 902. Credit for corporate stockholder in foreign corporation.

(a) Treatment of taxes paid by foreign corporation.

For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall—

(1) to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in subsection (c)(1)(A)) of a year for which such foreign corporation is not a less developed country corporation, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States on or with respect to such accumulated profits, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid); and

(2) to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in subsection (c)(1)(B)) of a year for which such foreign corporation is a less developed country corporation, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States on or with respect to such accumulated profits, which the amount of such dividends bears to the amount of such accumulated profits.

(b) Foreign subsidiary of first and second foreign corporation.

(1) If the foreign corporation described in subsection (a) (hereinafter in this subsection referred to as the "first foreign corporation") owns 10 percent or more of the voting stock of a second foreign corporation from which it receives dividends in any taxable year, it shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such second foreign corporation to any foreign country or to any possession of the United States on or with respect to the accumulated profits of the corporation from which such dividends were paid which—

(A) for purposes of applying subsection (a)(1), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(A)) of such second foreign corporation from which such dividends were paid in excess of such income, war profits, and excess profits taxes, or

(B) for purposes of applying subsection (a)(2), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(B)) of such second foreign corporation from which such dividends were paid.

(2) If such first foreign corporation owns 10 percent or more of the voting stock of a second foreign corporation which, in turn, owns 10 percent or more of the voting stock of a third foreign corporation from which the second foreign corporation receives dividends in any taxable year, the second foreign corporation shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid by such third foreign corporation to any foreign country or to any possession of the United States on or with respect to the accumulated profits of the corporation from which such dividends were paid which—

(A) for purposes of applying subsection (a)(1), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(A)) of such third foreign corporation from which such dividends were paid in excess of such income, war profits, and excess profits taxes, or

(B) for purposes of applying subsection (a)(2), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(B)) of such third foreign corporation from which such dividends were paid.

(3) For purposes of this subpart, subsection (b)(1) shall not apply unless the percentage of voting stock owned by the domestic corporation in the first foreign corporation and the percentage of voting stock owned by the first foreign corporation in the second foreign corporation when multiplied together equal at least 5 percent, and for purposes of this subpart, subsection (b)(2) shall not apply unless the percentage arrived at for purposes of applying subsection (b)(1) when multiplied by the percentage of voting stock owned by the second foreign corporation in the third foreign corporation is equal to at least 5 percent.

(c) Applicable rules.

(1) Accumulated profits defined.

For purposes of this section, the term "accumulated profits" means with respect to any foreign corporation—

(A) for purposes of subsections (a)(1), (b)(1)(A), and (b)(2)(A), the amount of its gains, profits, or income computed without reduction by the amount of the income, war profits, and excess profits taxes imposed on or with respect to such profits or income by any foreign country or any possession of the United States; and

(B) for purposes of subsections (a)(2), (b)(1)(B), and (b)(2)(B), the amount of its gains, profits, or income in excess of the income, war profits, and excess profits taxes imposed on or with respect to such profits or income.

The Secretary or his delegate shall have full power to determine from the accumulated profits of what year or years such dividends were paid, treating dividends paid in the first 60 days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings.

(2) Accounting periods.

In the case of a foreign corporation, the income, war profits, and excess profits taxes of which are determined on the basis of an accounting period of less than 1 year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(d) Less developed country corporation defined.

For purposes of this section, the term "less developed country corporation" means—

(1) a foreign corporation which, for its taxable year, is a less developed country corporation within the meaning of section 955(c)(1) or (2), and

(2) a foreign corporation which owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation which is a less developed country corporation within the meaning of section 955(c)(1), and—

(A) 80 percent or more of the gross income of which for its taxable year meets the requirement of section 955(c)(1)(A); and

(B) 80 percent or more in value of the assets of which on each day of such year consists of property described in section 955(c)(1)(B).

A foreign corporation which is a less developed country corporation for its first taxable year beginning after December 31, 1962, shall, for purposes of this section, be treated as having been a less developed country corporation for each of its taxable years beginning before January 1, 1963.

(e) Cross references.

(1) For inclusion in gross income of an amount equal to taxes deemed paid under subsection (a)(1), see section 78.

(2) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxable year by a United States shareholder with respect to a controlled foreign corporation, see section 960.

(3) For reduction of credit with respect to dividends paid out of accumulated profits for years for which certain information is not furnished, see section 6038.

(Aug. 16 1954, ch. 736, 68A Stat. 286; Sept. 14, 1960, Pub. L. 86-780, § 6(b)(2), 74 Stat. 1016; Oct. 16, 1962, Pub. L. 87-834, § 9(a), 76 Stat. 999; Jan. 12, 1971, Pub. L. 91-684, §§ 1, 2, 84 Stat. 2068, 2069.)

AMENDMENTS

1971—Subsec. (b). Pub. L. 91-684, § 1, in the subsection catchline substituted "Foreign subsidiary of first and second foreign corporation" for "Foreign subsidiary of foreign corporation", designated existing provisions as par. (1), and, as so designated, added terminology denominating corporations involved as first foreign corporation and second foreign corporation, and reduced the ownership percentage requirement in voting stock from 50 percent to 10 percent between the first and second foreign corporations, and added pars. (2), and (3).

Subsec. (c)(1)(A). Pub. L. 91-684, § 2(1), substituted "(b)(1)(A), and (b)(2)(A)" for "and (b)(1)".

Subsec. (c)(1)(B). Pub. L. 91-684, § 2(2), substituted "(b)(1)(B), and (b)(2)(B)" for "and (b)(2)".

1962—Subsec. (a). Pub. L. 87-834 limited provisions which required a domestic corporation owning at least 10 per cent of the voting stock of a foreign corporation from which it receives dividends in any taxable year to be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States which the amount of such dividends bears to the amount of accumulated profits to those cases where a foreign corporation paid such dividends out of accumulated profits of a year for which such foreign corporation is a less developed country corporation, and inserted provisions requiring, in the case of a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in a taxable year, to the extent such dividends are paid by such foreign corporation out of accumulated profits of a year for which such foreign corporation is not a less developed country corporation, to be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States on or with respect to such accumulated profits, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid).

Subsec. (b). Pub. L. 87-834 substituted "from which such dividends were paid which—

"(1) for purposes of applying subsection (a)(1), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(A)) of such other foreign corporation from which such dividends were paid in excess of such income, war profits, and excess profits taxes, or

"(2) for purposes of applying subsection (a)(2), the amount of such dividends bears to the amount of the accumulated profits (as defined in subsection (c)(1)(B)) of such other foreign corporation from which such dividends were paid"

for "from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits."

Subsec. (c). Pub. L. 87–834 defined "accumulated profits" for purposes of subsec. (a)(1) and (b)(1) as meaning the amount of its gains, profits, or income computed without reduction by the amount of the income, war profits, and excess profits taxes imposed on or with respect to such profits or income by and foreign country or any possession of the United States, and limited the provisions defining "accumulated profits" as the amount of its gains, profits, or income in excess of the income, war profits, and excess profits taxes imposed on or with respect to such profits or income to subsecs. (a)(2) and (b)(2).

Subsec. (d). Pub. L. 87–834 substituted provisions defining "less developed country corporation" for provisions which established special rules for certain wholly-owned foreign corporations.

Subsec. (e). Pub. L. 87–834 designated existing provisions as par. (3) and added pars. (1) and (2).

1960—Subsec. (e). Pub. L. 86–780 added subsec. (e).

EFFECTIVE DATE OF 1971 AMENDMENT

Section 3 of Pub. L. 91–684 provided that: "The amendments made by this Act [amending subsecs. (b) and (c) of this section] shall apply with respect to all taxable years of domestic corporations, ending after the date of enactment of this Act [Jan. 12, 1971], but only in respect of dividends paid by one corporation to another corporation after the date of the enactment of this Act."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 9(e) of Pub. L. 87-634 provided that:

"The amendments made by this section [adding section 78 of this title and amending this section and sections 535, 545, 861 and 901 of this title] shall apply—

"(1) in respect of any distribution received by a domestic corporation after December 31, 1964, and

"(2) in respect of any distribution received by a domestic corporation before January 1, 1965, in a taxable year of such corporation beginning after December 31, 1962, but only to the extent that such distribution is made out of the accumulated profits of a foreign corporation for a taxable year (of such foreign corporation) beginning after December 31, 1962.

For purposes of paragraph (2), a distribution made by a foreign corporation out of its profits which are attributable to a distribution received from a foreign subsidiary to which section 902(b) applies shall be treated as made out of the accumulated profits of a foreign corporation for a taxable year beginning before January 1, 1963, to the extent that such distribution was paid out of the accumulated profits of such foreign subsidiary for a taxable year beginning before January 1, 1963."

EFFECTIVE DATE OF 1960 AMENDMENT

Amendment of section by Pub. L. 86–780 applicable to taxable years beginning after Dec. 31, 1960, see section 6(c) of Pub. L. 86–780, set out as a note under section 6038 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 78, 535, 545, 901, 906, 960, 963, 1248, 6038 of this title.

§ 903. Credit for taxes in lieu of income, etc., taxes.

For purposes of this subpart and of sections 164(a) and 275(a), the term "income, war profits, and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States. (Aug. 16, 1954, ch. 736, 68A Stat. 287; Feb. 26, 1964, Pub. L. 88–272, title II, § 207(b)(8), 78 Stat. 42.)

AMENDMENTS

1964—Pub. L. 88–272 substituted "sections 164(a) and 275(a)" for "section 164(b)."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 207(c) of Pub. L. 88–272, set out as a note under section 164 of this title.

§ 904. Limitation on credit.

(a) Alternative limitations.

(1) Per-country limitation.

In the case of any taxpayer who does not elect the limitation provided by paragraph (2), the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(2) Overall limitation.

In the case of any taxpayer who elects the limitation provided by this paragraph, the total amount of the credit in respect of taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(b) Election of overall limitation.

(1) In general.

A taxpayer may elect the limitation provided by subsection (a)(2) for any taxable year beginning after December 31, 1960. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked (A) with the consent of the Secretary or his delegate with respect to any taxable year or (B) for the taxpayer's first taxable year beginning after December 31, 1969.

(2) Election after revocation.

Except in a case to which paragraph (1)(B) applies, if the taxpayer has made an election under paragraph (1) and such election has been revoked, such taxpayer shall not be eligible to make a new election under paragraph (1) for any taxable year, unless the Secretary or his delegate consents to such new election.

(3) Form and time of election and revocation.

An election under paragraph (1), and any revocation of such an election, may be made only in such manner as the Secretary or his delegate may by regulations prescribe. Such an election or revocation with respect to any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year.

(c) Taxable income for purpose of computing limitation.

For purposes of computing the applicable limitation under subsection (a), the taxable income in the case of an individual, estate, or trust shall be computed without any deduction for personal exemptions under section 151 or 642(b).

(d) Carryback and carryover of excess tax paid.

Any amount by which any such tax paid or accrued to any foreign country or possession of the United States for any taxable year beginning after December 31, 1957, for which the taxpayer chooses to have the benefits of this subpart exceeds the applicable limitation under subsection (a) shall be deemed tax paid or accrued to such foreign country or possession of the United States in the second preceding taxable year, in the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable years, in that order and to the extent not deemed tax paid or accrued in a prior taxable year, in the amount by which the applicable limitation under subsection (a) for such preceding or succeeding taxable year exceeds the sum of the tax paid or accrued to such foreign country or possession for such preceding or succeeding taxable year and the amount of the tax for any taxable year earlier than the current taxable year which shall be deemed to have been paid or accrued in such preceding or subsequent taxable year (whether or not the taxpayer chooses to have the benefits of this subpart with respect to such earlier taxable year). Such amount deemed paid or accrued in any year may be availed of only as a tax credit and not as a deduction and only if taxpayer for such year chooses to have the benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions. For purposes of this subsection, the terms "second preceding taxable year" and "first preceding taxable year" do not include any taxable year beginning before January 1, 1958.

(e) Carrybacks and carryovers where overall limitation is elected.

(1) Foreign taxes to be aggregated for purposes of subsection (d).

With respect to each taxable year of the taxpayer to which the limitation provided by subsection (a)(2) applies, the taxes referred to in the first sentence of subsection (d) shall, for purposes of applying such first sentence, be aggregated on an overall basis (rather than taken into account on a per-country basis).

(2) Foreign taxes may not be carried from per-country year to overall year or from overall year to per-country year.

No amount paid or accrued for any taxable year to which the limitation provided by subsection (a)(1) applies shall (except for purposes of determining the number of taxable years which have elapsed) be deemed paid or accrued under subsection (d) in any taxable year to which the limitation provided by subsection (a)(2) applies. No amount paid or accrued for any taxable year to which the limitation provided by subsection (a)(2) applies shall (except for purposes of determining the number of taxable years which have elapsed) be deemed paid or accrued under subsection (d) in any taxable year to which the limitation provided by subsection (a)(1) applies.

(f) Application of section in case of certain interest income.

(1) In general.

The provisions of subsections (a), (c), (d), and (e) of this section shall be applied separately with respect to—

(A) the interest income described in paragraph (2), and

(B) income other than the interest income described in paragraph (2).

(2) Interest income to which applicable.

For purposes of this subsection, the interest income described in this paragraph is interest other than interest—

(A) derived from any transaction which is directly related to the active conduct of a trade or business in a foreign country or a possession of the United States,

(B) derived in the conduct of a banking, financing, or similar business,

(C) received from a corporation in which the taxpayer (or one or more includible corporations in an affiliated group, as defined in section 1504, of which the taxpayer is a member) owns, directly or indirectly, at least 10 percent of the voting stock,

(D) received on obligations acquired as a result of the disposition of a trade or business actively conducted by the taxpayer in a foreign country or possession of the United States or as a result of the disposition of stock or obligations of a corporation in which the taxpayer owned at least 10 percent of the voting stock.

For purposes of subparagraph (C), stock owned, directly or indirectly, by or for a foreign corporation shall be considered as being proportionately owned by its shareholders.

(3) Overall limitation not to apply.

The limitation provided by subsection (a)(2) shall not apply with respect to the interest income described in paragraph (2). The Secretary or his delegate shall by regulations prescribe the manner of application of subsection (e) with respect to cases in which the limitation provided by subsection (a)(2) applies with respect to income other than the interest income described in paragraph (2).

(4) Transitional rules for carrybacks and carryovers.

(A) Carrybacks to years prior to Revenue Act of 1962.

Where, under the provisions of subsection (d), taxes (i) paid or accrued to any foreign country or possession of the United States in any taxable year beginning after the date of the enactment of the Revenue Act of 1962 are deemed (ii) paid or accrued in one or more taxable years beginning on or before the date of enactment of the Revenue Act of 1962, the amount of such taxes deemed paid or accrued shall be determined without regard to the provisions of this subsection. To the extent the

taxes paid or accrued to a foreign country or possession of the United States in any taxable year described in clause (i) are not, with the application of the preceding sentence, deemed paid or accrued in any taxable year described in clause (ii), such taxes shall, for purposes of applying subsection (d), be deemed paid or accrued in a taxable year beginning after the date of the enactment of the Revenue Act of 1962, with respect to interest income described in paragraph (2), and with respect to income other than interest income described in paragraph (2), in the same ratios as the amount of such taxes paid or accrued with respect to interest income described in paragraph (2), and the amount of such taxes paid or accrued with respect to income other than interest income described in paragraph (2), respectively, bear to the total amount of such taxes paid or accrued to such foreign country or possession of the United States.

(B) Carryovers to years after Revenue Act of 1962.

Where, under the provisions of subsection (d), taxes (i) paid or accrued to any foreign country or possession of the United States in any taxable year beginning on or before the date of the enactment of the Revenue Act of 1962 are deemed (ii) paid or accrued in one or more taxable years beginning after the date of the enactment of the Revenue Act of 1962, the amount of such taxes deemed paid or accrued in any year described in clause (ii) shall, with respect to interest income described in paragraph (2), be an amount which bears the same ratio to the amount of such taxes deemed paid or accrued as the amount of the taxes paid or accrued to such foreign country or possession for such year with respect to interest income described in paragraph (2) bears to the total amount of the taxes paid or accrued to such foreign country or possession for such year; and the amount of such taxes deemed paid or accrued in any year described in clause (ii) with respect to income other than interest income described in paragraph (2) shall be an amount which bears the same ratio to the amount of such taxes deemed paid or accrued for such year as the amount of taxes paid or accrued to such foreign country or possession for such year with respect to income other than interest income described in paragraph (2) bears to the total amount of the taxes paid or accrued to such foreign country or possession for such year.

(g) Cross reference.

(1) For increase of applicable limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States shareholder with respect to a controlled foreign corporation, see section 960(b).

(2) For special rule relating to the application of the credit provided by section 901 in the case of affiliated groups which include Western Hemisphere trade corporations for years in which the limitation provided by subsection (a)(2) applies, see section 1503(b).

(Aug. 16, 1954, ch. 736, 68A Stat. 287; Sept. 2, 1958, Pub. L. 85–866, title I, § 42(a), 72 Stat. 1639; Sept. 14, 1960, Pub. L. 86–780, § 1, 74 Stat. 1010; Oct. 16, 1962, Pub. L. 87–834, §§ 10(a), 12(b)(2), 76 Stat. 1002, 1031; Feb. 26, 1964, Pub. L. 88–272, title II, § 234(b)(6), 78 Stat. 116; Nov. 13, 1966, Pub. L. 89–809, title I, § 106(c)(1), 80 Stat. 1570; Dec. 30, 1969, Pub. L. 91–172, title V, § 506(b), 83 Stat. 635.)

REFERENCES IN TEXT

The date of the enactment of the Revenue Act of 1962, referred to in subsec. (f)(4), means the date of the enactment of Pub. L. 87–834, which was approved on Oct. 16, 1962.

AMENDMENTS

1969—Subsec. (b)(1). Pub. L. 91–172, § 506(b)(1), substituted "(A) with the consent of the Secretary or his delegate with respect to any taxable year or (B) for the taxpayer's first taxable year beginning after December 31, 1969" for "with the consent of the Secretary or his delegate with respect to any taxable year."

Subsec. (b)(2). Pub. L. 91–172, § 506(b)(2), substituted "Except in a case to which paragraph (1)(B) applies, if the taxpayer" for "If a taxpayer."

1966—Subsec. (f)(2). Pub. L. 89–809 inserted reference to includible corporations in an affiliated group, as defined in section 1504, of which the taxpayer is a member and inserted reference to both direct and indirect ownership in subpar. (C) and added provision that, for purposes of subpar. (C), stock owned directly or indirectly by or for a foreign corporation shall be considered as being proportionately owned by its shareholders.

1964—Subsec. (g)(2). Pub. L. 88–272 substituted "section 1503(b)" for "section 1503(d)."

1962—Subsec. (f). Pub. L. 87–834, § 10(a), added subsec. (f) and redesignated former subsec. (f) as (g).

Subsec. (g). Pub. L. 87–834, §§ 10(a), 12(b)(2), redesignated former subsec. (f) as (g), designated existing provisions as par. (2), and added par. (1).

1960—Subsec. (a). Pub. L. 86–780, § 1(a), designated existing provisions as par. (1), added the introductory clause "In the case of any taxpayer who elects the limitation provided by this paragraph" and inserted the words "foreign", "or possession of the United States" and "or possession" therein and added par. (2).

Subsec. (b). Pub. L. 86–780, § 1(a), added subsec. (b). Former subsec. (b) redesignated (c).

Subsec. (c). Pub. L. 86–780, § 1(b), redesignated former subsec. (b) as (c) and inserted "applicable" preceding "limitation" therein. Former subsec. (c) redesignated (d).

Subsec. (d). Pub. L. 86–780, § 1(c), redesignated former subsec. (c) as (d) and inserted "applicable" preceding "limitation" in two instances therein.

Subsecs. (e), (f). Pub. L. 86–780, § 1(d), added subsecs. (e) and (f).

1958—Subsec. (c). Pub. L. 85–866 added subsec. (c).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 506(c) of Pub. L. 91–172, set out as a note under section 901 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 106(c)(2) of Pub. L. 89–809 provided that: "The amendments made by paragraph (1) [amending subsec. (f)(2)] shall apply to interest received after December 31, 1965, in taxable years ending after such date."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 234(c) of Pub. L. 88–272, set out as a note under section 1503 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Section 10(b) of Pub. L. 87–834 provided that: "The amendments made by subsection (a) [adding subsec. (f) of this section and redesignating former subsec. (f) as (g)] shall apply with respect to taxable years beginning after the date of the enactment of this Act [Oct. 16, 1962], but only with respect to interest resulting from transactions consummated after April 2, 1962."

EFFECTIVE DATE OF 1960 AMENDMENT

Section 4 of Pub. L. 86-780 provided that: "The amendments made by the first section [amending this section], section 2 [amending section 1503(d) of this title], and subsection (a) of section 3 of this Act [amending section 901 (a), (b) of this title] shall apply with respect to taxable years beginning after December 31, 1960. The amendment made by subsection (b) of section 3 of this Act [amending section 901(a) of this title] shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. The amendments made by subsection (c) of section 3 of this Act [adding section 6501(i) of this title[shall apply with respect to taxable years beginning after December 31, 1957."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 42 (c) of Pub. L. 85-866 provided that: "The amendments made by subsections (a) and (b) [adding subsec. (c) of this section and amending section 6611 (g) (h) of this title] shall apply only with respect to taxable years beginning after December 31, 1957."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 243, 841, 901, 906, 960, 1351, 1503, 6038, 6501 of this title.

§ 905. Applicable rules.

(a) Year in which credit taken.

The credits provided in this subpart may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c). If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken on the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(b) Proof of credits.

The credits provided in this subpart shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary or his delegate—

(1) the total amount of income derived from sources without the United States, determined as provided in part I,

(2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this subpart, such amount to be determined under regulations prescribed by the Secretary or his delegate, and

(3) all other information necessary for the verification and computation of such credits.

For purposes of this subpart, the recipient of a royalty or other amount paid or accrued as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulas, trademarks, and other like property, and derived from sources within the United Kingdom of Great Britain and Northern Ireland, shall be deemed to have paid or accrued any income, war-profits and excess-profits taxes paid or accrued to the United Kingdom with respect to such royalty or other amount (including the amount by which the payor's United Kingdom tax was increased by in- such recipient elects to include in its gross income ability to deduct such royalty or other amount) if the amount of such United Kingdom tax.

(c) Adjustments on payment of accrued taxes.

If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary or his delegate, who shall redetermine the amount of the tax for the year or years affected. The amount of tax due on such redetermination, if any, shall be paid by the taxpayer on notice and demand by the Secretary or his delegate, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (sec. 6511 and following). In the case of such a tax accrued but not paid, the Secretary or his delegate, as a condition precedent to the allowance of this credit, may require the taxpayer to give a bond, with sureties satisfactory to and to be approved by the Secretary or his delegate, in such sum as the Secretary or his delegate may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination; and the bond herein prescribed shall contain such further conditions as the Secretary or his delegate may require. In such redetermination by the Secretary or his delegate of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, and no deduction under section 164 (relating to deduction for taxes) shall be allowed for any taxable year with respect to such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary or his delegate, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country or possession of the United States on such refund for such period. (Aug. 16, 1954, ch. 736, 68A Stat. 288; Sept. 2, 1958, Pub. L. 85-866, title I, § 103 (b), 72 Stat. 16.)

AMENDMENTS

1958—Subsec. (b). Pub. L. 85-866 added sentence deeming recipient of a royalty or other amount for use of copyright, patent, and other like property derived from sources within United Kingdom, to have paid or accrued taxes paid or accrued to United Kingdom with respect to royalty if recipient elects to include in its gross income the amount of such United Kingdom tax.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 103 (c) of Pub. L. 85-866 provided that: "The amendment made by subsection (a) of this section [to section 131 (e) of Internal Revenue Code of 1939] shall apply for all taxable years beginning on or after January 1, 1950, as to which section 131 of the Internal Revenue Code of 1939 is the applicable provision. The amendment made by subsection (b) of this section [to subsec. (b) of this section] shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. No interest shall be allowed or paid on any overpayment resulting from the amendments made by subsections (a) and (b) of this section."

§ 906. Nonresident alien individuals and foreign corporations.

(a) Allowance of credit.

A nonresident alien individual or a foreign corporation engaged in trade or business within the

United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

(b) Special rules.

(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income from sources within the United States which would not be taxed by such foreign country or possession but for the fact that—

(A) in the case of a nonresident alien individual, such individual is a citizen or resident of such foreign country or possession, or

(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country or possession.

(2) For purposes of subsection (a), in applying section 904 the taxpayer's taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States.

(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business).

(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives dividends shall, with respect to such dividends, be treated as a domestic corporation.

(Added Pub. L. 89–809, title I, § 106(a)(1), Nov. 13, 1966, 80 Stat. 1568.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1966, and, in applying section 904 of this title with respect to this section, no amount to be carried from or to any taxable year beginning before Jan. 1, 1967, and no such year to be taken into account, see section 106(a)(6) of Pub. L. 89–809, set out as a note under section 874 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 841, 874, 882, 901 of this title.

SUBPART B.—EARNED INCOME OF CITIZENS OF UNITED STATES

Sec.
911. Earned income from sources without the United States.
912. Exemption for certain allowances.

§ 911. Earned income from sources without the United States.

(a) General rule.

The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Bona fide resident of foreign country.

In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

(2) Presence in foreign country for 17 months.

In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such 18-month period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) Definition of earned income.

For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

(c) Special rules.

For purposes of computing the amount excludable under subsection (a), the following rules shall apply:

(1) Limitations on amount of exclusion.

The amount excluded from the gross income of an individual under subsection (a) for any taxable

year shall not exceed an amount which shall be computed on a daily basis at an annual rate of—

(A) except as provided in subparagraph (B), $20,000 in the case of an individual who qualifies under subsection (a), or

(B) $25,000 in the case of an individual who qualifies under subsection (a)(1), but only with respect to that portion of such taxable year occuring after such individual has been a bona fide resident of a foreign country or countries for an uninterrupted period of 3 consecutive years.

(2) Attribution to year in which services are performed.

For purposes of applying paragraph (1), amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed.

(3) Treatment of community income.

In applying paragraph (1) with respect to amounts received for services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount excludable under subsection (a) from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income.

(4) Requirement as to time of receipt.

No amount received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed may be excluded under subsection (a).

(5) Certain amounts not excludable.

No amount—

(A) received as a pension or annuity, or

(B) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of non-exempt trust), section 403(c) (relating to taxability of beneficiary under a non-qualified annuity), or section 403(d) (relating to taxability of beneficiary under certain forfeitable contracts purchased by exempt organizations),

may be excluded under subsection (a).

(6) Test of bona fide residence.

A statement by an individual who has earned income from sources within a foreign country to the authorities of that country that he is not a resident of that country, if he is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings, shall be conclusive evidence with respect to such earnings that he is not a bona fide resident of that country for purposes of subsection (a)(1).

(7) Certain noncash remuneration.

If an individual who qualifies under subsection (a)(1) receives compensation from sources without the United States (except from the United States or any agency thereof) in the form of the right to use property or facilities, the limitation under paragraph (1) applicable with respect to such individual—

(A) for a taxable year ending in 1963, shall be increased by an amount equal to the amount of such compensation so received during such taxable year;

(B) for a taxable year ending in 1964, shall be increased by an amount equal to two-thirds of such compensation so received during such taxable year; and

(C) for a taxable year ending in 1965, shall be increased by an amount equal to one-third of such compensation so received during such taxable year.

(d) Cross reference.

(1) For administrative and penal provisions relating to the exclusion provided for in this section, see sections 6001, 6011, 6012 (c), and the other provisions of subtitle F.

(2) For elections as to treatment of income subject to foreign community property laws, see section 981.

(Aug. 16, 1954, ch. 736, 68A Stat. 289; Sept. 2, 1958, Pub. L. 85–866, title I, § 72(b), 72 Stat. 1660; Oct. 16, 1962, Pub. L. 87–834, § 11(a), 76 Stat. 1003; Feb. 26, 1964, Pub. L. 88–272, title II, § 237(a), 78 Stat. 128; Nov. 13, 1966, Pub. L. 89–809; title I, § 105(e)(3), 80 Stat. 1567.)

AMENDMENTS

1966—Subsec. (d). Pub. L. 89–809 designated existing par. as par. (1) and added par. (2).

1964—Subsec. (c)(1)(B). Pub. L. 88–272 substituted "$25,000" for "$35,000."

1962—Subsec. (a). Pub. L. 87–834 substituted "which constitute earned income attributable to services performed during such uninterrupted period" for "if such amounts constitute earned income (as defined in subsection (b)) attributable to such period" in par. (1), and "which constitute earned income attributable to services performed during such 18-month period" for "if such amounts constitute earned income (as defined in subsection (b)) attributable to such period" in par. (2), inserted provisions in pars. (1) and (2) requiring the amount excluded under such paragraphs to be computed by applying the special rules contained in subsec. (c), and eliminated provisions from par. (2) which limited the amount excluded under such paragraph to not more than $20,000 if the 18-month period includes the entire taxable year, and to not more than an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year if the 18-month period does not include the entire taxable year.

Subsec. (c). Pub. L. 87–834 added subsec. (c) and redesignated former subsec. (c) as (d).

Subsec. (d). Pub. L. 87–834 redesignated former subsec. (c) as (d).

1958—Subsec. (c). Pub. L. 85–866 added subsec. (c).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 237(b) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to this section] shall apply to taxable years beginning after December 31, 1964."

EFFECTIVE DATE OF 1962 AMENDMENT

Section 11(c)(1) of Pub. L. 87–834 provided that:

"The amendment made by subsection (a) [to this section] shall apply to taxable years ending after September 4, 1962, but only with respect to amounts—

"(A) received after March 12, 1962, which are attributable to services performed after December 31, 1962, or

"(B) received after December 31, 1962, which are attributable to services performed on or before December 31, 1962, unless on March 12, 1962, there existed a right (whether forfeitable or nonforfeitable) to receive such amounts."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of section by Pub. L. 85–866, which added subsec. (c), applicable to taxable years beginning after Dec. 31, 1957, see note set out under section 6012 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 37, 72, 403, 981, 1302, 1303, 1304, 1348, 1402, 3401, 4914, 6091 of this title; title 42 section 411.

§ 912. Exemption for certain allowances.

The following items shall not be included in gross income, and shall be exempt from taxation under this subtitle:

(1) Foreign areas allowances.

In the case of civilian officers and employees of the Government of the United States, amounts received as allowances or otherwise (but not amounts received as post differentials) under—

(A) title IX of the Foreign Service Act of 1946, as amended (22 U.S.C., sec. 1131 and following),

(B) section 4 of the Central Intelligence Agency Act of 1949, as amended (50 U.S.C., sec. 403e),

(C) title II of the Overseas Differentials and Allowances Act, or

(D) subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

(2) Cost-of-living allowances.

In the case of civilian officers or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President.

(3) Peace Corps allowances.

In the case of an individual who is a volunteer or volunteer leader within the meaning of the Peace Corps Act and members of his family, amounts received as allowances under section 5 or 6 of the Peace Corps Act other than amounts received as—

(A) termination payments under section 5(c) or section 6(1) of such Act,

(B) leave allowances,

(C) if such individual is a volunteer leader training in the United States, allowances to members of his family, and

(D) such portion of living allowances as the President may determine under the Peace Corps Act as constituting basic compensation.

(Aug. 16, 1954, ch. 736, 68A Stat. 290; Sept. 6, 1960, Pub. L. 86–707, title V, § 523(a), 74 Stat. 802; Sept. 22, 1961, Pub. L. 87–293, title II, § 201(a), 75 Stat. 625.)

REFERENCES IN TEXT

Title II of the Overseas Differentials and Allowances Act, referred to in pars. (1)(c) and (2), is classified to sections 5922 to 5925 of Title 5, Government Organization and Employees.

Subsections (e) and (f) of the first section of the Administrative Expenses Act of 1946, as amended, referred to in par. (1)(D), are classified to sections 5726, 5727 of Title 5.

Section 22 of such Act, referred to in par. (1)(D), means section 22 of the Administrative Expenses Act of 1946, which is classified to section 5913(b) of Title 5.

The Peace Corps Act, referred to in par. (3) and par. (3)(D), is classified to section 2501 et seq. of Title 22, Foreign Relations and Intercourse.

Sections 5 and 6 of the Peace Corps Act, referred to in par. (3), and sections 5(c) and 6(1) of such Act, referred to in par. (3)(A), are sections 5, 6, 5(c) and 6(1) of Pub. L. 87–293, which are classified to sections 2504, 2505, 2504(c) and 2505(1) of Title 22, Foreign Relations and Intercourse, respectively.

AMENDMENTS

1961—Par. (3). Pub. L. 87–293 added par. (3).

1960—Pub. L. 86–707 exempted foreign areas allowances received under section 4 of the Central Intelligence Agency Act of 1949, title II of the Overseas Differentials and Allowances Act, subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, or section 22 of such Act, provided that amounts received as post differentials shall not be exempt and in the provisions relating to cost-of-living allowances excluded Alaska from the term "continental United States" and amounts received under title II of the Overseas Differentials and Allowances Act.

EFFECTIVE DATE OF 1961 AMENDMENT

Section 201(d) of Pub. L. 87–293 provided that: "The amendments made by subsections (a) and (b) of this section [to this section and section 1303 of this title] shall apply with respect to taxable years ending after March 1, 1961. The amendment made by subsection (c) [to section 3401 of this title] shall apply with respect to remuneration paid after the date of the enactment of this Act [Sept. 22, 1961]."

Section 201(d) of Pub. L. 87–293 repealed by Pub. L. 89–572, § 5(a), Sept. 13, 1966, 80 Stat. 765. Such repeal not deemed to affect amendments contained in such provisions, see sections 5(b) of Pub. L. 89–572, set out as a note under former section 2515 of Title 22, Foreign Relations and Intercourse.

EFFECTIVE DATE OF 1960 AMENDMENT

Section 523(b) of Pub. L. 86–707 provided that: "Paragraphs (1) and (2) of section 912 of the Internal Revenue Code of 1954, as amended by subsection (a) of this section [pars. (1) and (2) of this section], shall apply only with respect to amounts received on or after the date of the enactment of this Act [Sept. 6, 1960] in taxable years ending on or after such date."

REPEALS; AMENDMENTS AND APPLICATION OF AMENDMENTS UNAFFECTED

Section 201(a) of Pub. L. 87–293 repealed by Pub. L. 89–572, § 5(a), Sept. 13, 1966, 80 Stat. 765. Such repeal not deemed to affect amendments to this section contained in such provisions, and continuation in full force and effect until modified by appropriate authority of all determinations, authorization, regulations, orders, contracts, agreements, and other actions issued undertaken, or entered into under authority of the repealed provisions, see section 5(b) of Pub. L. 89–572, set out as a note under former section 2515 of Title 22, Foreign Relations and Intercourse.

DELEGATION OF FUNCTIONS

Functions of the President under subsec. (3)(D) of this section delegated to the Secretary of State, see section 101(b) of Ex. Ord. No. 11041, Aug. 6, 1962, 27 F.R. 7859, set out as a note under section 2501 of Title 22, Foreign Relations and Intercourse.

DELEGATION OF AUTHORITY

Authority of the President under par. (2) of this section delegated to the Secretary of Defense with respect to the military departments, and the Secretary of the Treasury with respect to the Coast Guard, concerning civilian employees of nonappropriated fund instrumentalites of the armed forces, see section 201 of Ex. Ord. No. 11137, Jan. 7, 1964, set out as a note under section 150k of Title 5, Executive Departments and Government Officers and Employees.

SUBPART C.—WESTERN HEMISPHERE TRADE CORPORATIONS

Sec.

921. Definition of Western Hemisphere trade corporations.

922. Special deduction.

§ 921. Definition of Western Hemisphere trade corporations.

For purposes of this subtitle, the term "Western Hemisphere trade corporation" means a domestic corporation all of whose business (other than incidental purchases) is done in any country or countries in North, Central, or South America, or in the West Indies, and which satisfies the following conditions:

(1) if 95 percent or more of the gross income of such domestic corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources without the United States; and

(2) if 90 percent or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

For any taxable year beginning prior to January 1, 1954, the determination as to whether any corporation meets the requirements of section 109 of the Internal Revenue Code of 1939 shall be made as if this section had not been enacted and without inferences drawn from the fact that this section is not expressly made applicable with respect to taxable years beginning prior to January 1, 1954. (Aug. 16, 1954, ch. 736, 68A Stat. 290.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1503 of this title.

§ 922. Special deduction.

In the case of a Western Hemisphere trade corporation there shall be allowed as a deduction in computing taxable income an amount computed as follows—

(1) First determine the taxable income of such corporation computed without regard to this section.

(2) Then multiply the amount determined under paragraph (1) by the fraction—

(A) the numerator of which is 14 percent, and

(B) the denominator of which is that percentage which equals the sum of the normal tax rate and the surtax rate for the taxable year prescribed by section 11.

(Aug. 16, 1954, ch. 736, 68A Stat. 291.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 172, 1562, 6091 of this title.

SUBPART D.—POSSESSIONS OF THE UNITED STATES

Sec.
931. Income from sources within possessions of the United States.
932. Citizens of possessions of the United States.
933. Income from sources within Puerto Rico.
934. Limitation on reduction in income tax liability incurred to the Virgin Islands.

AMENDMENTS

1960—Pub. L. 86-779, § 4(a)(2), Sept. 14, 1960, 74 Stat. 999, added item 934.

SUBPART REFERRED TO IN OTHER SECTIONS

This subpart is referred to in section 1304 of this title.

§ 931. Income from sources within possessions of the United States.

(a) General rule.

In the case of citizens of the United States or domestic corporations, gross income means only gross income from sources within the United States if the conditions of both paragraph (1) and paragraph (2) are satisfied:

(1) Three-year period.

If 80 percent or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) Trade or business.

If—

(A) in the case of such corporation, 50 percent or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(B) in the case of such citizen, 50 percent or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) Amounts received in United States.

Notwithstanding subsection (a), there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) Definition.

For purposes of this section, the term "possession of the United States" does not include the Virgin Islands of the United States, and such term when used with respect to citizens of the United States does not include Puerto Rico.

(d) Deductions.

(1) General rule.

Except as otherwise provided in this subsection and subsection (e), in the case of persons entitled to the benefits of this section the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

(2) Exceptions.

The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

(A) The deduction, for losses not connected with the trade or business if incurred in trans-

actions entered into for profit, allowed by section 165(c)(2), but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

(B) The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property within the United States.

(C) The deduction for charitable contributions and gifts allowed by section 170.

(3) Deduction disallowed.

For disallowance of standard deduction, see section 142 (b)(2).

(e) Deduction for personal exemption.

A citizen of the United States entitled to the benefits of this section shall be allowed a deduction for only one exemption under section 151.

(f) Allowance of deductions and credits.

Persons entitled to the benefits of this section shall receive the benefit of the deductions and credits allowed to them in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return of their total income received from all sources in the United States, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits.

(g) Foreign tax credit.

Persons entitled to the benefits of this section shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(h) Internees.

In the case of a citizen of the United States interned by the enemy while serving as an employee within a possession of the United States—

(1) if such citizen was confined in any place not within a possession of the United States, such place of confinement shall, for purposes of this section, be considered as within a possession of the United States; and

(2) subsection (b) shall not apply to any compensation received within the United States by such citizen attributable to the period of time during which such citizen was interned by the enemy.

(i) Employees of the United States.

For purposes of this section, amounts paid for services performed by a citizen of the United States as an employee of the United States or any agency thereof shall be deemed to be derived from sources within the United States. (Aug. 16, 1954, ch. 736, 68A Stat. 291; Nov. 13, 1966, Pub. L. 89–809, title I, § 107(a), 80 Stat. 1571.)

AMENDMENTS

1966—Subsec (d). Pub. L. 89–809 made applicable to United States citizens and domestic corporations engaged in trade or business in possessions, who qualify for the special tax treatment of income qualifying for the exclusion relating to income from United States possessions, provisions which allow deductions to nonresident aliens or foreign corporations engaged in trade or business in the United States by allowing deductions only where they are allocable to income effectively connected with the trade or business in the United States and by spelling out the exceptions allowing deductions whether or not connected with income from sources within the United States in the case of losses not connected with the trade or business but incurred in transactions entered into for profit, casualty losses, and charitable contributions.

EFFECTIVE DATE OF 1966 AMENDMENT

Section 107(b) of Pub. L. 89–809 provided that: "The amendment made by this section [amending subsec. (d) of this section] shall apply with respect to taxable years beginning after December 31, 1966."

CROSS REFERENCES

Consolidated returns, definition of "includible corporation" as not meaning corporation entitled to the benefits of this section, see section 1504 (b) (4) of this title.

Income from sources within the United States, see section 861 of this title.

Optional tax, citizen entitled to benefits of this section as ineligible, see section 4 (d) (2) of this title.

Partial exclusion of dividends received by individuals, corporation to which this section applies, see section 116 (b) (2) (B) of this title.

Special deductions for corporations, deductions not allowed for dividends from corporation to which this section applies, see section 246 (a) (2) (B) of this title.

Standard deduction, citizen entitled to benefits of this section ineligible, see section 142 (b) (2) of this title.

Taxes of foreign countries and of possessions of the United States, corporations entitled to benefits of this section treated as foreign, see section 901 (c) (1) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 4, 48, 116, 142, 246, 861, 901, 957, 1302, 1402, 1504, 6091 of this title; title 42 section 411; title 48 section 1421i.

§ 932. Citizens of possessions of the United States.

(a) General rule.

Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States shall be subject to taxation under this subtitle in the same manner and subject to the same conditions as in the case of a nonresident alien individual. This section shall have no application in the case of a citizen of Puerto Rico.

(b) Virgin Islands.

Nothing in this section shall be construed to alter or amend the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes", approved July 12, 1921 (48 U. S. C. 1397), relating to the imposition of income taxes in the Virgin Islands of the United States.

(c) Guam.

For applicability of United States income tax laws in Guam, see section 31 of the Act of August 1, 1950 (48 U. S. C. 1421i); for disposition of the proceeds of such taxes, see section 30 of such Act (48 U. S. C. 1421h).

(Aug. 16, 1954, ch. 736, 68A Stat. 292; Nov. 13, 1966, Pub. L. 89–809, title I, § 103(m), 80 Stat. 1554.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809 substituted "in the same manner and subject to the same conditions as in the case of a nonresident alien individual" for "only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources" following "this subtitle".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 103(n)(1) of Pub. L. 89–809, set out as a note under section 871 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 1402 of this title and in title 42 section 411.

§ 933. Income from sources within Puerto Rico.

The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Resident of Puerto Rico for entire taxable year.

In the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, income derived from sources within Puerto Rico (except amounts received for services performed as an employee of the United States or any agency thereof); but such individual shall not be allowed as a deduction from his gross income any deductions (other than the deduction under section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Taxable year of change of residence from Puerto Rico.

In the case of an individual citizen of the United States who has been a bona fide resident of Puerto Rico for a period of at least 2 years before the date on which he changes his residence from Puerto Rico, income derived from sources therein (except amounts received for services performed as an employee of the United States or any agency thereof) which is attributable to that part of such period of Puerto Rican residence before such date; but such individual shall not be allowed as a deduction from his gross income any deductions (other than the deduction for personal exemptions under section 151) properly allocable to or chargeable against amounts excluded from gross income under this paragraph. (Aug. 16, 1954, ch. 736, 68A Stat. 293.)

CROSS REFERENCES

Self-employment income, resident of Puerto Rico to compute his net earnings without regard to this section, see section 1402(a)(6) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 957, 1402, 6091 of this title; title 42 section 411.

§ 934. Limitation on reduction in income tax liability incurred to the Virgin Islands.

(a) General rule.

Tax liability incurred to the Virgin Islands pursuant to this subtitle, as made applicable in the Virgin Islands by the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes", approved July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands, except to the extent provided in subsection (b) or (c).

(b) Exception for certain domestic and Virgin Islands corporations.

In the case of a domestic corporation or a Virgin Islands corporation, subsection (a) shall not apply (if the information required by subsection (d) is supplied) to the extent such corporation derived its income from sources without the United States if the conditions of both paragraph (1) and paragraph (2) are satisfied:

(1) Three-year period.

If 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Virgin Islands; and

(2) Trade or business.

If 50 percent or more of the gross income of such corporation for such period or such part thereof was derived from the active conduct of a trade or business within the Virgin Islands.

For purposes of the preceding sentence, the gross income of a Virgin Islands corporation, and the sources from which the income of such corporation is derived, shall be determined as if such corporation were a domestic corporation. For the purposes of this subsection, all amounts received by such corporation within the United States, whether derived from sources within or without the United States, shall be considered as being derived from sources within the United States.

(c) Exception for certain residents of the Virgin Islands.

Subsection (a) shall not apply in the case of an individual citizen of the United States who is a bona fide resident of the Virgin Islands during the entire taxable year (if the information required by subsection (d) is supplied), to the extent his income is derived from sources within the Virgin Islands (except that subsection (a) shall apply in the case of amounts received for services performed as an employee of the United States or any agency thereof). For purposes of the preceding sentence, gain or loss from the sale or exchange of any security (as defined in section 165(g)(2)) shall not be treated as derived from sources within the Virgin Islands.

(d) Requirement to supply information.

Subsections (b) and (c) shall apply only in the case of persons who supply (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) such information as the Secretary or his delegate may by regulations prescribe for purposes of determining the applicability of such subsections. (Added Pub. L. 86–779, § 4(a)(1), Sept. 14, 1960, 74 Stat. 998.)

EFFECTIVE DATE

Section 4(e)(1) of Pub. L. 86–779 provided that: "The amendments made by subsection (a) [adding this section] shall apply to tax liability incurred with respect to taxable years beginning on or after January 1, 1960."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 48 of this title.

SUBPART E.—CHINA TRADE ACT CORPORATIONS

Sec.
941. Special deduction for China Trade Act corporations.
942. Disallowance of foreign tax credit.
943. Exclusion of dividends to residents of Formosa or Hong Kong.

§ 941. Special deduction for China Trade Act corporations.

(a) Allowance of deduction.

For purposes only of the taxes imposed by section 11, there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922 (15 U. S. C. ch. 4, sec. 141 and following), in addition to the deductions from taxable income otherwise allowed such corporation, a special deduction, in computing the taxable income, of an amount equal to the proportion of the taxable income derived from sources within Formosa and Hong Kong (determined without regard to this section and determined in a similar manner to that provided in part I) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by—

(1) persons resident in Formosa, Hong Kong, the United States, or possessions of the United States, and

(2) individual citizens of the United States wherever resident,

bears to the par value of the whole number of shares of stock of the corporation outstanding on such date. In no case shall the diminution, by reason of such special deduction, of the taxes imposed by section 11 (computed without regard to this section) exceed the amount of the special dividend certified under subsection (b) of this section.

(b) Special dividend.

The special deduction provided in subsection (a) shall not be allowed unless the Secretary of Commerce has certified to the Secretary of the Treasury or his delegate—

(1) the amount which, during the year ending on the date fixed by law for filing the return, the corporation has distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in Formosa, Hong Kong, the United States, or possessions of the United States, or were individual citizens of the United States, and owned shares of stock of the corporation;

(2) that such special dividend was in addition to all other amounts, payable or to be payable to such persons or for their benefit, by reason of their interest in the corporation; and

(3) that such distribution has been made to or for the benefit of such persons in proportion to the par value of the shares of stock of the corporation owned by each; except that if the corporation has more than one class of stock, the certificates shall contain a statement that the articles of incorporation provide a method for the apportionment of such special dividend among such persons, and that the amount certified has been distributed in accordance with the method so provided.

(c) Ownership of stock.

For purposes of this section, shares of stock of a corporation shall be considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested. (Aug. 16, 1954, ch. 736, 68A Stat. 293.)

CROSS REFERENCES

Partial exclusion of dividends received by individuals, not applicable to dividend from corporation organized under China Trade Act, see section 116 (b) (1) of this title.

Special deductions for corporations, deduction not allowed for dividends from corporation organized under China Trade Act, see section 246 (a) (1) of this title.

Taxes of foreign countries and of possessions of United States, corporations treated as foreign, see section 901 (c) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 901, 6091 of this title.

§ 942. Disallowance of foreign tax credit.

A corporation organized under the China Trade Act, 1922, shall not be allowed the credits against tne tax for taxes of foreign countries and possessions of the United States allowed by section 901. (Aug. 16, 1954, ch. 736, 68A Stat. 294.)

REFERENCES IN TEXT

China Trade Act, 1922, referred to in the text, is classified to section 141 et seq. of Title 15, Commerce and Trade.

§ 943. Exclusion of dividends to residents of Formosa or Hong Kong.

Amounts distributed as dividends to or for the benefit of any person by a corporation organized under the China Trade Act, 1922, shall not be included in gross income and shall be exempt from taxation under this subtitle if, at the time of such distribution, such person is a resident of Formosa or Hong Kong, and the equitable right to the income of the shares of stock of the corporation is in good faith vested in him. (Aug. 16, 1954, ch. 736, 68A Stat. 294.)

REFERENCES IN TEXT

China Trade Act, 1922, referred to in the text, is classified to section 141 et seq. of Title 15, Commerce and Trade.

SUBPART F.—CONTROLLED FOREIGN CORPORATIONS

Sec.
951. Amounts included in gross income of United States shareholders.
952. Subpart F income defined.
953. Income from insurance of United States risks.
954. Foreign base company income.
955. Withdrawal of previously excluded subpart F income from qualified investment.
956. Investment of earnings in United States property.
957. Controlled foreign corporations; United States persons.
958. Rules for determining stock ownership.
959. Exclusion from gross income of previously taxed earnings and profits.
960. Special rules for foreign tax credit.
961. Adjustment to basis of stock in controlled foreign corporations and of other property.
962. Election by individuals to be subject to tax at corporate rates.
963. Receipt of minimum distributions by domestic corporations.
964. Miscellaneous provisions.

AMENDMENTS

1962—Pub. L. 87-834, § 12(a), Oct. 16, 1962, 76 Stat. 1006, added the heading of Subpart F, and items 951—964.

§ 951. Amounts included in gross income of United States shareholders.

(a) Amounts included.

(1) In general.

If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year beginning after December 31, 1962, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—

(A) the sum of—

(i) except as provided in section 963, his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year, and

(ii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year; and

(B) his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

(2) Pro rata share of subpart F income.

(The pro rata share referred to in paragraph (1)(A)(i) in the case of any United States shareholder is the amount—

(A) which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in its taxable year, on which the corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount (i) which bears the same ratio to its subpart F income for the taxable year, as (ii) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by

(B) the amount of distributions received by any other person during such year as a dividend with respect to such stock, but only to the extent of the dividend which would have been received if the distribution by the corporation had been the amount (i) which bears the same ratio to the subpart F income of such corporation for the taxable year, as (ii) the part of such year during which such shareholder did not own (within the meaning of section 958(a)) such stock bears to the entire year.

(3) Limitation on pro rata share of previously excluded subpart F income withdrawn from investment.

For purposes of paragraph (1)(A)(ii), the pro rata share of any United States shareholder of the previously excluded subpart F income of a controlled foreign corporation withdrawn from investment in less developed countries shall not exceed an amount (A) which bears the same ratio to his pro rata share of such income withdrawn (as determined under section 955(a)(3)) for the taxable year, as (B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

(4) Limitation on pro rata share of investment in United States property.

For purposes of paragraph (1)(B), the pro rata share of any United States shareholder in the increase of the earnings of a controlled foreign corporation invested in United State property shall not exceed an amount (A) which bears the same ratio to his pro rata share of such increase (as determined under section 956(a)(2)) for the taxable year, as (B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

(b) United States shareholder defined.

For purposes of this subpart, the term "United States shareholder" means, with respect to any foreign corporation, a United States person (as defined in section 957(d)) who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

(c) Coordination with election of a foreign investment company to distribute income.

A United States shareholder who, for his taxable year, is a qualified shareholder (within the meaning of section 1247(c)) of a foreign investment company with respect to which an election under section 1247 is in effect shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company.

(d) Coordination with foreign personal holding company provisions.

A United States shareholder who, for his taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) on income of a controlled foreign corporation shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company. (Added Pub. L. 87-834, § 12(a), Oct. 16, 1962, 76 Stat. 1006.)

EFFECTIVE DATE

Section 12(c) of Pub. L. 87-834 provided that: "The amendments made by this section [adding sections 951—964 and 970—972 of this title, and amending sections 901, 904 and 1016 of this title] shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable year of United States shareholders within which or with which such taxable years of such foreign corporations end."

ECONOMICALLY LESS DEVELOPED COUNTRIES

Designation of certain foreign countries as economically less developed countries, see Ex. Ord. No. 11071, Dec. 27, 1962, 27 F.R. 12875, set out as a note under section 955 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 958, 959, 960, 961, 962, 963, 970, 1246, 1248 of this title.

§ 952. Subpart F income defined.

(a) In general.

For purposes of this subpart, the term "subpart F income" means, in the case of any controlled foreign corporation, the sum of—

(1) the income derived from the insurance of United States risks (as determined under section 953), and

(2) the foreign base company income (as determined under section 954).

(b) Exclusion of United States income.

In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(c) Limitation.

For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such year reduced by the amount (if any) by which—

(1) an amount equal to—

(A) the sum of the deficits in earnings and profits for prior taxable years beginning after December 31, 1962, plus

(B) the sum of the deficits in earnings and profits for taxable years beginning after December 31, 1959, and before January 1, 1963 (reduced by the sum of the earnings and profits for such taxable years); exceeds

(2) an amount equal to the sum of the earnings and profits for prior taxable years beginning after December 31, 1962, allocated to other earnings and profits under section 959(c)(3).

For purposes of the preceding sentence, any deficit in earnings and profits for any prior taxable year shall be taken into account under paragraph (1) for any taxable year only to the extent it has not been taken into account under such paragraph for any preceding taxable year to reduce earnings and profits of such preceding year.

(d) Special rule in case of indirect ownership.

For purposes of subsection (c), if—

(1) a United States shareholder owns (within the meaning of section 958(a)) stock of a foreign corporation, and by reason of such ownership owns (within the meaning of such section) stock of any other foreign corporation, and

(2) any of such foreign corporations has a deficit in earnings and profits for the taxable year,

then the earnings and profits for the taxable year of each such foreign corporation which is a controlled foreign corporation shall, with respect to such United States shareholder, be properly reduced to take into account any deficit described in paragraph (2) in such manner as the Secretary or his delegate shall prescribe by regulations. (Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1008, and amended Pub. L. 89–809, title I, § 104(j), Nov. 13, 1966, 80 Stat. 1562.)

AMENDMENTS

1966—Subsec. (b). Pub. L. 89–809 substituted "In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States" for "Subpart F income does not include any item includible in gross income under this chapter (other than this subpart) as income derived from sources within the United States of a foreign corporation engaged in trade or business in the United States".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 864, 953, 954, 956, 964 of this title.

§ 953. Income from insurance of United States risks.

(a) General rule.

For purposes of section 952(a)(1), the term "income derived from the insurance of United States risks" means that income which—

(1) is attributable to the reinsurance or the issuing of any insurance or annuity contract—

(A) in connection with property in, or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, or

(B) in connection with risks not included in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect to any reinsurance or the issuing of any insurance or annuity contract in connection with property in, or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, and

(2) would (subject to the modifications provided by paragraphs (1), (2), and (3) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance corporation.

This section shall apply only in the case of a controlled foreign corporation which receives, during any taxable year, premiums or other consideration in respect of the reinsurance, and the issuing, of insurance and annuity contracts described in paragraph (1) in excess of 5 percent of the total of premiums and other consideration received during such taxable year in respect of all reinsurance and issuing of insurance and annuity contracts.

(b) Special rules.

For purposes of subsection (a)—

(1) In the application of part I of subchapter L, life insurance company taxable income is the gain from operations as defined in section 809(b).

(2) A corporation which would, if it were a domestic insurance corporation, be taxable under part II of subchapter L shall apply subsection (a) as if it were taxable under part III of subchapter L.

(3) The following provisions of subchapter L shall not apply:

(A) Section 809(d)(4) (operations loss deduction).

(B) Section 809(d)(5) (certain nonparticipating contracts).

(C) Section 809(d)(6) (group life, accident, and health insurance).

(D) Section 809(d)(10) (small business deduction).

(E) Section 817(b) (gain on property held on December 31, 1958, and certain substituted property acquired after 1958).

(F) Section 832(c)(5) (certain capital losses).

(4) The items referred to in—

(A) section 809(c)(1) (relating to gross amount of premiums and other considerations),

(B) section 809(c)(2) (relating to net decrease in reserves),

(C) section 809(d)(2) (relating to net increase in reserves), and

(D) section 832(b)(4) (relating to premiums earned on insurance contracts),

shall be taken into account only to the extent they are in respect of any reinsurance or the issuing of any insurance or annuity contract described in subsection (a)(1).

(5) All items of income, expenses, losses, and deductions (other than those taken into account under paragraph (4)) shall be properly allocated or apportioned under regulations prescribed by the Secretary or his delegate.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1008, and amended Pub. L. 89–809, title I § 104(m)(2), Nov. 13, 1966, 80 Stat. 1563.)

AMENDMENTS

1966—Subsec. (b)(3)(F). Pub. L. 89–809 substituted "832(c)(5)" for "832(b)(5)".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 37–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 952, 956, 957, of this title.

§ 954. Foreign base company income.

(a) Foreign base company income.

For purposes of section 952(a)(2), the term "foreign base company income" means for any taxable year the sum of—

(1) the foreign personal holding company income for the taxable year (determined under subsection (c) and reduced as provided in subsection (b)(5)),

(2) the foreign base company sales income for the taxable year (determined under subsection (d) and reduced as provided in subsection (b)(5)), and

(3) the foreign base company services income for the taxable year (determined under subsection (e) and reduced as provided in subsection (b)(5)).

(b) Exclusions and special rules.

(1) Exclusion of certain dividends, interest, and gains from qualified investments in less developed countries.

For purposes of subsection (a), foreign base company income does not include—

(A) dividends and interest received during the taxable year from investments which at the time of receipt are qualified investments in less developed countries (as defined in section 955(b)), or

(B) if the gains from the sale or exchange during the taxable year of investments which at the time of sale or exchange are qualified investments in less developed countries exceed the losses from the sale or exchange during the taxable year of such qualified investments, the amount by which such gains exceed such losses.

The preceding sentence shall apply only to the extent that the sum of the dividends and interest described in subparagraph (A) and the amount described in subparagraph (B) does not exceed the increase for the taxable year in qualified investments in less developed countries of the controlled foreign corporation (as determined under subsection (f)).

(2) Exclusion of certain shipping income.

For purposes of subsection (a), foreign base company income does not include income derived from, or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, or the performance of services directly related to the use of any such aircraft or vessel.

(3) Special rule where foreign base company income is less than 30 percent or more than 70 percent of gross income.

For purposes of subsection (a)—

(A) If the foreign base company income (determined without regard to paragraphs (1) and (5)) is less than 30 percent of gross income, no part of the gross income of the taxable year shall be treated as foreign base company income.

(B) If the foreign base company income (determined without regard to paragraphs (1) and (5)) exceeds 70 percent of gross income, the entire gross income of the taxable year shall, subject to the provisions of paragraphs (1), (2), (4), and (5), be treated as foreign base company income.

(4) Exception for foreign corporations not availed of to reduce taxes.

For purposes of subsection (a), foreign base company income does not include any item of income received by a controlled foreign corporation if it is established to the satisfaction of the Secretary or his delegate that neither—

(A) the creation or organization of such controlled foreign corporation under the laws of the foreign country in which it is incorporated (or, in the case of a controlled foreign corporation which is an acquired corporation, the acquisition of such corporation created or organized under the laws of the foreign country in which it is incorporated), nor

(B) the effecting of the transaction giving rise to such income through the controlled foreign corporation,

has as one of its significant purposes a substantial reduction of income, war profits, or excess profits or similar taxes.

(5) Deductions to be taken into account.

For purposes of subsection (a), the foreign personal holding company income, the foreign base company sales income, and the foreign base company services income shall be reduced, under regulations prescribed by the Secretary or his delegate, so as to take into account deductions (including taxes) properly allocable to such income.

(c) Foreign personal holding company income.

(1) In general.

For purposes of subsection (a)(1), the term "foreign personal holding company income" means the foreign personal holding company income (as defined in section 553), modified and adjusted as provided in paragraphs (2), (3), and (4).

(2) Rents included without regard to 50 percent limitation.

For purposes of paragraph (1), all rents shall be included in foreign personal holding company income without regard to whether or not such rents constitute 50 percent or more of gross income.

(3) Certain income derived in active conduct of trade or business.

For purposes of paragraph (1), foreign personal holding company income does not include—

(A) rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person (within the meaning of subsection (d)(3)), or

(B) dividends, interest, and gains from the sale or exchange of stock or securities derived in the conduct of a banking, financing, or similar business, or derived from the investments made by an insurance company of its unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business, and which are received from a person other than a related person (within the meaning of subsection (d)(3)).

(4) Certain income received from related persons.

For purposes of paragraph (1), foreign personal holding company income does not include—

(A) dividends and interest received from a related person which (i) is created or organized under the laws of the same foreign country under the laws of which the controlled foreign corporation is created or organized, and (ii) has a substantial part of its assets used in its trade or business located in such same foreign country;

(B) interest received in the conduct of a banking, financing, or similar business from a related person engaged in the conduct of a banking, financing, or similar business if the businesses of the recipient and the payor are predominantly with persons other than related persons; and

(C) rents, royalties, and similar amounts received from a related person for the use of, or the privilege of using, property within the country under the laws of which the controlled foreign corporation is created or organized.

(d) Foreign base company sales income.

(1) In general.

For purposes of subsection (a)(2), the term "foreign base company sales income" means income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where—

(A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown, or extracted outside the country under the laws of which the controlled foreign corporation is created or organized, and

(B) the property is sold for use, consumption, or disposition outside such foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

(2) Certain branch income.

For purposes of determining foreign base company sales income in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, under regulations prescribed by the Secretary or his delegate the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation.

(3) Related person defined.

For purposes of this section, a person is a related person with respect to a controlled foreign corporation, if—

(A) such person is an individual, partnership, trust, or estate which controls the controlled foreign corporation;

(B) such person is a corporation which controls, or is controlled by, the controlled foreign corporation; or

(C) such person is a corporation which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this paragraph, the rules for determining ownership of stock prescribed by section 958 shall apply.

(e) Foreign base company services income.

For purposes of subsection (a)(3), the term "foreign base company services income" means income (whether in the form of compensation, commissions, fees, or otherwise) derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which—

(1) are performed for or on behalf of any related person (within the meaning of subsection (d)(3)), and

(2) are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

The preceding sentence shall not apply to income derived in connection with the performance of services which are directly related to the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed prior to the time of the sale or exchange, or of services directly related to an offer or effort to sell or exchange such property.

(f) Increase in qualified investments in less developed countries.

For purposes of subsection (b)(1), the increase for any taxable year in qualified investments in less developed countries of any controlled foreign corporation is the amount by which—

(1) the qualified investments in less developed countries (as defined in section 955(b)) of the controlled foreign corporation at the close of the taxable year, exceeds

(2) the qualified investments in less developed countries (as so defined) of the controlled foreign corporation at the close of the preceding taxable year.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1009, and amended Pub. L. 91–172, title IX, § 909(a), Dec. 30, 1969, 83 Stat. 718.)

AMENDMENTS

1969—Subsec. (b)(4). Pub. L. 91–172 inserted reference to a foreign corporation which is an acquired corporation, and made the effecting of a transaction giving rise to foreign base income through the controlled foreign corporation subject to the Secretary's power to disallow inclusion of any item of such income where such inclusion will have one of the effects proscribed by this section.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 909(b) of Pub. L. 91–172 provided that: "The amendment made by subsection (a) [amending subsec. (b)(4) of this section] shall apply to taxable years ending after October 9, 1969."

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 952, 956, 958, 970, 971 of this title.

§ 955. Withdrawal of previously excluded subpart F income from qualified investment.

(a) General rules.

(1) Amount withdrawn.

For purposes of this subpart, the amount of previously excluded subpart F income of any controlled foreign corporation withdrawn from investment in less developed countries for any taxable year is an amount equal to the decrease in the amount of qualified investments in less developed countries of the controlled foreign corporation for such year, but only to the extent that the amount of such decrease does not exceed an amount equal to—

(A) the sum of the amounts excluded under section 954(b)(1) from the foreign base company income of such corporation for all prior taxable years, reduced by

(B) the sum of the amounts of previously excluded subpart F income withdrawn from investment in less developed countries of such corporation determined under this subsection for all prior taxable years.

(2) Decrease in qualified investments.

For purposes of paragraph (1), the amount of the decrease in qualified investments in less developed countries of any controlled foreign corporation for any taxable year is the amount by which—

(A) the amount of qualified investments in less developed countries of the controlled foreign corporation at the close of the preceding taxable year, exceeds

(B) the amount of qualified investments in less developed countries of the controlled foreign corporation at the close of the taxable year,

to the extent the amount of such decrease does not exceed the sum of the earnings and profits for the taxable year and the earnings and profits accumulated for prior taxable years beginning after December 31, 1962. For purposes of this paragraph, if qualified investments in less developed countries are disposed of by the controlled foreign corporation during the taxable year, the amount of the decrease in qualified investments in less developed countries of such controlled foreign corporation for such year shall be reduced by an amount equal to the amount (if any) by which the losses on such dispositions during such year exceed the gains on such dispositions during such year.

(3) Pro rata share of amount withdrawn.

In the case of any United States shareholder, the pro rata share of the amount of previously excluded subpart F income of any controlled for-

eign corporation withdrawn from investment in less developed countries for any taxable year is his pro rata share of the amount determined under paragraph (1).

(b) Qualified investments in less developed countries.

(1) In general.

For purposes of this subpart, the term "qualified investments in less developed countries" means property which is—

(A) stock of a less developed country corporation held by the controlled foreign corporation but only if the controlled foreign corporation owns 10 percent or more of the total combined voting power of all classes of stock of such less developed country corporation;

(B) an obligation of a less developed country corporation held by the controlled foreign corporation, which, at the time of its acquisition by the controlled foreign corporation, has a maturity of one year or more, but only if the controlled foreign corporation owns 10 percent or more of the total combined voting power of all classes of stock of such less developed country corporation; or

(C) an obligation of a less developed country.

(2) Country ceases to be less developed country.

For purposes of this subpart, property which would be a qualified investment in less developed countries, but for the fact that a foreign country has, after the acquisition of such property by the controlled foreign corporation, ceased to be a less developed country, shall be treated as a qualified investment in less developed countries.

(3) Special rule.

For purposes of this subpart, a United States shareholder of a controlled foreign corporation may, under regulations prescribed by the Secretary or his delegate, make the determinations under subsection (a)(2) of this section and under subsection (f) of section 954 as of the close of the years following the years referred to in such subsections, or as of the close of such longer period of time as such regulations may permit, in lieu of on the last day of such years. Any election under this paragraph made with respect to any taxable year shall apply to such year and to all succeeding taxable years unless the Secretary or his delegate consents to the revocation of such election.

(4) Exception.

For purposes of this subpart, property shall not constitute qualified investments in less developed countries if such property is disposed of within 6 months after the date of its acquisition.

(5) Amount attributable to property.

The amount taken into account under this subpart with respect to any property described in paragraph (1) or (2) shall be its adjusted basis, reduced by any liability to which such property is subject.

(c) Less developed country corporations.

(1) In general.

For purposes of this subpart, the term "less developed country corporation" means a foreign corporation which during the taxable year is engaged in the active conduct of one or more trades or businesses and—

(A) 80 percent or more of the gross income of which for the taxable year is derived from sources within less developed countries; and

(B) 80 percent or more in value of the assets of which on each day of the taxable year consists of—

(i) property used in such trades or businesses and located in less developed countries,

(ii) money, and deposits with persons carrying on the banking business,

(iii) stock, and obligations which, at the time of their acquisition, have a maturity of one year or more, of any other less developed comtry corporation,

(iv) an obligation of a less developed country,

(v) an investment which is required because of restrictions imposed by a less developed country, and

(vi) property described in section 956(b)(2).

For purposes of subparagraph (A), the determination as to whether income is derived from sources within less developed countries shall be made under regulations prescribed by the Secretary or his delegate.

(2) Shipping companies.

For purposes of this subpart, the term "less developed country corporation" also means a foreign corporation—

(A) 80 percent or more of the gross income of which for the taxable year consists of—

(i) gross income derived from, or in connection with, the using (or hiring or leasing for use) in foreign commerce of aircraft or vessels registered under the laws of a less developed country, or from, or in connection with, the performance of services directly related to use of such aircraft or vessels, or from the sale or exchange of such aircraft or vessels, and

(ii) dividends and interest received from foreign corporations which are less developed country corporations within the meaning of this paragraph and 10 percent or more of the total combined voting power of all classes of stock of which are owned by the foreign corporation, and gain from the sale or exchange of stock or obligations of foreign corporations which are such less developed country corporations, and

(B) 80 percent or more of the assets of which on each day of the taxable year consists of (i) assets used, or held for use, for or in connection with the production of income described in subparagraph (A), and (ii) property described in section 956(b)(2).

(3) Less developed country defined.

For purposes of this subpart, the term "less developed country" means (in respect of any foreign corporation) any foreign country (other than an area within the Sino-Soviet bloc) or any possession of the United States with respect to which,

on the first day of the taxable year, there is in effect an Executive order by the President of the United States designating such country or possession as an economically less developed country for purposes of this subpart. For purposes of the preceding sentence, an overseas territory, department, province, or possession may be treated as a separate country. No designation shall be made under this paragraph with respect to—

Australia	Liechtenstein
Austria	Luxembourg
Belgium	Monaco
Canada	Netherlands
Denmark	New Zealand
France	Norway
Germany	Union of South Africa
(Federal Republic)	San Marino
Hong Kong	Sweden
Italy	Switzerland
Japan	United Kingdom

After the President has designated any foreign country or any possession of the United States as an economically less developed country for purposes of this subpart, he shall not terminate such designation (either by issuing an Executive order for that purpose or by issuing an Executive order under the first sentence of this paragraph which has the effect of terminating such designation) unless, at least 30 days prior to such termination, he has notified the Senate and the House of Representatives of his intention to terminate such designation. (Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1013.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

EX. ORD. NO. 11071. DESIGNATION OF ECONOMICALLY LESS DEVELOPED COUNTRIES

Ex. Ord. No. 11071, Dec. 27, 1962, 27 F.R. 12875, provided:

By virtue of the authority vested in me by section 955 (c) (3) of the Internal Revenue Code of 1954, as added by section 12(a) of the Revenue Act of 1962, approved October 16, 1962 (Public Law 87–834, 76 Stat. 1015) [subsec. (c) (3) of this section], by section 301 of title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

SECTION 1. *Economically less developed countries.* For purposes of subpart A (sec. 901 and following) and subpart F (sec. 951 and following) of part III of subchapter N, and section 1248 of part IV of subchapter P, of chapter 1 of the Internal Revenue Code of 1954, the following areas are designated as economically less developed countries:

(a) all foreign countries (including Trust Territories) in existence on or after December 31, 1962, other than Australia, Austria, Belgium, Canada, Denmark, France, Federal Republic of Germany, Italy, Japan, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Union of South Africa, San Marino, Spain, Sweden, Switzerland, United Kingdom, and any foreign country within the Sino-Soviet bloc, as defined in section 2;

(b) each territory, department, province, and possession (other than Hong Kong) of any foreign country in existence on or after December 31, 1962, other than of a foreign country within the Sino-Soviet bloc, as defined in section 2, if the territory, department, province, or possession is overseas from the foreign country of which it is a territory, department, province, or possession; and

(c) the Commonwealth of Puerto Rico and all possessions of the United States.

SEC. 2. *Definition of the term "foreign country within the Sino-Soviet bloc".* For purposes of this Order, the term "foreign country within the Sino-Soviet bloc" shall mean Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet-Nam which is dominated or controlled by International Communism.

SEC. 3. *Rules and regulations.* The Secretary of the Treasury or his delegate is authorized to prescribe from time to time regulations, rulings, directions, and instructions to carry out the purposes of this Order.

SEC. 4. *Effective date.* This Order shall become effective December 31, 1962.

JOHN F. KENNEDY

Ex. Ord. No. 11071, Dec. 27, 1962, 27 F.R. 12875, set out as a note under this section, which designated economically less developed countries, was superseded, to the extent that such order applied to section 4916 of this title, by Ex. Ord. No. 11224, May 13, 1965, 30 F.R. 6679, set out as a note under section 4916 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 902, 951, 954, 956, 958, 963, 964, 970, 4916 of this title.

§ 956. Investment of earnings in United States property.

(a) General rules.

For purposes of this subpart—

(1) Amount of investment.

The amount of earnings of a controlled foreign corporation invested in United States property at the close of any taxable year is the aggregate amount of such property held, directly or indirectly, by the controlled foreign corporation at the close of the taxable year, to the extent such amount would have constituted a dividend (determined after the application of section 955(a)) if it had been distributed.

(2) Pro rata share of increase for year.

In the case of any United States shareholder, the pro rata share of the increase for any taxable year in the earnings of a controlled foreign corporation invested in United States property is the amount determined by subtracting his pro rata share of—

(A) the amount determined under paragraph (1) for the close of the preceding taxable year, reduced by amounts paid during such preceding taxable year to which section 959(c)(1) applies, from

(B) the amount determined under paragraph (1) for the close of the taxable year.

The determinations under subparagraphs (A) and (B) shall be made on the basis of stock owned (within the meaning of section 958(a)) by such United States shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation.

(3) Amount attributable to property.

The amount taken into account under paragraph (1) or (2) with respect to any property shall be its adjusted basis, reduced by any liability to which the property is subject.

(b) United States property defined.

(1) In general.

For purposes of subsection (a), the term "United States property" means any property acquired after December 31, 1962, which is—

(A) tangible property located in the United States;

(B) stock of a domestic corporation;

(C) an obligation of a United States person; or

(D) any right to the use in the United States of—

(i) a patent or copyright,

(ii) an invention, model, or design (whether or not patented),

(iii) a secret formula or process, or

(iv) any other similar right,

which is acquired or developed by the controlled foreign corporation for use in the United States.

(2) Exceptions.

For purposes of subsection (a), the term "United States property" does not include—

(A) obligations of the United States, money, or deposits with persons carrying on the banking business;

(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;

(C) any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person had the sale or processing transaction been made between unrelated persons;

(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States;

(E) an amount of assets of an insurance company equivalent to the unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business attributable to contracts which are not contracts described in section 953(a)(1); and

(F) an amount of assets of the controlled foreign corporation equal to the earnings and profits accumulated after December 31, 1962, and excluded from subpart F income under section 952(b).

(c) Pledges and guarantees.

For purposes of subsection (a), a controlled foreign corporation shall, under regulations prescribed by the Secretary or his delegate, be considered as holding an obligation of a United States person if such controlled foreign corporation is a pledgor or guarantor of such obligations. (Added Pub. L. 87-834, § 12(a), Oct. 16, 1962, 76 Stat. 1015.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87-834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 951, 955, 964, 4916 of this title.

§ 957. Controlled foreign corporations; United States persons.

(a) General rule.

For purposes of this subpart, the term "controlled foreign corporation" means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

(b) Special rule for insurance.

For purposes only of taking into account income described in section 953(a) (relating to income derived from insurance of United States risks), the term "controlled foreign corporation" includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of the reinsurance or the issuing of insurance or annuity contracts described in section 953(a)(1) exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

(c) Corporations organized in United States possessions.

For purposes of this subpart, the term "controlled foreign corporation" does not include any corporation created or organized in the Commonwealth of Puerto Rico or a possession of the United States or under the laws of the Commonwealth of Puerto Rico or a possession of the United States if—

(1) 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Commonwealth of Puerto Rico or a possession of the United States; and

(2) 50 percent or more of the gross income of such corporation for such period, or for such part thereof, was derived from the active conduct within the Commonwealth of Puerto Rico or a possession of the United States of any trades or businesses constituting the manufacture or

processing of goods, wares, merchandise, or other tangible personal property; the processing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, or fur-bearing animals); the catching or taking of any kind of fish or the mining or extraction of natural resources, or any manufacturing or processing of any products or commodities obtained from such activities; or the ownership or operation of hotels.

For purposes of paragraphs (1) and (2), the determination as to whether income was derived from sources within the Commonwealth of Puerto Rico or a possession of the United States and was derived from the active conduct of a described trade or business within the Commonwealth of Puerto Rico or a possession of the United States shall be made under regulations prescribed by the Secretary or his delegate.

(d) United States person.

For purposes of this subpart, the term "United States person" has the meaning assigned to it by section 7701(a)(30) except that—

(1) with respect to a corporation organized under the laws of the Commonwealth of Puerto Rico, such term does not include an individual who is a bona fide resident of Puerto Rico, if a dividend received by such individual during the taxable year from such corporation would, for purposes of section 933(1), be treated as income derived from sources within Puerto Rico,

(2) with respect to a corporation organized under the laws of the Virgin Islands, such term does not include an individual who is a bona fide resident of the Virgin Islands and whose income tax obligation under this subtitle for the taxable year is satisfied pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), by paying tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands, and

(3) with respect to a corporation organized under the laws of any other possession of the United States, such term does not include an individual who is a bona fide resident of any such other possession and whose income derived from sources within possessions of the United States is not, by reason of section 931(a), includible in gross income under this subtitle for the taxable year.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1017.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is refrred to in sections 951, 958, 963, 971, 1248, 4916 of this title.

§ 958. Rules for determining stock ownership.

(a) Direct and indirect ownership.

(1) General rule.

For purposes of this subpart (other than sections 955(b)(1)(A) and (B), 955(c)(2)(A)(ii), and 960(a)(1)), stock owned means—

(A) stock owned directly, and

(B) stock owned with the application of paragraph (2).

(2) Stock ownership through foreign entities.

For purposes of subparagraph (B) of paragraph (1), stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, or foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

(3) Special rule for mutual insurance companies.

For purposes of applying paragraph (1) in the case of a foreign mutual insurance company, the term "stock" shall include any certificate entitling the holder to voting power in the corporation.

(b) Constructive ownership.

For purposes of sections 951(b), 954(d)(3), and 957, section 318(a) (relating to constructive ownership of stock) shall apply to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b), to treat a person as a related person within the meaning of section 954(d)(3), or to treat a foreign corporation as a controlled foreign corporation under section 957, except that—

(1) In applying paragraph (1)(A) of section 318(a), stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered as owned by a citizen or by a resident alien individual.

(2) In applying subparagraphs (A), (B), and (C) of section 318(a)(2), if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of a corporation, it shall be considered as owning all the stock entitled to vote.

(3) In applying subparagraph (C) of section 318(a)(2), the phrase "10 percent" shall be substituted for the phrase "50 percent" used in subparagraph (C).

(4) Subparagraph (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1018, and amended Pub. L. 88–554, § 4(b)(5), Aug. 31, 1964, 78 Stat. 763.)

AMENDMENTS

1964—Subsec. (b). Pub. L. 88–554 redesignated pars. (4) and (5) as (3) and (4), respectively, eliminated former par. (3) which related to ownership of stock by a

partnership, estate, trust, or corporation for purposes of applying the first sentence of subpars. (A) and (B), and subpar. (C)(i) of section 318(a)(2) of this title, and made amendments throughout subsec. (b) to conform to the changes made in section 318 of this title by Pub. L. 88–554.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by section 4 of Pub. L. 88–554 effective Aug. 31, 1964, except that for purposes of sections 302 and 304 of this title, such amendments shall not apply to distributions in payment for stock acquisitions or redemptions, if such acquisitions or redemptions occurred before Aug. 31, 1964, see section 4(c) of Pub. L. 88–554 set out as a note under section 318 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 545, 864, 951, 952, 956, 957, 959, 961, 963, 964, 1246, 1248, 1249, 2107, 4916 of this title.

§ 959. Exclusion from gross income of previously taxed earnings and profits.

(a) Exclusion from gross income of United States persons.

For purposes of this chapter, the earnings and profits for a taxable year of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) shall not, when—

(1) such amounts are distributed to, or

(2) such amounts would, but for this subsection, be included under section 951(a)(1)(B) in the gross income of,

such shareholder (or any other United States person who acquires from any person any portion of the interest of such United States shareholder in such foreign corporation, but only to the extent of such portion, and subject to such proof of the identity of such interest as the Secretary or his delegate may by regulations prescribe) directly or indirectly through a chain of ownership described under section 958(a), be again included in the gross income of such United States shareholder (or of such other United States person).

(b) Exclusion from gross income of certain foreign subsidiaries.

For purposes of section 951(a), the earnings and profits for a taxable year of a controlled foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a), shall not, when distributed through a chain of ownership described under section 958(a), be also included in the gross income of another controlled foreign corporation in such chain for purposes of the application of section 951(a) to such other controlled foreign corporation with respect to such United States shareholder (or to any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder in the controlled foreign corporation, but only to the extent of such portion, and subject to such proof of identity of such interest as the Secretary or his delegate may prescribe by regulations).

(c) Allocation of distributions.

For purposes of subsections (a) and (b), section 316(a) shall be applied by applying paragraph (2) thereof, and then paragraph (1) thereof—

(1) first to earnings and profits attributable to amounts included in gross income under section 951(a)(1)(B) (or which would have been included except for subsection (a)(2) of this section),

(2) then to earnings and profits attributable to amounts included in gross income under section 951(a)(1)(A) (but reduced by amounts not included under section 951(a)(1)(B) because of the exclusion in subsection (a)(2) of this section), and

(3) then to other earnings and profits.

(d) Distributions excluded from gross income not to be treated as dividends.

Except as provided in section 960(a)(3), any distribution excluded from gross income under subsection (a) shall be treated, for purposes of this chapter, as a distribution which is not a dividend. (Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1019.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 951, 952, 956, 960, 961, 962, 1246, 1248 of this title.

§ 960. Special rules for foreign tax credit.

(a) Taxes paid by a foreign corporation.

(1) General rule.

For purposes of subpart A of this part, if there is included, under section 951(a), in the gross income of a domestic corporation any amount attributable to earnings and profits—

(A) of a foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation, or

(B) of a foreign corporation at least 50 percent of the voting stock of which is owned by a foreign corporation at least 10 percent of the voting stock of which is in turn owned by such domestic corporation,

then, under regulations prescribed by the Secretary or his delegate, such domestic corporation shall be deemed to have paid the same proportion of the total income, war profits, and excess profits taxes paid (or deemed paid) by such foreign corporation to a foreign country or possession of the United States for the taxable year on or with respect to the earnings and profits of such foreign corporation which the amount of earnings and profits of such foreign corporation so included in gross income of the domestic corporation bears to—

(C) if the foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation referred to in subparagraph (A) or (B) is not a less developed country corporation (as defined in section 902

(d)) for such taxable year, the entire amount of the earnings and profits of such foreign corporation for such taxable year, or

(D) if the foreign corporation at least 10 percent of the voting stock of which is owned by such domestic corporation referred to in subparagraph (A) or (B) is a less developed country corporation (as defined in section 902 (d)) for such taxable year, the sum of the entire amount of the earnings and profits of such foreign corporation for such taxable year and the total income, war profits, and excess profits taxes paid by such foreign corporation to foreign countries or possessions of the United States for such taxable year.

(2) Taxes previously deemed paid by domestic corporation.

If a domestic corporation receives a distribution from a foreign corporation, any portion of which is excluded from gross income under section 959, the income, war profits, and excess profits taxes paid or deemed paid by such foreign corporation to any foreign country or to any possession of the United States in connection with the earnings and profits of such foreign corporation from which such distribution is made shall not be taken into account for purposes of section 902, to the extent such taxes were deemed paid by a domestic corporation under paragraph (1) for any prior taxable year.

(3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation.

Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under paragraph (1) for any prior taxable year.

(b) Special rules for foreign tax credit in year of receipt of previously taxed earnings and profits.

(1) Increase in section 904 limitation.

In the case of any taxpayer who—

(A) either (i) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951(a) to include in his gross income an amount in respect of a controlled foreign corporation, or (ii) did not pay or accrue for such taxable year any income, war profits, or excess profits taxes to any foreign country or to any possession of the United States, and

(B) chooses to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded from gross income under section 959(a) and which is attributable to earnings and profits of the controlled foreign corporation which was included in his gross income for the taxable year referred to in subparagraph (A), and

(C) for the taxable year in which such distribution or amount is received, pays, or is deemed to have paid, or accrues income, war profits, or excess profits taxes to a foreign country or to any possession of the United States with respect to such distribution or amount,

the applicable limitation under section 904 for the taxable year in which such distribution or amount is received shall be increased as provided in paragraph (2), but such increase shall not exceed the amount of such taxes paid, or deemed paid, or accrued with respect to such distribution or amount.

(2) Amount of increase.

The amount of increase of the applicable limitation under section 904(a) for the taxable year in which the distribution or amount referred to in paragraph (1)(B) is received shall be an amount equal to—

(A) the amount by which the applicable limitation under section 904(a) for the taxable year referred to in paragraph (1)(A) was increased by reason of the inclusion in gross income under section 951(a) of the amount in respect of the controlled foreign corporation, reduced by

(B) the amount of any income, war profits, and excess profits taxes paid, or deemed paid, or accrued to any foreign country or possession of the United States which were allowable as a credit under section 901 for the taxable year referred to in paragraph (1)(A) and which would not have been allowable but for the inclusion in gross income of the amount described in subparagraph (A).

(3) Cases in which taxes not to be allowed as deduction.

In the case of any taxpayer who—

(A) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951(a) to include in his gross income an amount in respect of a controlled foreign corporation, and

(B) does not choose to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded from gross income under section 959(a) and which is attributable to earnings and profits of the controlled foreign corporation which was included in his gross income for the taxable year referred to in subparagraph (A),

no deduction shall be allowed under section 164 for the taxable year in which such distribution or amount is received for any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States on or with respect to such distribution or amount.

(4) Insufficient taxable income.

If an increase in the limitation under this subsection exceeds the tax imposed by this chapter for such year, the amount of such excess shall be deemed an overpayment of tax for such year.

(Added Pub. L. 87-834, § 12(a), Oct. 16, 1962, 76 Stat. 1020.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87-834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 78, 535, 545, 901, 958, 959, 962, 6038 of this title.

§ 961. Adjustments to basis of stock in controlled foreign corporations and of other property.

(a) Increase in basis.

Under regulations prescribed by the Secretary or his delegate, the basis of a United States shareholder's stock in a controlled foreign corporation, and the basis of property of a United States shareholder by reason of which he is considered under section 958(a)(2) as owning stock of a controlled foreign corporation, shall be increased by the amount required to be included in his gross income under section 951(a) with respect to such stock or with respect to such property, as the case may be, but only to the extent to which such amount was included in the gross income of such United States shareholder. In the case of a United States shareholder who has made an election under section 962 for the taxable year, the increase in basis provided by this subsection shall not exceed an amount equal to the amount of tax paid under this chapter with respect to the amounts required to be included in his gross income under section 951(a).

(b) Reduction in basis.

(1) In general.

Under regulations prescribed by the Secretary or his delegate, the adjusted basis of stock or other property with respect to which a United States shareholder or a United States person receives an amount which is excluded from gross income under section 959(a) shall be reduced by the amount so excluded. In the case of a United States shareholder who has made an election under section 962 for any prior taxable year, the reduction in basis provided by this paragraph shall not exceed an amount equal to the amount received which is excluded from gross income under section 959(a) after the appplication of section 962(d).

(2) Amount in excess of basis.

To the extent that an amount excluded from gross income under section 959(a) exceeds the adjusted basis of the stock or other property with respect to which it is received, the amount shall be treated as gain from the sale or exchange of property.

(Added Pub. L. 87-834, § 12(a), Oct. 16, 1962, 76 Stat. 1022.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87-834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is refererd to in section 1016 of this title.

§ 962. Election by individuals to be subject to tax at corporate rates.

(a) General rule.

Under regulations prescribed by the Secretary or his delegate, in the case of a United States shareholder who is an individual and who elects to have the provisions of this section apply for the taxable year—

(1) the tax imposed under this chapter on amounts which are included in his gross income under section 951(a) shall (in lieu of the tax determined under section 1) be an amount equal to the tax which would be imposed under section 11 if such amounts were received by a domestic corporation, and

(2) for purposes of applying the provisions of section 960 (relating to foreign tax credit) such amounts shall be treated as if they were received by a domestic corporation.

(b) Election.

An election to have the provisions of this section apply for any taxable year shall be made by a United States shareholder at such time and in such manner as the Secretary or his delegate shall prescribe by regulations. An election made for any taxable year may not be revoked except with the consent of the Secretary or his delegate.

(c) Surtax exemption.

For purposes of applying subsection (a)(1), the surtax exemption provided by section 11(c) shall not exceed, in the case of any United States shareholder, an amount which bears the same ratio to $25,000 as the amounts included in his gross income under section 951(a) for the taxable year bears to his pro rata share of the earnings and profits for the taxable year of all controlled foreign corporations with respect to which such United States shareholder includes any amount in gross income under section 951(a).

(d) Special rule for actual distributions.

The earnings and profits of a foreign corporation attributable to amounts which were included in the gross income of a United States shareholder under section 951(a) and with respect to which an election under this section applied shall, when such earnings and profits are distributed, notwithstanding the provisions of section 959(a)(1), be included in gross income to the extent that such earnings and profits so distributed exceed the amount of tax paid under this chapter on the amounts to which such election applied. (Added Pub. L. 87-834, § 12(a), Oct. 16, 1962, 76 Stat. 1023.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United State shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87-834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 961 of this title.

§ 963. Receipt of minimum distributions by domestic corporations.

(a) General rule.

In the case of a United States shareholder which is a domestic corporation and which consents to all

the regulations prescribed by the Secretary or his delegate under this section prior to the last day prescribed by law for filing its return of the tax imposed by this chapter for the taxable year, no amount shall be included in gross income under section 951(a)(1)(A)(i) for the taxable year with respect to the subpart F income of a controlled foreign corporation, if—

(1) in the case of a controlled foreign corporation described in subsection (c)(1), the United States shareholder receives a minimum distribution of the earnings and profits for the taxable year of such controlled foreign corporation;

(2) in the case of controlled foreign corporations described in subsection (c)(2), the United States shareholder receives a minimum distribution with respect to the consolidated earnings and profits for the taxable year of all such controlled foreign corporations; or

(3) in the case of controlled foreign corporations described in subsection (c)(3), the United States shareholder receives a minimum distribution of the consolidated earnings and profits for the taxable year of all such controlled foreign corporations.

(b) Minimum distribution.

For purposes of this section, a minimum distribution with respect to the earnings and profits for the taxable year of any controlled foreign corporation or corporations shall, in the case of any United States shareholder, be its pro rata share of an amount determined in accordance with whichever of the following tables applies to the taxable year:

(1) Taxable years beginning in 1963 and taxable years entirely within the surcharge period ending before January 1, 1970.

If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 10	90
10 or over but less than 20	86
20 or over but less than 28	82
28 or over but less than 34	75
34 or over but less than 39	68
39 or over but less than 42	55
42 or over but less than 44	40
44 or over but less than 46	27
46 or over but less than 47	14
47 or over	0

(2) Taxable years beginning in 1964 and taxable years beginning in 1969 and ending in 1970 to the extent subparagraph (B) applies.

If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 10	87
10 or over but less than 19	83
19 or over but less than 27	79
27 or over but less than 33	72
33 or over but less than 37	65
37 or over but less than 40	53
40 or over but less than 42	38
42 or over but less than 44	26
44 or over but less than 45	13
45 or over	0

(3) Taxable years beginning after 1964 (except taxable years which include any part of the surcharge period).

If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 9	83
9 or over but less than 18	79
18 or over but less than 26	76
26 or over but less than 32	69
32 or over but less than 36	63
36 or over but less than 39	51
39 or over but less than 41	37
41 or over but less than 42	25
42 or over but less than 43	13
43 or over	0

In the case of a taxable year beginning before the surcharge period and ending within the surcharge period, or beginning within the surcharge period and ending after the surcharge period, or beginning before January 1, 1970, and ending after December 31, 1969, the required minimum distribution shall be equal to the sum of—

(A) that portion of the minimum distribution which would be required if the provisions of paragraph (1) were applicable to the taxable year, which the number of days in such taxable year which are within the surcharge period and before January 1, 1970, bears to the total number of days in such taxable year,

(B) that portion of the minimum distribution which would be required if the provisions of paragraph (2) were applicable to such taxable year, which the number of days in such taxable year which are within the surcharge period and after December 31, 1969, bears to the total number of days in such taxable year, and

(C) that portion of the minimum distribution which would be required if the provisions of paragraph (3) were applicable to such taxable year, which the number of days in such taxable year which are not within the surcharge period bears to the total number of days in such taxable year.

As used in this subsection, the term "surcharge period" means the period beginning January 1, 1968, and ending June 30, 1970.

(c) Amounts to which section applies.

(1) Foreign subsidiaries.

Subsection (a)(1) shall apply to amounts which (but for the provisions of this section) would be included in the gross income of the United States shareholder under section 951(a)(1)(A)(i) by reason of its ownership, within the meaning of section 958(a)(1)(A), of stock of a controlled foreign corporation.

(2) Chain of controlled foreign corporations.

Subsection (a)(2) shall apply to amounts which (but for the provisions of this section) would be included in the gross income of the United States shareholder under section 951(a)(1)(A)(i)—

(A) by reason of its ownership, within the meaning of section 958(a)(1)(A), of stock of a controlled foreign corporation, and

(B) to the extent that the United States shareholder so elects, by reason of its ownership, within the meaning of section 958(a)(2), of stock of any other controlled foreign corporation (on account of its ownership of the stock described in subparagraph (A) or of stock described in this subparagraph), but only if there is taken into account the earnings and profits of each foreign corporation, whether or not a controlled foreign corporation, by reason of which the United States shareholder owns, within the meaning of section 958(a)(2), stock of such controlled foreign corporation.

(3) All controlled foreign corporations.

Except as provided in paragraph (4), subsection (a)(3) shall apply to amounts which (but for the provisions of this section) would be included in the gross income of the United States shareholder under section 951(a)(1)(A)(i)—

(A) by reason of its ownership, within the meaning of section 958(a)(1)(A), of stock of all controlled foreign corporations in which it owns stock within the meaning of such section, and

(B) by reason of its ownership, within the meaning of section 958(a)(2), of stock of all controlled foreign corporations in which it owns stock within the meaning of such section, but only if there is taken into account the earnings and profits of each foreign corporation, whether or not a controlled foreign corporation, by reason of which the United States shareholder owns, within the meaning of section 958(a), stock of any of such controlled foreign corporations.

(4) Exceptions and special rules.

(A) Less developed country corporations.

If the United States shareholder so elects, subsection (a)(3) and paragraph (3) of this subsection shall not apply to amounts which would be included in the gross income of such shareholder under section 951(a)(1)(A)(i) by reason of its ownership, within the meaning of section 958(a), of stock of controlled foreign corporations which are less developed country corporations (as defined in section 955(c)). This subparagraph shall not apply with respect to a less developed country corporation if, by reason of the ownership of the stock of such corporation, the United States shareholder owns, within the meaning of section 958(a)(2), stock of any other controlled foreign corporation which is not a less developed country corporation. Except as provided in the preceding sentence, an election under this subparagraph may be made only with respect to all controlled foreign corporations which are less developed country corporations and with respect to which the domestic corporation making the election is a United States shareholder.

(B) Foreign branches.

In applying subsection (a)(3) and paragraph (3) of this subsection, if a United States shareholder so elects, all branches maintained by such shareholder in foreign countries, the Commonwealth of Puerto Rico, or possessions of the United States shall, under regulations prescribed by the Secretary or his delegate, be treated as wholly owned subsidiary corporations of such shareholder organized under the laws of such foreign countries, the Commonwealth of Puerto Rico, or possessions of the United States, as the case may be. Each branch so treated shall, for purposes of this section, be considered to have distributed to the United States shareholder all of its earnings and profits for the taxable year. This subparagraph shall not apply to a branch maintained by a United States shareholder in the Commonwealth of Puerto Rico or a possession of the United States unless—

(i) such branch would be a controlled foreign corporation (as defined in section 957) if it were incorporated under the laws of the Commonwealth of Puerto Rico or the possession of the United States, as the case may be, and

(ii) the gross income of the United States shareholder for the taxable year includes income derived from sources within the Commonwealth of Puerto Rico and possessions of the United States.

(C) Blocked foreign income.

If a United States shareholder so elects, the provisions of subsection (a)(3) and of paragraph (3) of this subsection shall not apply with respect to any foreign corporation, if it is established to the satisfaction of the Secretary or his delegate that the earnings and profits of such foreign corporation could not have been distributed to United States shareholders who own (within the meaning of section 958(a)) stock of such foreign corporation because of currency or other restrictions or limitations imposed under the laws of any foreign country.

(d) Effective foreign tax rate.

For purposes of this section, the term "effective foreign tax rate" means—

(1) with respect to a single controlled foreign corporation, the percentage which—

(A) the income, war profits, or excess profits taxes paid or accrued to foreign countries or possessions of the United States by the controlled foreign corporation for the taxable year on or with respect to its earnings and profits for the taxable year, is of

(B) the sum of (i) the earnings and profits of the controlled foreign corporation described in subparagraph (A) and (ii) and the taxes described in subparagraph (A); and

(2) with respect to two or more foreign corporations, the percentage which—

(A) the total income, war profits, or excess profits taxes paid or accrued to foreign countries or possessions of the United States by such foreign corporations for the taxable year on or with respect to the consolidated earnings and profits of such foreign corporations for the taxable year, is of

(B) the sum of (i) the consolidated earnings and profits of such foreign corporations described in subparagraph (A) and (ii) the taxes described in subparagraph (A).

For purposes of the preceding sentence, in the case of any United States shareholder, the computation of the effective foreign tax rate applicable with respect to any controlled foreign corporation or corporations shall be made without regard to distributions made by such controlled foreign corporation or corporations to such United States shareholder.

(e) Special rules.

(1) Year from which distributions are made.

For purposes of this section, the second sentence of section 902(c)(1) shall apply in determining from the earnings and profits of what year distributions are made by any foreign corporation, except that the Secretary or his delegate may by regulations provide a period in excess of 60 days in lieu of the 60-day period prescribed in such section.

(2) Insufficient distributions.

If—

(A) a United States shareholder, in making its return of the tax imposed by this chapter for any taxable year, applies the provisions of this section with respect to any controlled foreign corporation,

(B) it is subsequently determined that this section did not apply with respect to such controlled foreign corporation for such taxable year due to the failure of the United States shareholder to receive a minimum distribution with respect to such controlled foreign corporation, and

(C) such failure is due to reasonable cause, then a subsequent distribution made with respect to such controlled foreign corporation may, if made at a time and in a manner prescribed by the Secretary or his delegate by regulations, be treated, for purposes of this chapter, as having been made for, and received in, the taxable year of the United States shareholder for which such shareholder applied the provisions of this section.

(3) Affiliated groups of corporations.

An affiliated group of corporations which makes a consolidated return under section 1501 for the taxable year, may, if it so elects, be treated as a single United States shareholder for purposes of applying this section for the taxable year.

(f) Regulations.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the provisions of this section, including regulations for the determination of the amount of foreign tax credit in the case of distributions with respect to the earnings and profits of two or more foreign corporations. (Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1023, and amended Pub. L. 88–272, title I, § 123(b), Feb. 26, 1964, 78 Stat. 29; Pub. L. 90–364, title I, § 102(b), June 28, 1968, 82 Stat. 255; Pub. L. 91–53, § 5(b), Aug. 7, 1969, 83 Stat. 95; Pub. L. 91–172, title VII, § 701(b), Dec. 30, 1969, 83 Stat. 659.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91–53, § 5(b), substituted "December 31, 1969" for "June 30, 1969", in the last sentence.

Subsec. (b)(1). Pub. L. 91–172, § 701(b)(1), added reference to Jan. 1, 1970 in the heading preceding the table.

Subsec. (b)(2). Pub. L. 91–172, § 701(b)(2), added references to taxable years beginning in 1969 and ending in 1970, and to subpar. (B) in the heading preceding the table.

Subsec. (b)(3). Pub. L. 91–172, § 701(b)(3), added reference to taxable years beginning before Jan. 1, 1970 and ending after Dec. 31, 1969 in the material immediately following the table, and added provisions for the apportioning of minimum distribution with reference to the taxable years within the surcharge period after Dec. 31, 1969 and before Jan. 1, 1970, and extended the surcharge period from Dec. 31, 1969 to June 30, 1970.

1968—Subsec. (b)(1). Pub. L. 90–364, § 102(b)(1), inserted "and taxable years entirely within the surcharge period" following "beginning in 1963" in the catchline.

Subsec. (b)(3). Pub. L. 90–364, § 102(b)(2), (3), substituted "after 1964 (except taxable years which include any part of the surcharge period)" for "after December 31, 1964" in the catchline and added provisions following the table covering the required minimum distribution in the case of a taxable year beginning before the surcharge period and ending within the surcharge period, or beginning within the surcharge period and ending after the surcharge period.

1964—Subsec. (b). Pub. L. 88–272 limited existing provisions to taxable years beginning in 1963, and inserted provisions relating to taxable years beginning in 1964 and beginning after Dec. 31, 1964.

EFFECTIVE DATE OF 1969 AMENDMENTS

Amendment by Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, and beginning before July 1, 1970, see section 701(c) of Pub. L. 91–172, set out as a note under section 51 of this title.

Amendment of subsec. (b) of this section by Pub. L. 91–53 applicable to taxable years ending after June 30, 1969, and beginning before Jan. 1, 1970, see section 5(c) of Pub. L. 91–53, set out as a note under section 51 of this title.

EFFECTIVE DATE OF 1968 AMENDMENT

Amendment Pub. L. 90–364 applicable, insofar as they relate to taxpayers other than corporations, to taxable years ending after Mar. 31, 1968, and beginning before July 1, 1969, and, insofar as they relate to corporations, to taxable years ending after Dec. 31, 1967, and beginning before July 1, 1969, except as provided in section 104 of Pub. L. 90–364, see section 102(e) of Pub. L. 90–364, set out as a note under section 51 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272, except for purposes of section 21 of this title, effective with respect to taxable years beginning after Dec. 31, 1963, see section 131 of Pub. L. 88–272, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 951 of this title.

§ 964. Miscellaneous provisions.

(a) Earnings and profits.

Except as provided in section 312(m)(3), for purposes of this subpart, the earnings and profits of any foreign corporation, and the deficit in earnings and profits of any foreign corporation, for any taxable

year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary or his delegate.

(b) Blocked foreign income.

Under regulations prescribed by the Secretary or his delegate, no part of the earnings and profits of a controlled foreign corporation for any taxable year shall be included in earnings and profits for purposes of sections 952, 955, and 956, if it is established to the satisfaction of the Secretary or his delegate that such part could not have been distributed by the controlled foreign corporation to United States shareholders who own (within the meaning of section 958(a)) stock of such controlled foreign corporation because of currency or other restrictions or limitations imposed under the laws of any foreign country.

(c) Records and accounts of United States shareholders.

(1) Records and accounts to be maintained.

The Secretary or his delegate may by regulations require each person who is, or has been, a United States shareholder of a controlled foreign corporation to maintain such records and accounts as may be prescribed by such regulations as necessary to carry out the provisions of this subpart and subpart G.

(2) Two or more persons required to maintain or furnish the same records and accounts with respect to the same foreign corporation.

Where, but for this paragraph, two or more United States persons would be required to maintain or furnish the same records and accounts as may by regulations be required under paragraph (1) with respect to the same controlled foreign corporation for the same period, the Secretary or his delegate may by regulations provide that the maintenance or furnishing of such records and accounts by only one such person shall satisfy the requirements of paragraph (1) for such other persons.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1027, and amended Pub. L. 91–172, title IV, § 442(b)(1), Dec. 30, 1969, 83 Stat. 628.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 added reference to the exception provided for in section 312(m)(3).

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SUBPART G.—EXPORT TRADE CORPORATIONS

Sec.
970. Reduction of subpart F income of export trade corporations.
971. Definitions.
972. Consolidation of group of export trade corporations.

AMENDMENTS

1962—Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1027, added the heading of subpart G, and items 970—972.

§ 970. Reduction of subpart F income of export trade corporations.

(a) Export trade income constituting foreign base company income.

(1) In general.

In the case of a controlled foreign corporation (as defined in section 957) which for the taxable year is an export trade corporation, the subpart F income (determined without regard to this subpart) of such corporation for such year shall be reduced by an amount equal to so much of the export trade income (as defined in section 971(b)) of such corporation for such year as constitutes foreign base company income (as defined in section 954), but only to the extent that such amount does not exceed whichever of the following amounts is the lesser:

(A) an amount equal to 1½ times so much of the export promotion expenses (as defined in section 971(d)) of such corporation for such year as is probably allocable to the export trade income which constitutes foreign base company income of such corporation for such year, or

(B) an amount equal to 10 percent of so much of the gross receipts for such year (or, in the case of gross receipts arising from commissions, fees, or other compensation for its services, so much of the gross amount upon the basis of which such commissions, fees, or other compensation is computed) accruing to such export trade corporation from the sale, installation, operation, maintenance, or use of property in respect of which such corporation derives export trade income as is properly allocable to the export trade income which constitutes foreign base company income of such corporation for such year.

The allocations with respect to export trade income which constitutes foreign base company income under subparagraphs (A) and (B) shall be made under regulations prescribed by the Secretary or his delegate.

(2) Overall limitation.

The reduction under paragraph (1) for any taxable years shall not exceed an amount which bears the same ratio to the increase in the investments in export trade assets (as defined in section 971(c)) of such corporation for such year as the export trade income which constitutes foreign base company income of such corporation for such year bears to the entire export trade income of such corporation for such year.

(b) Inclusion of certain previously excluded amounts.

Each United States shareholder of a controlled foreign corporation which for any prior taxable year was an export trade corporation shall include in his gross income under section 951(a)(1)(A)(ii), as an amount to which section 955 (relating to withdrawal of previously excluded subpart F income from qualified investment) applies, his pro rata share of the amount of decrease in the investments in export trade assets of such corporation for such

year, but only to the extent that his pro rata share of such amount does not exceed an amount equal to—

(1) his pro rata share of the sum of (A) the amounts by which the subpart F income of such corporation was reduced for all prior taxable years under subsection (a), and (B) the amounts not included in subpart F income (determined without regard to this subpart) for all prior taxable years by reason of the application of section 972, reduced by

(2) the sum of the amounts which were included in his gross income under section 951(a)(1)(A)(ii) under the provisions of this subsection for all prior taxable years.

(c) Investments in export trade assets.

(1) Amount of investments.

For purposes of this section, the amount taken into account with respect to any export trade asset shall be its adjusted basis, reduced by any liability to which the asset is subject.

(2) Increase in investments in export trade assets.

For purposes of subsection (a), the amount of increase in investments in export trade assets of any controlled foreign corporation for any taxable year is the amount by which—

(A) the amount of such investments at the close of the taxable year, exceeds

(B) the amount of such investments at the close of the preceding taxable year.

(3) Decrease in investments in export trade assets.

For purposes of subsection (b), the amount of decrease in investments in export trade assets of any controlled foreign corporation for any taxable year is the amount by which—

(A) the amount of such investments at the close of the preceding taxable year (reduced by an amount equal to the amount of net loss sustained during the taxable year with respect to export trade assets), exceeds

(B) the amount of such investments at the close of the taxable year.

(4) Special rule.

A United States shareholder of an export trade corporation may, under regulations prescribed by the Secretary or his delegate, make the determinations under paragraphs (2) and (3) as of the close of the 75th day after the close of the years referred to in such paragraphs in lieu of on the last day of such years. A United States shareholder of an export trade corporation may, under regulations prescribed by the Secretary or his delegate, make the determinations under paragraphs (2) and (3) with respect to export trade assets described in section 971(c)(3) as of the close of the years following the years referred to in such paragraphs, or as of the close of such longer period of time as such regulations may permit, in lieu of on the last day of such years and in lieu of on the day prescribed in the preceding sentence. Any election under this paragraph made with respect to any taxable year shall apply to such year and to all succeeding taxable years unless the Secretary or his delegate consents to the revocation of such election.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1027.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

§ 971. Definitions.

(a) Export trade corporations.

For purposes of this subpart, the term "export trade corporation" means—

(1) In general.

A controlled foreign corporation (as defined in section 957) which satisfies the following conditions:

(A) 90 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or such part of such period subsequent to the effective date of this subpart during which the corporation was in existence) was derived from sources without the United States, and

(B) 75 percent or more of the gross income of such corporation for such period constituted gross income in respect of which such corporation derived export trade income.

(2) Special rule.

If 50 percent or more of the gross income of a controlled foreign corporation in the period specified in subsection (a)(1)(A) is gross income in respect of which such corporation derived export trade income in respect of agricultural products grown in the United States, it may qualify as an export trade corporation although it does not meet the requirements of subsection (a)(1)(B).

(b) Export trade income.

For the purposes of this subpart, the term "export trade income" means net income from—

(1) the sale to an unrelated person for use, consumption, or disposition outside the United States of export property (as defined in subsection (e)), or from commissions, fees, compensation, or other income from the performance of commercial, industrial, financial, technical, scientific, managerial, engineering, architectural, skilled, or other services in respect to such sales or in respect of the installation or maintenance of such export property;

(2) commissions, fees, compensation, or other income from commercial, industrial, financial, technical, scientific, managerial, engineering, architectural, skilled, or other services performed in connection with the use by an unrelated person outside the United States of patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like property acquired or developed and owned by the manufacturer, producer, grower, or extractor of

export property in respect of which the export trade corporation earns export trade income under paragraph (1);

(3) commissions, fees, rentals, or other compensation or income attributable to the use of export property by an unrelated person or attributable to the use of export property in the rendition of technical, scientific, or engineering services to an unrelated person; and

(4) interest from export trade assets described in subsection (c)(4).

For purposes of paragraph (3), if a controlled foreign corporation receives income from an unrelated person attributable to the use of export property in the rendition of services to such unrelated person together with income attributable to the rendition of other services to such unrelated person, including personal services, the amount of such aggregate income which shall be considered to be attributable to the use of the export property shall (if such amount cannot be established by reference to transactions between unrelated persons) be that part of such aggregate income which the cost of the export property consumed in the rendition of such services (including a reasonable allowance for depreciation) bears to the total cost and expenses attributable to such aggregate income.

(c) Export trade assets.

For purposes of this subpart, the term "export trade assets" means—

(1) working capital reasonably necessary for the production of export trade income,

(2) inventory of export property held for use, consumption, or disposition outside the United States,

(3) facilities located outside the United States for the storage, handling, transportation, packaging, or servicing of export property, and

(4) evidences of indebtedness executed by persons, other than related persons, in connection with payment for purchases of export property for use, consumption, or disposition outside the United States, or in connection with the payment for services described in subsections (b) (2) and (3).

(d) Export promotion expenses.

For purposes of this subpart, the term "export promotion expenses" means the following expenses paid or incurred in the receipt or production of export trade income—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered for such purpose,

(2) rentals or other payments for the use of property actually used for such purpose,

(3) a reasonable allowance for the exhaustion, wear and tear, or obsolescence of property actually used for such purpose, and

(4) any other ordinary and necessary expenses of the corporation to the extent reasonably allocable to the receipt or production of export trade income.

No expense incurred within the United States shall be treated as an export promotion expense within the meaning of the preceding sentence, unless at least 90 percent of each category of expenses described in such sentence is incurred outside the United States.

(e) Export property.

For purposes of this subpart, the term "export property" means any property or any interest in property manufactured, produced, grown, or extracted in the United States.

(f) Unrelated person.

For purposes of this subpart, the term "unrelated person" means a person other than a related person as defined in section 954(d)(3). (Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1029.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 970 of this title.

§ 972. Consolidation of group of export trade corporations.

For purposes of this subpart and subpart F of this part, a United States shareholder of a controlled foreign corporation which is an export trade corporation may, under regulations prescribed by the Secretary or his delegate, treat as a single controlled foreign corporation—

(1) such controlled foreign corporation,

(2) all controlled foreign corporations which are export trade corporations and 80 percent or more of the total combined voting power of all classes of stock entitled to vote of which is owned by such controlled foreign corporation; and

(3) all controlled foreign corporations which are export trade corporations and 80 percent or more of the total combined voting power of all classes of stock entitled to voto of which is owned by controlled foreign corporations described in paragraph (2).

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1031.)

EFFECTIVE DATE

Section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 970 of this title.

SUBPART H.—INCOME OF CERTAIN NONRESIDENT UNITED STATES CITIZENS SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS

Sec.

981. Election as to treatment of income subject to foreign community property laws.

AMENDMENTS

1966—Pub. L. 89–809, title I, § 105(e)(1), Nov. 13, 1966, 80 Stat. 1565, added the heading of Subpart H and item 981.

§ 981. Election as to treatment of income subject to foreign community property laws.

(a) General rule.

In the case of any taxable year beginning after December 31, 1966, if—

(1) an individual is (A) a citizen of the United States, (B) a bona fide resident of a foreign country or countries during the entire taxable year, and (C) married at the close of the taxable year to a spouse who is a nonresident alien during the entire taxable year, and

(2) such individual and his spouse elect to have subsection (b) apply to their community income under foreign community property laws,

then subsection (b) shall apply to such income of such individual and such spouse for the taxable year and for all subsequent taxable years for which the requirements of paragraph (1) are met, unless the Secretary or his delegate consents to a termination of the election.

(b) Treatment of community income.

For any taxable year to which an election made under subsection (a) applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as follows:

(1) Earned income (within the meaning of the first sentence of section 911(b)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.

(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5).

(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable foreign community property law) of one spouse shall be treated as the income of such spouse.

(4) All other such community income shall be treated as provided in the applicable foreign community property law.

(c) Election for pre-1967 years.

(1) Election.

If an individual meets the requirements of subsections (a)(1)(A) and (C) for any taxable year beginning before January 1, 1967, and if such individual and the spouse referred to in subsection (a)(1)(C) elect under this subsection, then paragraph (2) of this subsection shall apply to their community income under foreign community property laws for all open taxable years beginning before January 1, 1967 (whether under this chapter, the corresponding provisions of the Internal Revenue Code of 1939, or the corresponding provisions of prior revenue laws), for which the requirements of subsection (a)(1)(A) and (C) are met.

(2) Effect of election.

For any taxable year to which an election made under this subsection applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as provided by subsection (b), except that the other community income described in paragraph (4) of subsection (b) shall be treated as the income of the spouse who, for such taxable year, had gross income under paragraphs (1), (2), and (3) of subsection (b), plus separate gross income, greater than that of the other spouse.

(d) Time for making elections; period of limitations; etc.

(1) Time.

An election under subsection (a) or (c) for a taxable year may be made at any time while such year is still open, and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe.

(2) Extension of period for assessing deficiencies and making refunds.

If any taxable year to which an election under subsection (a) or (c) applies is open at the time such election is made, the period for assessing a deficiency against, and the period for filing claim for credit or refund of any overpayment by, the husband and wife for such taxable year, to the extent such deficiency or overpayment is attributable to such an election, shall not expire before 1 year after the date of such election.

(3) Alien spouse need not join in subsection (c) election in certain cases.

If the Secretary or his delegate determines—

(A) that an election under subsection (c) would not affect the liability for Federal income tax of the spouse referred to in subsection (a)(1)(C) for any taxable year, or

(B) that the effect on such liability for tax cannot be ascertained and that to deny the election to the citizen of the United States would be inequitable and cause undue hardship,

such spouse shall not be required to join in such election, and paragraph (2) of this subsection shall not apply with respect to such spouse.

(4) Interest.

To the extent that any overpayment or deficiency for a taxable year is attributable to an election made under this section, no interest shall be allowed or paid for any period before the day which is 1 year after the date of such election.

(e) Definitions and special rules.

For purposes of this section—

(1) Deductions.

Deductions shall be treated in a manner consistent with the manner provided by this section for the income to which they relate.

(2) Open years.

A taxable year of a citizen of the United States and his spouse shall be treated as "open" if the period for assessing a deficiency against such citizen for such year has not expired before the date of the election under subsection (a) or (c), as the case may be.

(3) Elections in case of decedents.

If a husband or wife is deceased his election under this section may be made by his executor, administrator, or other person charged with his property.

(4) Death of spouse during taxable year.

In applying subsection (a) (1) (C), and in determining under subsection (c) (2) which spouse has the greater income for a taxable year, if a husband or wife dies the taxable year of the surviving spouse shall be treated as ending on the date of such death.

(Added Pub. L. 89–809, title I, § 105(e) (1), Nov. 13, 1966, 80 Stat. 1565.)

Subchapter O.—Gain or Loss on Disposition of Property

Part
I. Determination of amount of and recognition of gain or loss.
II. Basis rules of general application.
III. Common nontaxable exchanges.
IV. Special rules.
V. Changes to effectuate F. C. C. policy.
VI. Exchanges in obedience to S. E. C. orders.
VII. Wash sales of stock or securities.
VIII. Distributions pursuant to Bank Holding Company Act of 1956
IX. Distributions pursuant to orders enforcing the anti-trust laws.

AMENDMENTS

1962—Pub. L. 87–403, § 1(b), Feb. 2, 1962, 76 Stat. 5, added the heading of Part IX.

1956—Act May 9, 1956, ch. 240, § 10 (b), 70 Stat. 146, added Part VIII.

PART I.—DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

Sec.
1001. Determination of amount of and recognition of gain or loss.
1002. Recognition of gain or loss.

§ 1001. Determination of amount of and recognition of gain or loss.

(a) Computation of gain or loss.

The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount realized.

The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized—

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164 (d) as imposed on the purchaser, and

(2) there shall be taken into account amounts representing real property taxes which are treated under section 164 (d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) Recognition of gain or loss.

In the case of a sale or exchange of property, the extent to which the gain or loss determined under this section shall be recognized for purposes of this subtitle shall be determined under section 1002.

(d) Installment sales.

Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

(e) Certain term interests.

(1) In general.

In determining gain or loss from the sale or other disposition of a term interest in property, that portion of the adjusted basis of such interest which is determined pursuant to section 1014 or 1015 (to the extent that such adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded.

(2) Term interest in property defined.

For purposes of paragraph (1), the term "term interest in property" means—

(A) a life interest in property,

(B) an interest in property for a term of years, or

(C) an income interest in a trust.

(3) Exception.

Paragraph (1) shall not apply to a sale or other disposition which is a part of a transaction in which the entire interest in property is transferred to any person or persons.

(f) Cross reference.

For treatment of certain expenses incident to the sale of a residence which were deducted as moving expenses by the taxpayer or his spouse under section 217(a), see section 217(e).

(Aug. 16, 1954, ch. 736, 68A Stat. 295; Dec. 30, 1969, Pub. L. 91–172, title II, § 231(c) (2), title V, § 516(a), 83 Stat. 579, 646.)

AMENDMENTS

1969—Subsec. (e). Pub. L. 91–172, § 516(a), added subsec. (e).

Subsec. (f). Pub. L. 91–172, § 231(c) (2), added subsec. (f).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 516(d) of Pub. L. 91–172 provided that:

"(1) The amendment made by subsection (a) [amending this section] shall apply to sales or other dispositions after October 9, 1969.

"(2) The amendment made by subsection (b), [amending section 1231 of this title] shall apply to taxable years beginning after December 31, 1969.

"(3) The amendments made by subsection (c) [enacting section 1253 and amending sections 162 and 1016 of this title] shall apply to transfers after December 31, 1969, except that section 1253(d) (1) of the Internal Revenue Code of 1954 [section 1253(d) (1) of this title] (as added by subsection (c) shall, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate may by regulations prescribe), apply to transfers before January 1, 1970, but only with respect to payments made in taxable years ending after December 31, 1969, and beginning before January 1, 1980."

Amendment of section by section 231(c) (2) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 231(d) of Pub. L. 91–172, set out as a note under section 217 of this title.

CROSS REFERENCES

Gain or loss to shareholders in corporate liquidations, see section 331 of this title.

Installment method of accounting, see section 453 of this title.

Recognition of gain or loss on transfer of obsolete vessels under Merchant Marine Act, section 1101 et seq. of Title 46, see section 1160 (e) of Title 46, Shipping.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1002 of this title.

§ 1002. Recognition of gain or loss.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized. (Aug. 16, 1954, ch. 736, 68A Stat. 295.)

CROSS REFERENCES

Gain or loss to shareholders in corporate liquidations, see section 331 of this title.

Liquidation of certain foreign personal holding companies, see section 342 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 342, 1002 of this title.

PART II.—BASIS RULES OF GENERAL APPLICATION

Sec.
1011. Adjusted basis for determining gain or loss.
1012. Basis of property—cost.
1013. Basis of property included in inventory.
1014. Basis of property acquired from a decedent.
1015. Basis of property acquired by gifts and transfers in trust.
1016. Adjustments to basis.
1017. Discharge of indebtedness.
1018. Adjustment of capital structure before September 22, 1938.
1019. Property on which lessee has made improvements.
1020. Election in respect of depreciation, etc., allowed before 1952.
1021. Sale of annuities.
1022. Increase in basis with respect to certain foreign personal holding company stock or securities.
1023. Cross references.

AMENDMENTS

1964—Pub. L. 88-272, title II, § 225(j)(3), Feb. 26, 1964, 78 Stat. 93, added item 1022, and redesignated former item 1022 as 1023.

CROSS REFERENCES

Basis of transferee partner's interest, see section 742 of this title.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 742 of this title.

§ 1011. Adjusted basis for determining gain or loss.

(a) General rule.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016.

(b) Bargain sale to a charitable organization.

If a deduction is allowable under section 170 (relating to charitable contributions) by reason of a sale, then the adjusted basis for determining the gain from such sale shall be that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property. (Aug. 16, 1954, ch. 736, 68A Stat. 296; Dec. 30, 1969, Pub. L. 91-172, title II, § 201(f), 83 Stat. 564.)

AMENDMENTS

1969—Pub. L. 91-172 redesignated existing provisions as subsec. (a) and added subsec. (b).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable with respect to sales made after Dec. 19, 1969, see section 201(g)(6) of Pub. L. 91-172, set out as a note under section 170 of this title.

CROSS REFERENCES

Bad debt deduction determined by reference to adjusted basis provided in this section, see section 166 of this title.

Basis for determining gain or loss on new vessel acquired in exchange for obsolete vessel under Merchant Marine Act, section 1101 et seq. of Title 46, see section 1160 (e) of Title 46, Shipping.

Computation of gain or loss by reference to adjusted basis provided in this section, see section 1001 of this title.

Cost depletion basis as the adjusted basis provided in this section, see section 612 of this title.

Depreciation basis as the adjusted basis provided in this section, see section 167 of this title.

Loss deduction determined by reference to adjusted basis provided in this section, see section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 165, 166, 612, 1001, 4914 of this title.

§ 1012. Basis of property—cost.

The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). The cost of real property shall not include any amount in respect of real property taxes which are treated under section 164 (d) as imposed on the taxpayer. (Aug. 16, 1954, ch. 736, 68A Stat. 296.)

CROSS REFERENCES

Involuntary conversions, see section 1033 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 172, 1011, 1033, 1039 of this title.

§ 1013. Basis of property included in inventory.

If the property should have been included in the last inventory, the basis shall be the last inventory value thereof. (Aug. 16, 1954, ch. 736, 68A Stat. 296.)

CROSS REFERENCES

Capital assets as not including property includible in inventory if on hand at close of taxable year, see section 1221 of this title.

Character of gain or loss on disposition by distributee partner of inventory items, see section 735 of this title.

General rules for inventories, see section 471 of this title.

Inventory carryovers, see section 381 of this title.

LIFO inventories—

Generally, see section 472 of this title.

Involuntary liquidation, see section 1321 of this title.

Property includible within inventories as not property used in trade or business, see section 1231 of this title.

Taxability of corporation on distribution of inventories, see section 311 of this title.

§ 1014. Basis of property acquired from a decedent.

(a) In general.

Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death,

or, in the case of an election under either section 2032 or section 811 (j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

(b) Property acquired from the decedent.

For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;

(2) Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust;

(3) In the case of decedents dying after December 31, 1951, property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent with the right reserved to the decedent at all times before his death to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust;

(4) Property passing without full and adequate consideration under a general power of appointment exercised by the decedent by will;

(5) In the case of decedents dying after August 26, 1937, property acquired by bequest, devise, or inheritance or by the decedent's estate from the decedent, if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year next preceding the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company. In such case, the basis shall be the fair market value of such property at the date of the decedent's death or the basis in the hands of the decedent, whichever is lower;

(6) In the case of decedents dying after December 31, 1947, property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under chapter 11 of subtitle B (section 2001 and following, relating to estate tax) or section 811 of the Internal Revenue Code of 1939;

(7) In the case of decedents dying after October 21, 1942, and on or before December 31, 1947, such part of any property, representing the surviving spouse's one-half share of property held by a decedent and the surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, as was included in determining the value of the gross estate of the decedent, if a tax under chapter 3 of the Internal Revenue Code of 1939 was payable on the transfer of the net estate of the decedent. In such case, nothing in this paragraph shall reduce the basis below that which would exist if the Revenue Act of 1948 had not been enacted;

(8) In the case of decedents dying after December 31, 1950, and before January 1, 1954, property which represents the survivor's interest in a joint and survivor's annuity if the value of any part of such interest was required to be included in determining the value of decedent's gross estate under section 811 of the Internal Revenue Code of 1939;

(9) In the case of decedents dying after December 31, 1953, property acquired from the decedent by reason of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate under chapter 11 of subtitle B or under the Internal Revenue Code of 1939. In such case, if the property is acquired before the death of the decedent, the basis shall be the amount determined under subsection (a) reduced by the amount allowed to the taxpayer as deductions in computing taxable income under this subtitle or prior income tax laws for exhaustion, wear and tear, obsolescence, amortization, and depletion on such property before the death of the decedent. Such basis shall be applicable to the property commencing on the death of the decedent. This paragraph shall not apply to—

(A) annuities described in section 72;

(B) property to which paragraph (5) would apply if the property had been acquired by bequest; and

(C) property described in any other paragraph of this subsection.

(c) Property representing income in respect of a decedent.

This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691. (Aug. 16, 1954, ch. 736, 68A Stat. 296; Feb. 11, 1958, Pub. L. 85-320, § 2, 72 Stat. 5.)

AMENDMENTS

1958—Subsec. (d). Pub. L. 85-320 repealed subsec. (d), which made section inapplicable to restricted stock options described in section 421 which the employee has not exercised at death.

EFFECTIVE DATE OF 1958 AMENDMENT

Repeal of subsec. (d) of this section applicable with respect to taxable years ending after Dec. 31, 1956, but only in the case of employees dying after such date, see section 3 of Pub. L. 85-320, set out as a note under section 421 of this title.

CROSS REFERENCES

Definition of purchase for purpose of determining basis of property received in liquidation of subsidiary as excluding a determination of basis under this section, see section 334 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 179, 334, 1001, 1022, 1223, 1232, 1246 of this title.

§ 1015. Basis of property acquired by gifts and transfers in trust.

(a) Gifts after December 31, 1920.

If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Secretary or his delegate shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Secretary or his delegate finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Secretary or his delegate as of the date or approximate date at which, according to the best information that the Secretary or his delegate is able to obtain, such property was acquired by such donor or last preceding owner.

(b) Transfer in trust after December 31, 1920.

If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer under the law applicable to the year in which the transfer was made.

(c) Gift or transfer in trust before January 1, 1921.

If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition.

(d) Increased basis for gift tax paid.

(1) In general.

If—

(A) the property is acquired by gift on or after the date of the enactment of the Technical Amendments Act of 1958, the basis shall be the basis determined under subsection (a), increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid with respect to such gift, or

(B) the property was acquired by gift before the date of the enactment of the Technical Amendments Act of 1958 and has not been sold, exchanged, or otherwise disposed of before such date, the basis of the property shall be increased on such date by the amount of gift tax paid with respect to such gift, but such increase shall not exceed an amount equal to the amount by which the fair market value of the property at the time of the gift exceeded the basis of the property in the hands of the donor at the time of the gift.

(2) Amount of tax paid with respect to gift.

For purposes of paragraph (1), the amount of gift tax paid with respect to any gift is an amount which bears the same ratio to the amount of gift tax paid under chapter 12 with respect to all gifts made by the donor for the calendar quarter (or calendar year if the gift was made before January 1, 1971) in which such gift is made as the amount of such gift bears to the taxable gifts (as defined in section 2503 (a) but computed without the deduction allowed by section 2521) made by the donor during such calendar quarter or year. For purposes of the preceding sentence, the amount of any gift shall be the amount included with respect to such gift in determining (for the purposes of section 2503 (a)) the total amount of gifts made during the calendar quarter or year, reduced by the amount of any deduction allowed with respect to such gift under section 2522 (relating to charitable deduction) or under section 2523 (relating to marital deduction).

(3) Gifts treated as made one-half by each spouse.

For purposes of paragraph (1), where the donor and his spouse elected, under section 2513 to have the gift considered as made one-half by each, the amount of gift tax paid with respect to such gift under chapter 12 shall be the sum of the amounts of tax paid with respect to each half of such gift (computed in the manner provided in paragraph (2)).

(4) Treatment as adjustment to basis.

For purposes of section 1016 (b), an increase in basis under paragraph (1) shall be treated as an adjustment under section 1016 (a).

(5) Application to gifts before 1955.

With respect to any property acquired by gift before 1955, references in this subsection to any provision of this title shall be deemed to refer to the corresponding provision of the Internal Revenue Code of 1939 or prior revenue laws which was effective for the year in which such gift was made.

(Aug. 16, 1954, ch. 736, 68A Stat. 298; Sept. 2, 1958, Pub. L. 85–866, title I, § 43 (a), 72 Stat. 1640; Dec. 31, 1970, Pub. L. 91–614, title I, § 102(d)(1), 84 Stat. 1841.)

REFERENCES IN TEXT

Date of the enactment of the Technical Amendments Act of 1958, referred to in subsec. (d) (1) (A), (B), was Sept. 2, 1958.

AMENDMENTS

1970—Subsec. (d)(2). Pub. L. 91–614 substituted "calendar quarter (or calendar year if the gift was made before January 1, 1971)" for "calendar year" the first place it appears and "calendar quarter or year" for "calendar year" every other place it appears therein.

1958—Subsec. (d). Pub. L. 85–866 added subsec. (d).

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91–614 applicable with respect to gifts made after Dec. 31, 1970, see section 102(e) of Pub. L. 91–614, set out as a note under section 2501 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Subsec. (d) of this section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

CROSS REFERENCES

Basis of property after erroneous treatment of a prior transaction, see section 1312 of this title.

Gift tax, see section 2501 et seq. of this title.

Gifts specifically excluded from gross income, see section 102 of this title.

Valuation of gifts, see section 2512 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1001, 1312 of this title.

§ 1016. Adjustments to basis.

(a) General rule.

Proper adjustment in respect of the property shall in all cases be made—

(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made—

(A) for taxes or other carrying charges described in section 266, or

(B) for expenditures described in section 173 (relating to circulation expenditures),

for which deductions have been taken by the taxpayer in determining taxable income for the taxable year or prior taxable years;

(2) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

(A) allowed as deductions in computing taxable income under this subtitle or prior income tax laws, and

(B) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this subtitle (other than chapter 2, relating to tax on self-employment income), or prior income, war-profits, or excess-profits tax laws,

but not less than the amount allowable under this subtitle or prior income tax laws. Where no method has been adopted under section 167 (relating to depreciation deduction), the amount allowable shall be determined under section 167 (b) (1). Subparagraph (B) of this paragraph shall not apply in respect of any period since February 28, 1913, and before January 1, 1952, unless an election has been made under section 1020. Where for any taxable year before the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(3) in respect of any period—

(A) before March 1, 1913,

(B) since February 28, 1913, during which such property was held by a person or an organization not subject to income taxation under this chapter or prior income tax laws,

(C) since February 28, 1913, and before January 1, 1958, during which such property was held by a person subject to tax under part I of subchapter L (or the corresponding provisions of prior income tax laws), to the extent that paragraph (2) does not apply, and

(D) since February 28, 1913, during which such property was held by a person subject to tax under part II of subchapter L (or the corresponding provisions of prior income tax laws), to the extent that paragraph (2) does not apply,

for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained;

(4) in the case of stock (to the extent not provided for in the foregoing paragraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 (40 Stat. 1057), or the Revenue Act of 1921 (42 Stat. 227), out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921);

(5) in the case of any bond (as defined in section 171 (d)) the interest on which is wholly exempt from the tax imposed by this subtitle, to the extent of the amortizable bond premium disallowable as a deduction pursuant to section 171 (a) (2), and in the case of any other bond (as defined in section 171 (d)) to the extent of the deductions allowable pursuant to section 171 (a) (1) with respect thereto;

(6) in the case of any municipal bond (as defined in section 75 (b)), to the extent provided in section 75 (a) (2);

(7) in the case of a residence the acquisition of which resulted, under section 1034, in the nonrecognition of any part of the gain realized on the sale, exchange, or involuntary conversion of another residence, to the extent provided in section 1034 (e);

(8) in the case of property pledged to the Commodity Credit Corporation, to the extent of the amount received as a loan from the Commodity Credit Corporation and treated by the taxpayer as income for the year in which received pursuant to section 77, and to the extent of any deficiency on such loan with respect to which the taxpayer has been relieved from liability;

(9) for amounts allowed as deductions as deferred expenses under section 616 (b) (relating to certain expenditures in the development of mines) and resulting in a reduction of the taxpayer's taxes under this subtitle, but not less than the amounts allowable under such section for the taxable year and prior years;

(10) for amounts allowed as deductions as deferred expenses under section 615 (b) (relating to certain pre-1970 exploration expenditures) and resulting in a reduction of the taxpayer's taxes under this subtitle but not less than the amounts allowable under such section for the taxable year and prior years;

(11) for deductions to the extent disallowed under section 268 (relating to sale of land with unharvested crops), notwithstanding the provisions of any other paragraph of this subsection;

(12) to the extent provided in section 28 (h) of the Internal Revenue Code of 1939 in the case of amounts specified in a shareholder's consent made under section 28 of such code;

(13) to the extent provided in section 551 (f) in the case of the stock of United States shareholders in a foreign personal holding company;

(14) for amounts allowed as deductions as deferred expenses under section 174 (b) (1) (relating to research and experimental expenditures) and resulting in a reduction of the taxpayers' taxes under this subtitle, but not less than the amounts allowable under such section for the taxable year and prior years;

(15) for deductions to the extent disallowed under section 272 (relating to disposal of coal or domestic iron ore), notwithstanding the provisions of any other paragraph of this subsection;

(16) for amounts allowed as deductions for expenditures treated as deferred expenses under section 177 (relating to trademark and trade name expenditures) and resulting in a reduction of the taxpayer's taxes under this subtitle, but not less than the amounts allowable under such section for the taxable year and prior years.

(17) in the case of any evidence of indebtedness referred to in section 818(b) (relating to amortization of premium and accrual of discount in the case of life insurance companies), to the extent of the adjustments required under section 818(b) (or the corresponding provisions of prior income tax laws) for the taxable year and all prior taxable years;

(18) to the extent provided in section 1376 in the case of stock of, and indebtedness owing, shareholders of an electing small business corporation (as defined in section 1371(b));

(19) to the extent provided in section 48(g) and in section 203(a)(2) of the Revenue Act of 1964, in the case of property which is or has been section 38 property (as defined in section 48(a));

(20) to the extent provided in section 961 in the case of stock in controlled foreign corporations (or foreign corporations which were controlled foreign corporations) and of property by reason of which a person is considered as owning such stock;

(21) to the extent provided in section 1022, relating to increase in basis for certain foreign personal holding company stock or securities;

(22) for amounts allowed as deductions for payments made on account of transfers of franchises, trademarks, or trade names under section 1253(d)(2).

(b) Substituted basis.

Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, then the adjustments provided in subsection (a) shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases. The term "substituted basis" as used in this section means a basis determined under any provision of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses), or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(1) by reference to the basis in the hands of a transferor, donor, or grantor, or

(2) by reference to other property held at any time by the person for whom the basis is to be determined.

(c) Cross references.

(1) For treatment of certain expenses incident to the purchase of a residence which were deducted as moving expenses by the taxpayer or his spouse under section 217(a), see section 217(e).

(2) For treatment of separate mineral interests as one property, see section 614.

(Aug. 16, 1954, ch. 736, 68A Stat. 299; June 29, 1956, ch. 464, § 4(c), 70 Stat. 407; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 2(b), 64(d)(2), 72 Stat. 1607, 1656; June 25, 1959, Pub. L. 86–69, § 3(d), 73 Stat. 139; Oct. 16, 1962, Pub. L. 87–834, §§ 2(f), 8(g)(2), 12(b)(4), 76 Stat. 972, 998, 1031; Feb. 26, 1964, Pub. L. 88–272, title II, §§ 203(a)(3)(C), 225(j)(2), 227(b)(5), 78 Stat. 34, 93, 98; Dec. 30, 1969, Pub. L. 91–172, title II, § 231(c)(3), title V, §§ 504(c)(4), 516(c)(2)(B), 83 Stat. 580, 633, 648.)

REFERENCES IN TEXT

Section 203(a)(2), of the Revenue Act of 1964, referred to in subsec. (a)(19), is set out as a note under section 48 of this title.

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 516(c)(2)(B), added par. (22).

Subsec. (a)(10). Pub. L. 91–172, § 504(c)(4), limited exploration expenditures referred to in this par. to pre-1970 exploration expenditures.

Subsec. (c). Pub. L. 91–172, § 231(c)(3) redesignated existing provisions as par. (2) and added par. (1).

1964—Subsec. (a)(15) Pub. L. 88–272, § 227(b)(5), inserted "or domestic iron ore" in par. (15).

Subsec. (a)(19). Pub. L. 88–272, § 203(a)(3)(C), inserted "and in section 203(a)(2) of the Revenue Act of 1964."

Subsec. (a)(21). Pub. L. 88–272, § 225(j)(2), added subsec. (a)(21).

1962—Subsec. (a)(3)(D). Pub. L. 87–834, § 8(g)(2), added subsec. (a)(3)(D).

Subsec. (a)(19). Pub. L. 87–834, § 2(f), added subsec. (a)(19).

Subsec. (a)(20). Pub. L. 87–834, § 12(b)(4), added subsec. (a)(20).

1959—Subsec. (a)(3)(C). Pub. L. 86–69, § 3(d)(1), added subsec. (a)(3)(C).

Subsec. (a)(17). Pub. L. 86–69, § 3(d)(2), added subsec. (a)(17).

1958—Subsec. (a)(6). Pub. L. 85–866, § 2(b), eliminated "short-term" preceding "municipal bond."

Subsec. (a)(18). Pub. L. 85–866, § 64(d)(2), added subsec. (a)(18).

1956—Subsec. (a)(16). Act June 29, 1956, added subsec. (a)(16).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a) by section 516(c)(2)(B) of Pub. L. 91–172 applicable to transfers after Dec. 31, 1969, see section 561(d)(3) of Pub. L. 91–172, set out as a note under section 1001 of this title.

Amendment of subsec. (a)(10) by section 504(c)(4) of Pub. L. 91–172 applicable with respect to exploration expenditures paid or incurred after Dec. 31, 1969, see section 504(d)(1) of Pub. L. 91–172, set out as a note under section 615 of this title.

Amendment of subsec. (c) by section 231(c)(3) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 231(d) of Pub. L. 91–172, set out as a note under section 217 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (a)(15) by Pub. L. 88–272 applicable with respect to amounts received or accrued in taxable years beginning after Dec. 31, 1963, attributable to iron ore mined in such years, see section 227(c) of Pub. L. 88–272, set out as a note under section 272 of this title.

Amendment of subsec. (a)(19) by Pub. L. 88–272 applicable in case of property placed in service after Dec. 31, 1963, with respect to taxable years ending after such date, and in case of property placed in service before Jan. 1, 1964, with respect to taxable years beginning after Dec. 31, 1963, see section 203(a)(4) of Pub. L. 88–272, set out as a note under section 48 of this title.

Amendment of subsec. (a)(21) by Pub. L. 88–272 applicable in respect of decedents dying after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272, set out as a note under section 316 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Subsec. (a)(3)(D) of this section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87–834, set out as a note under section 821 of this title.

Subsec. (a)(19) of this section applicable with respect to taxable years ending after Dec. 31, 1961, see section 2(h) of Pub. L. 87–834, set out as a note under section 38 of this title.

Subsec. (a)(20) of this section applicable with respect to taxable years of foreign corporations beginning after Dec. 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end, see section 12(c) of Pub. L. 87–834, set out as a note under section 951 of this title.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86–69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (a)(6) by Pub. L. 85–866 applicable with respect to taxable years ending after December 31, 1957, but only with respect to obligations acquired after such date, see section 2 (c) of Pub. L. 85–866, set out as a note under section 75 of this title.

Subsec. (a) (18) of this section added by Pub. L. 85–866, applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85–866, set out as a note under section 172 of this title.

CHANGE FROM RETIREMENT TO STRAIGHT LINE METHOD OF COMPUTING DEPRECIATION IN CERTAIN CASES

Section 94 of Pub. L. 85–866 provided that:

"(a) **Short title.**—This section may be cited as the 'Retirement-Straight Line Adjustment Act of 1958'.

"(b) **Making of election.**—Any taxpayer who held retirement-straight line property on his 1956 adjustment date may elect to have this section apply. Such an election shall be made at such time and in such manner as the Secretary shall prescribe. Any election under this section shall be irrevocable and shall apply to all retirement-straight line property as hereinafter provided in this section (including such property for periods when held by predecessors of the taxpayer).

"(c) **Retirement-straight line property defined.**—For purposes of this section, the term 'retirement-straight line property' means any property of a kind or class with respect to which the taxpayer or a predecessor (under the terms and conditions prescribed for him by the Commissioner) for any taxable year beginning after December 31, 1940, and before January 1, 1956, changed from the retirement to the straight line method of computing the allowance of deductions for depreciation.

"(d) **Basis adjustments as of 1956 adjustment date.**—If the taxpayer has made an election under this section, then in determining the adjusted basis on his 1956 adjustment date of all retirement-straight line property held by the taxpayer, in lieu of the adjustments for depreciation provided in section 1016 (a) (2) and (3) of the Internal Revenue Code of 1954, the following adjustments shall be made (effective as of his 1956 adjustment date) in respect of all periods before the 1956 adjustment date:

"(1) **Depreciation sustained before March 1, 1913.**—For depreciation sustained before March 1, 1913, on retirement-straight line property held by the taxpayer or a predecessor on such date for which cost was or is claimed as basis and which either—

"(A) **Retired before changeover.**—Was retired by the taxpayer or a predecessor before the changeover date, but only if (i) a deduction was allowed in computing net income by reason of such retirement, and (ii) such deduction was computed on the basis of cost without adjustment for depreciation sustained before March 1, 1913. In the case of any such property retired during any taxable year beginning after December 31, 1929, the adjustment under this subparagraph shall not exceed that portion of the amount attributable to depreciation sustained before March 1, 1913, which resulted (by reason of the deduction so allowed) in a reduction in taxes under the Internal Revenue Code of 1954 or prior income, war-profits, or excess-profits tax laws.

"(B) **Held on changeover date.**—Was held by the taxpayer or a predecessor on the changeover date. This subparagraph shall not apply to property to which paragraph (2) applies.

The adjustment determined under this paragraph shall be allocated (in the manner prescribed by the Secretary) among all retirement-straight line property held by the taxpayer on his 1956 adjustment date.

"(2) **Property disposed of after changeover and before 1956 adjustment date.**—For that portion of the reserve prescribed by the Commissioner in connection with the changeover which was applicable to property—

"(A) sold, or

"(B) with respect to which a deduction was allowed for Federal income tax purposes by reason of casualty or 'abnormal' retirement in the nature of special obsolescence,

if such sale occurred in, or such deduction was allowed for, a period on or after the changeover date and before the taxpayer's 1956 adjustment date.

"(3) **Depreciation allowable from changeover to 1956 adjustment date.**—For depreciation allowable, under the terms and conditions prescribed by the Commissioner in connection with the changeover, for all periods on and after the changeover date and before the taxpayer's 1956 adjustment date.

This subsection shall apply only with respect to taxable years beginning after December 31, 1955.

"(e) **Effect on period from changeover to 1956 adjustment date.**—If the taxpayer has made an election under this section, then in determining the adjusted basis of any retirement-straight line property as of any time on or after the changeover date and before the taxpayer's 1956 adjustment date, in lieu of the adjustments for depreciation provided in section 1016 (a) (2) and (3) of the Internal Revenue Code of 1954 and the corresponding provisions of prior revenue laws, the following adjustments shall be made:

"(1) **For prescribed reserve.**—For the amount of the reserve prescribed by the Commissioner in connection with the changeover.

"(2) **For allowable depreciation.**—For the depreciation allowable under the terms and conditions prescribed by the Commissioner in connection with the changeover.

This subsection shall not apply in determining adjusted basis for purposes of section 437 (c) of the Internal Revenue Code of 1939. This subsection shall apply only with respect to taxable years beginning on or after the changeover date and before the taxpayer's 1956 adjustment date.

"(f) Equity invested capital, etc.—If an election is made under this section, then (not withstanding the terms and conditions prescribed by the Commissioner in connection with the changeover)—

"(1) Equity invested capital.—In determining equity invested capital under sections 458 and 718 of the Internal Revenue Code of 1939, accumulated earnings and profits as of the changeover date, and as of the beginning of each taxable year thereafter, shall be reduced by the depreciation sustained before March 1, 1913, as computed under subsection (d) (1) (B); and

"(2) Definition of equity capital.—In determining the adjusted basis of assets for the purpose of section 437 (c) of the Internal Revenue Code of 1939 (and in addition to any other adjustments required by such Code), the basis shall be reduced by depreciation sustained before March 1, 1913 (as computed under subsection (d)), together with any depreciation allowable under subsection (e) (2) for any period before the year for which the excess profits credit is being computed.

"(g) Definitions.—For purposes of this section—

"(1) Depreciation.—The term 'depreciation' means exhaustion, wear and tear, and obsolescence.

"(2) Changeover.—The term 'changeover' means a change from the retirement to the straight line method of computing the allowance of deductions for depreciation.

"(3) Changeover date.—The term 'changeover date' means the first day of the first taxable year for which the changeover was effective.

"(4) 1956 adjustment date.—The term '1956 adjustment date' means, in the case of any taxpayer, the first day of his first taxable year beginning after December 31, 1955.

"(5) Predecessor.—The term 'predecessor' means any person from whom property of a kind or class to which this section refers was acquired, if the basis of such property is determined by reference to its basis in the hands of such person. Where a series of transfers of property has occurred and where in each instance the basis of the property was determined by reference to its basis in the hands of the prior holder, the term includes each such prior holder.

"(6) The term 'Secretary' means the Secretary of the Treasury or his delegate.

"(7) The term 'Commissioner' means the Commissioner of Internal Revenue."

CROSS REFERENCES

Adjusted basis for determining gain or loss, see section 1011 of this title.

Distribution of proceeds of loan insured by United States, effect on earnings and profits, see section 312 of this title.

Election in respect of depreciation, etc., allowed before 1952, see section 1020 of this title.

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88-272, set out as a note under section 333 of this title.

Property acquired—

Before March 1, 1913, subject to adjustment provided in this section, see section 1053 of this title.

By gift, adjustment of basis for period antedating gift, see section 1015 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 75, 174, 177, 179, 312, 372, 615, 616, 317, 1011, 1015, 1020, 1034, 1053, 1250 of this title.

§ 1017. Discharge of indebtedness.

Where any amount is excluded from gross income under section 108 (a) (relating to income from discharge of indebtedness) on account of the discharge of indebtedness the whole or a part of the amount so excluded from gross income shall be applied in reduction of the basis of any property held (whether before or after the time of the discharge) by the taxpayer during any portion of the taxable year in which such discharge occurred. The amount to be so applied (not in excess of the amount so excluded from gross income, reduced by the amount of any deduction disallowed under section 108 (a)) and the particular properties to which the reduction shall be allocated, shall be determined under regulations (prescribed by the Secretary or his delegate) in effect at the time of the filing of the consent by the taxpayer referred to in section 108 (a). The reduction shall be made as of the first day of the taxable year in which the discharge occurred, except in the case of property not held by the taxpayer on such first day, in which case it shall take effect as of the time the holding of the taxpayer began. (Aug. 16, 1954, ch. 736, 68A Stat. 301.)

CROSS REFERENCES

Basis in connection with certain receivership and bankruptcy proceedings not subject to adjustment under this section, see section 372 of this title.

Rules and regulations, see section 7805 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 108, 372 of this title.

§ 1018. Adjustment of capital structure before September 22, 1938.

Where a plan of reorganization of a corporation, approved by the court in a proceeding under section 77B of the National Bankruptcy Act, as amended (48 Stat. 912), is consummated by adjustment of the capital or debt structure of such corporation without the transfer of its assets to another corporation, and a final judgment or decree in such proceeding has been entered before September 22, 1938, then the provisions of section 270 of the Bankruptcy Act, as amended (54 Stat. 709; 11 U. S. C. 670), shall not apply in respect of the property of such corporation. For purposes of this section, the term "reorganization" shall not be limited by the definition of such term in section 112 (g) of the Internal Revenue Code of 1939. (Aug. 16, 1954, ch. 736, 68A Stat. 301.)

§ 1019. Property on which lessee has made improvements.

Neither the basis nor the adjusted basis of any portion of real property shall, in the case of the lessor of such property, be increased or diminished on account of income derived by the lessor in respect of such property and excludable from gross income under section 109 (relating to improvements by lessee on lessor's property). If an amount representing any part of the value of real property attributable to buildings erected or other improvements made by a lessee in respect of such property was included in gross income of the lessor for any taxable year beginning before January 1, 1942, the basis of each portion of such property shall be properly adjusted for the amount so included in gross income. (Aug. 16, 1954, ch. 736, 68A Stat. 301.)

§ 1020. Election in respect of depreciation, etc., allowed before 1952.

Any person may elect to have subparagraph (B) of section 1016 (a) (2) apply in respect of periods since February 28, 1913, and before January 1, 1952. Such an election shall be made in such manner as the Secretary or his delegate may by regulations prescribe and shall be irrevocable when made, except

that an election made on or before December 31, 1952, may be revoked at any time before January 1, 1955. A revocation of an election shall be made in such manner as the Secretary or his delegate may by regulations prescribe, and no election may be made by any person after he has so revoked an election. The election shall apply in respect of all property held by the person making the election at any time on or before December 31, 1952, and in respect of all periods since February 28, 1913, and before January 1, 1952, during which such person held such property or for which adjustments must be made under section 1016 (b). An election or a revocation of an election by a transferor, donor, or grantor made after the date of the transfer, gift, or grant of property shall not affect the basis of such property in the hands of the transferee, donee, or grantee. No election may be made under this section after December 31, 1954. (Aug. 16, 1954, ch. 736, 68A Stat. 302.)

CROSS REFERENCES

Rules and regulations, see section 7805 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 1021. Sale of annuities.

In case of the sale of an annuity contract, the adjusted basis shall in no case be less than zero. (Aug. 16, 1954, ch. 736, 68A Stat. 302.)

CROSS REFERENCES

Annuities, see section 72 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 72 of this title.

§ 1022 Increase in basis with respect to certain foreign personal holding company stock or securities.

(a) General rule.

The basis (determined under section 1014(b)(5), relating to basis of stock or securities in a foreign personal holding company) of a share of stock or a security, acquired from a decedent dying after December 31, 1963, of a corporation which was a foreign personal holding company for its most recent taxable year ending before the date of the decedent's death shall be increased by its proportionate share of any Federal estate tax attributable to the net appreciation in value of all of such shares and securities determined as provided in this section.

(b) Proportionate share.

For purposes of subsection (a), the proportionate share of a share of stock or of a security is that amount which bears the same ratio to the aggregate increase determined under subsection (c)(2) as the appreciation in value of such share or security bears to the aggregate appreciation in value of all such shares and securities having appreciation in value.

(c) Special rules and definitions.

For purposes of this section—

(1) Federal estate tax.

The term "Federal estate tax" means only the tax imposed by section 2001 or 2101, reduced by any credit allowable with respect to a tax on prior transfers by section 2013 or 2102.

(2) Federal estate tax attributable to net appreciation in value.

The Federal estate tax attributable to the net appreciation in value of all shares of stock and securities to which subsection (a) applies is that amount which bears the same ratio to the Federal estate tax as the net appreciation in value of all of such shares and securities bears to the value of the gross estate as determined under chapter 11 (including section 2032, relating to alternate valuation).

(3) Net appreciation.

The net appreciation in value of all shares and securities to which subsection (a) applies is the amount by which the fair market value of all such shares and securities exceeds the adjusted basis of such property in the hands of the decedent.

(4) Fair market value.

For purposes of this section, the term "fair market value" means fair market value determined under chapter 11 (including section 2032, relating to alternate valuation).

(d) Limitations.

This section shall not apply to any foreign personal holding company referred to in section 342(a)(2). (Added Pub. L. 88–272, title II, § 225(j)(1), Feb. 26, 1964, 78 Stat. 92.)

EFFECTIVE DATE

Section applicable in respect of decedents dying after Dec. 31, 1963, see section 225(*l*) of Pub. L. 88–272, set out as a note under section 316 of this title.

CROSS REFERENCES

Liquidations before Jan. 1, 1966, see section 225(h) of Pub. L. 88–272, set out as a note under section 333 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

§ 1023. Cross references.

(1) For certain distributions by a corporation which are applied in reduction of basis of stock, see section 301 (c) (2).

(2) For basis of property in case of certain reorganizations and arrangements under the Bankruptcy Act, see sections 270, 396, and 522 of that Act, as amended (11 U. S. C. 670, 796, 922).

(3) For basis in case of construction of new vessels, see section 511 of the Merchant Marine Act, 1936, as amended (46 U. S. C. 1161).

(4) For rules applicable in case of payments in violation of Defense Production Act of 1950, as amended, see section 405 of that Act.

(Aug. 16, 1954, ch. 736, 68A Stat. 302, formerly § 1022, renumbered Feb. 26, 1964, Pub. L. 88–272, title II, § 225(j)(1), 78 Stat. 92.)

REFERENCES IN TEXT

Section 405 of the Defense Production Act of 1950, referred to in par. (4), was classified to former section 2105 of Title 50, Appendix, War and National Defense, and was omitted from the Code. See note under former section 2105 of Title 50, Appendix.

PART III.—COMMON NONTAXABLE EXCHANGES

Sec.

1031. Exchange of property held for productive use or investment.
1032. Exchange of stock for property.
1033. Involuntary conversions.
1034. Sale or exchange of residence.
1035. Certain exchanges of insurance policies.
1036. Stock for stock of same corporation.
1037. Certain exchanges of United States obligations.
1038. Certain reacquisitions of real property.
1039. Certain sales of low-income housing projects.

AMENDMENTS

1969—Pub. L. 91–172, title IX, § 910(c), Dec. 30, 1969, 83 Stat. 722, added item 1039.

1964—Pub. L. 88–570, § 2(b), Sept. 2, 1964, 78 Stat. 856, added item 1038.

1959—Pub. L. 86–346, title II, § 201(b), Sept. 22, 1959, 73 Stat. 623, added item 1037.

§ 1031. Exchange of property held for productive use or investment.

(a) Nonrecognition of gain or loss from exchanges solely in kind.

No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(b) Gain from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(c) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(d) Basis.

If property was acquired on an exchange described in this section, section 1035(a), section 1036(a), or section 1037(a), then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by this section, section 1035(a), section 1036(a), or section 1037(a), to be received without the recognition of gain or loss, and in part of other property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. For purposes of this section, section 1035 (a), and section 1036 (a), where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall be considered as money received by the taxpayer on the exchange.

(e) Exchanges of livestock of different sexes.

For purposes of this section, livestock of different sexes are not property of a like kind. (Aug. 16, 1954, ch. 736, 68A Stat. 302; Sept. 2, 1958, Pub. L. 85–866, title I, § 44, 72 Stat. 1641; Sept. 22, 1959, Pub. L. 86–346, title II, § 201 (c)—(e), 73 Stat. 624; Dec. 30, 1969, Pub. L. 91–172, title II, § 212(c)(1), 83 Stat. 571.)

AMENDMENTS

1969—Subsec. (e). Pub. L. 91–172 added subsec. (e).

1959—Pub. L. 86–346 inserted references to section 1037 (a) in subsecs. (b) and (c) and first two sentences of subsec. (d).

1958—Subsec. (d). Pub. L. 85–866 inserted in first sentence a comma between "exchanged" and "decreased" and the words "or decreased in the amount of loss", and substituted in the second sentence "subsection" for "paragraph".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 212(c)(2) of Pub. L. 91–172 provided that: "The amendment made by paragraph (1) [adding subsec. (e) of this section] shall apply to taxable years to which the Internal Revenue Code of 1954 applies."

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86–346, § 201(c)—(e), effective for taxable years ending after Sept. 22, 1959, see section 203 of Pub. L. 86–346, set out as a note under section 1037 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (d) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

CROSS REFERENCES

Stock for stock of same corporation, see section 1036 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 81, 425, 454, 1037, 1245, 1250, 1251 of this title.

§ 1032. Exchange of stock for property.

(a) Nonrecognition of gain or loss.

No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.

(b) Basis.

For basis of property acquired by a corporation in certain exchanges for its stock, see section 362.

(Aug. 16, 1954, ch. 736, 68A Stat. 303.)

§ 1033. Involuntary conversions.

(a) General rule.

If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(1) Conversion into similar property.

Into property similar or related in service or use to the property so converted, no gain shall be recognized.

(2) Conversion into money where disposition occurred prior to 1951.

Into money, and the disposition of the converted property occurred before January 1, 1951, no gain shall be recognized if such money is forthwith in good faith, under regulations prescribed by the Secretary or his delegate, expended in the acquisition of other property similar or related in

service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund. If any part of the money is not so expended, the gain shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain). For purposes of this paragraph and paragraph (3), the term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation. For purposes of this paragraph and paragraph (3), the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(3) Conversion into money where disposition occurred after 1950.

Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain.

If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. For purposes of this paragraph—

(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of subsection (c) of this section, the unadjusted basis of such property or stock would be its cost within the meaning of section 1012.

(B) Period within which property must be replaced.

The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

(C) Time for assessment of deficiency attributable to gain upon conversion.

If a taxpayer has made the election provided in subparagraph (A), then—

(i) the statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain on such conversion is realized, attributable to such gain shall not expire prior to the expiration of 3 years from the date the Secretary or his delegate is notified by the taxpayer (in such manner as the Secretary or his delegate may by regulations prescribe) of the replacement of the converted property or of an intention not to replace, and

(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of section 6212 (c) or the provisions of any other law or rule of law which would otherwise prevent such assessment.

(D) Time for assessment of other deficiencies attributable to election.

If the election provided in subparagraph (A) is made by the taxpayer and such other property or such stock was purchased before the beginning of the last taxable year in which any part of the gain upon such conversion is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last taxable year may be assessed (notwithstanding the provisions of section 6212 (c) or 6501 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

(b) Residence of taxpayer.

Subsection (a) shall not apply, in the case of property used by the taxpayer as his principal residence, if the destruction, theft, seizure, requisition, or condemnation of the residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950, and before January 1, 1954.

(c) Basis of property acquired through involuntary conversion.

If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in subsection (a) (1) or (2),

the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made. This subsection shall not apply in respect of property acquired as a result of a compulsory or involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, or condemnation of such residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950, and before January 1, 1954. In the case of property purchased by the taxpayer in a transaction described in subsection (a) (3) which resulted in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than one piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

(d) Property sold pursuant to reclamation laws.

For purposes of this subtitle, if property lying within an irrigation project is sold or otherwise disposed of in order to conform to the acreage limitation provisions of Federal reclamation laws, such sale or disposition shall be treated as an involuntary conversion to which this section applies.

(e) Livestock destroyed by disease.

For purposes of this subtitle, if livestock are destroyed by or on account of disease, or are sold or exchanged because of disease, such destruction or such sale or exchange shall be treated as an involuntary conversion to which this section applies.

(f) Livestock sold on account of drougbt.

For purposes of this subtitle, the sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell if he followed his usual business practices shall be treated as an involuntary conversion to which this section applies if such livestock are sold or exchanged by the taxpayer solely on account of drought.

(g) Condemnation of real property held for productive use in trade or business or for investment.

(1) Special rule.

For purposes of subsection (a), if real property (not including stock in trade or other property held primarily for sale) held for productive use in trade or business or for investment is (as the result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted.

(2) Limitations.

(A) Purchase of stock.

Paragraph (1) shall not apply to the purchase of stock in the acquisition of control of a corporation described in subsection (a) (3) (A).

(B) Conversions before January 1, 1958.

Paragraph (1) shall apply with respect to the compulsory or involuntary conversion of any real property only if the disposition of the converted property (within the meaning of subsection (a) (2)) occurs after December 31, 1957.

(h) Cross references.

(1) For determination of the period for which the taxpayer has held property involuntarily converted, see section 1223.

(2) For treatment of gains from involuntary conversions as capital gains in certain cases, see section 1231 (a).

(3) For exclusion from gross income of certain gain from involuntary conversion of residence of taxpayer who has attained age 65, see section 121.

(Aug. 16, 1954, ch. 736, 68A Stat. 303; June 29, 1956, ch. 464, § 5(a), 70 Stat. 407; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 45, 46(a), 72 Stat. 1641; Feb. 26, 1964, Pub. L. 88–272, title II, § 206(b)(3), 78 Stat. 40; Dec. 30, 1969, Pub. L. 91–172, title IX, § 915(a), 83 Stat. 723.)

AMENDMENTS

1969—Subsec. (a)(3)(B). Pub. L. 91–172 substituted "2 years" for "one year".

1964—Subsec. (h)(3). Pub. L. 88–272 added par. (3).

1958—Subsec. (a)(2). Pub. L. 85–866, § 45, added provision defining "control".

Subsec. (g). Pub. L. 85–866, § 46(a), added subsec. (g) and redesignated former subsec. (g) as (h).

Subsec. (h). Pub. L. 85–866, § 46(a), redesignated former subsec. (g) as (h).

1956—Subsec. (f). Act June 29, 1956, added subsec. (f). Former subsec. (f) redesignated (g).

Subsec. (g). Act June 29, 1956, redesignated former subsec. (f) as (g).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 915(b) of Pub. L. 91–172 provided that: "The amendment made by this section [amending subsec. (a)(3)(B) of this section] shall apply only if the disposition of the converted property (within the meaning of section 1033(a)(2) of the Internal Revenue Code of 1954 [subsec. (a)(2) of this section]) occurs after the date of the enactment of this Act [Dec. 30, 1969]."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 206(c) of Pub. L. 88–272 set out as a note under section 121 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (a)(2) of this section by Pub. L. 85–866, and subsecs. (g), (h) and (i)(3) of this section, applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Section 5(b) of act June 29, 1956, provided that: "The amendment made by this section [adding subsec. (f)] shall apply with respect to taxable years ending after December 31, 1955, but only in the case of sales and exchanges of livestock after December 31, 1955."

CROSS REFERENCES

Gain from sale or exchange to effectuate policies of F. C. C., see section 1071 of this title.

Gain or loss from involuntary conversion, see section 1231 of this title.

Holding period of property, see section 1223 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 121, 381, 1071, 1223, 1245, 1250, 1251, 1332, 1333, 1336, 1351 of this title.

§ 1034. Sale or exchange of residence.

(a) Nonrecognition of gain.

If property (in this section called "oid residence") used by the taxpayer as his principal residence is sold by him after December 31, 1953, and, within a period beginning 1 year before the date of such sale and ending 1 year after such date, property (in this section called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price (as defined in subsection (b)) of the old residence exceeds the taxpayer's cost of purchasing the new residence.

(b) Adjusted sales price defined.

(1) In general.

For purposes of this section, the term "adjusted sales price" means the amount realized, reduced by the aggregate of the expenses for work performed on the old residence in order to assist in its sale.

(2) Limitations.

The reduction provided in paragraph (1) applies only to expenses—

(A) for work performed during the 90-day period ending on the day on which the contract to sell the old residence is entered into;

(B) which are paid on or before the 30th day after the date of the sale of the old residence; and

(C) which are—

(i) not allowable as deductions in computing taxable income under section 63 (a) (defining taxable income), and

(ii) not taken into account in computing the amount realized from the sale of the old residence.

(3) Effective date.

The reduction provided in paragraph (1) applies to expenses for work performed in any taxable year (whether beginning before, on, or after January 1, 1954), but only in the case of a sale or exchange of an old residence which occurs after December 31, 1953.

(c) Rules for application of section.

For purposes of this section:

(1) An exchange by the taxpayer of his residence for other property shall be treated as a sale of such residence, and the acquisition of a residence on the exchange of property shall be treated as a purchase of such residence.

(2) A residence any part of which was constructed or reconstructed by the taxpayer shall be treated as purchased by the taxpayer. In determining the taxpayer's cost of purchasing a residence, there shall be included only so much of his cost as is attributable to the acquisition, construction, reconstruction, and improvements made which are properly chargeable to capital account, during the period specified in subsection (a).

(3) If a residence is purchased by the taxpayer before the date of his sale of the old residence, the purchased residence shall not be treated as his new residence if sold or otherwise disposed of by him before the date of the sale of the old residence.

(4) If the taxpayer, during the period described in subsection (a), purchases more than one residence which is used by him as his principal residence at some time within 1 year after the date of the sale of the old residence, only the last of such residences so used by him after the date of such sale shall constitute the new residence.

(5) In the case of a new residence the construction of which was commenced by the taxpayer before the expiration of one year after the date of the sale of the old residence, the period specified in subsection (a), and the 1 year referred to in paragraph (4) of this subsection, shall be treated as including a period of 18 months beginning with the date of the sale of the old residence.

(d) Limitation.

Subsection (a) shall not apply with respect to the sale of the taxpayer's residence if within 1 year before the date of such sale the taxpayer sold at a gain other property used by him as his principal residence, and any part of such gain was not recognized by reason of subsection (a) or section 112 (n) of the Internal Revenue Code of 1939.

(e) Basis of new residence.

Where the purchase of a new residence results, under subsection (a) or under section 112 (n) of the Internal Revenue Code of 1939, in the nonrecognition of gain on the sale of an old residence, in determining the adjusted basis of the new residence as of any time following the sale of the old residence, the adjustments to basis shall include a reduction by an amount equal to the amount of the gain not so recognized on the sale of the old residence. For this purpose, the amount of the gain not so recognized on the sale of the old residence includes only so much of such gain as is not recognized by reason of the cost, up to such time, of purchasing the new residence.

(f) Tenant-stockholder in a cooperative housing corporation.

For purposes of this section, section 1016 (relating to adjustments to basis), and section 1223 (relating to holding period), references to property used by the taxpayer as his principal residence, and references to the residence of a taxpayer, shall include stock held by a tenant-stockholder (as defined in section 216, relating to deduction for amounts representing taxes and interest paid to a cooperative housing corporation) in a cooperative housing corporation (as defined in such section) if—

(1) in the case of stock sold, the house or apartment which the taxpayer was entitled to occupy as such stockholder was used by him as his principal residence, and

(2) in the case of stock purchased, the taxpayer used as his principal residence the house or apartment which he was entitled to occupy as such stockholder.

(g) Husband and wife.

If the taxpayer and his spouse, in accordance with regulations which shall be prescribed by the Secretary or his delegate pursuant to this subsection, consent to the application of paragraph (2) of this subsection, then—

(1) for purposes of this section—

(A) the taxpayer's adjusted sales price of the old residence is the adjusted sales price (of the taxpayer, or of the taxpayer and his spouse) of the old residence, and

(B) the taxpayer's cost of purchasing the new residence is the cost (to the taxpayer, his spouse, or both) of purchasing the new residence (whether held by the taxpayer, his spouse, or the taxpayer and his spouse); and

(2) so much of the gain on the sale of the old residence as is not recognized solely by reason of this subsection, and so much of the adjustment under subsection (e) to the basis of the new residence as results solely from this subsection shall be allocated between the taxpayer and his spouse as provided in such regulations.

This subsection shall apply only if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence. In case the taxpayer and his spouse do not consent to the application of paragraph (2) of this subsection then the recognition of gain on the sale of the old residence shall be determined under this section without regard to the rules provided in this subsection.

(h) Members of Armed Forces.

The running of any period of time specified in subsection (a) or (c) (other than the 1 year referred to in subsection (c) (4)) shall be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) serves on extended active duty with the Armed Forces of the United States after the date of the sale of the old residence and during an induction period (as defined in section 112 (c) (5)) except that any such period of time as so suspended shall not extend beyond the date 4 years after the date of the sale of the old residence. For purposes of this subsection, the term "extended active duty" means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

(i) Special rule for involuntary conversions.

(1) In general.

For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property, or the sale or exchange of property under threat or imminence thereof—

(A) if occurring after December 31, 1950, and before January 1, 1954, shall be treated as the sale of such property; and

(B) if occurring after December 31, 1953, shall not be treated as the sale of such property.

(2) Condemnations after December 31, 1957.

For purposes of this section, the seizure, requisition, or condemnation of property, or the sale or exchange of property under threat or imminence thereof, if occurring after December 31, 1957, shall, at the election of the taxpayer, be treated as the sale of such property. Such election shall be made at such time and in such manner as the Secretary or his delegate shall prescribe by regulations.

(3) Cross reference.

For treatment of residences involuntarily converted after December 31, 1953, see section 1033 (relating to involuntary conversions).

(j) Statute of limitations.

If after December 31, 1950, the taxpayer during a taxable year sells at a gain property used by him as his principal residence, then—

(1) the statutory period for the assessment of any deficiency attributable to any part of such gain shall not expire before the expiration of 3 years from the date the Secretary or his delegate is notified by the taxpayer (in such manner as the Secretary or his delegate may by regulations prescribe) of—

(A) the taxpayer's cost of purchasing the new residence which the taxpayer claims results in nonrecognition of any part of such gain,

(B) the taxpayer's intention not to purchase a new residence within the period specified in subsection (a), or

(C) a failure to make such purchase within such period; and

(2) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(k) Cross reference.

For exclusion from gross income of certain gain from sale or exchange of residence of taxpayer who has attained age 65, see section 121.

(Aug. 16, 1954, ch. 736, 68A Stat. 306; Sept. 2, 1958, Pub. L. 85–866, title I, § 46(b), 72 Stat. 1642; Feb. 26, 1964, Pub. L. 88–272, title II, § 206(b)(4), 78 Stat. 40.)

AMENDMENTS

1964—Subsec. (k). Pub. L. 88–272 added subsec. (k).

1958—Subsec. (i)(2). Pub. L. 85–866 added subsec. (i)(2) and redesignated former par. (2) as (3).

Subsec. (i)(3). Pub. L. 85–866, redesignated former par. (2) as (3).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 206(c) of Pub. L. 88–272 set out as a note under section 121 of this title.

CROSS REFERENCES

Adjustments to basis, see section 1016 of this title.

Notice of deficiency, see section 6212 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 121, 512, 1016, 1038, 1223, 1250 of this title.

§ 1035. Certain exchanges of insurance policies.

(a) General rules.

No gain or loss shall be recognized on the exchange of—

(1) a contract of life insurance for another contract of life insurance or for an endowment or annuity contract; or

(2) a contract of endowment insurance (A) for another contract of endowment insurance which provides for regular payments beginning at a date

not later than the date payments would have begun under the contract exchanged, or (B) for an annuity contract; or

(3) an annuity contract for an annuity contract.

(b) Definitions.

For the purpose of this section—

(1) Endowment contract.

A contract of endowment insurance is a contract with a life insurance company as defined in section 801 which depends in part on the life expectancy of the insured, but which may be payable in full in a single payment during his life.

(2) Annuity contract.

An annuity contract is a contract to which paragraph (1) applies but which may be payable during the life of the annuitant only in installments.

(3) Life insurance contract.

A contract of life insurance is a contract to which paragraph (1) applies but which is not ordinarily payable in full during the life of the insured.

(c) Cross references.

(1) For rules relating to recognition of gain or loss where an exchange is not solely in kind, see subsections (b) and (c) of section 1031.

(2) For rules relating to the basis of property acquired in an exchange described in subsection (a), see subsection (d) of section 1031.

(Aug. 16, 1954, ch. 736, 68A Stat. 309.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1031 of this title.

§ 1036. Stock for stock of same corporation.

(a) General rule.

No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(b) Cross references.

(1) For rules relating to recognition of gain or loss where an exchange is not solely in kind, see subsections (b) and (c) of section 1031.

(2) For rules relating to the basis of property acquired in an exchange described in subsection (a), see subsection (d) of section 1031.

(Aug. 16, 1954, ch. 736, 68A Stat. 309.)

CROSS REFERENCES

Exchange of stock and securities in certain reorganizations, see section 354 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 81, 425, 1031 of this title.

§ 1037. Certain exchanges of United States obligations.

(a) General rule.

When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under the Second Liberty Bond Act in exchange solely for other obligations issued under such Act.

(b) Application of section 1232.

(1) Exchanges involving obligations issued at a discount.

In any case in which gain has been realized but not recognized because of the provisions of subsection (a) (or so much of section 1031(b) as relates to subsection (a) of this section), to the extent such gain is later recognized by reason of a disposition or redemption of an obligation received in an exchange subject to such provisions, the first sentence of section 1232(a)(2)(A) shall apply to such gain as though the obligation disposed of or redeemed were the obligation surrendered to the Government in the exchange rather than the obligation actually disposed of or redeemed. For purposes of this paragraph and section 1232, if the obligation surrendered in the exchange is a nontransferable obligation described in subsection (a) or (c) of section 454—

(A) the aggregate amount considered, with respect to the obligation surrendered, as gain from the sale or exchange of property which is not a capital asset shall not exceed the difference between the issue price and the stated redemption price which applies at the time of the exchange, and

(B) the issue price of the obligation received in the exchange shall be considered to be the stated redemption price of the obligation surrendered in the exchange, increased by the amount of other consideration (if any) paid to the United States as a part of the exchange.

(2) Exchanges of transferable obligations issued at not less than par.

In any case in which subsection (a) (or so much of section 1031 (b) or (c) as relates to subsection (a) of this section) has applied to the exchange of a transferable obligation which was issued at not less than par for another transferable obligation, the issue price of the obligation received from the Government in the exchange shall be considered for purposes of applying section 1232 to be the same as the issue price of the obligation surrendered to the Government in the exchange, increased by the amount of other consideration (if any) paid to the United States as a part of the exchange.

(c) Cross references.

(1) For rules relating to the recognition of gain or loss in a case where subsection (a) would apply except for the fact that the exchange was not made solely for other obligations of the United States, see subsections (b) and (c) of section 1031.

(2) For rules relating to the basis of obligations of the United States acquired in an exchange for other obligations described in subsection (a), see subsection (d) of section 1031.

(Added Pub. L. 86-346, title II, § 201(a), Sept. 22, 1959, 73 Stat. 622.)

REFERENCES IN TEXT

The Second Liberty Bond Act, referred to in subsec. (a), is classified to sections 745, 752—754b, 757, 757b—758, 760, 764—766, 769, 771, 773, 774, and 801 of Title 31, Money and Finance.

Such Act, referred to in subsec. (a), refers to the Second Liberty Bond Act.

EFFECTIVE DATE

Section 203 of Pub. L. 86-346 provided that: "The amendments made by this title [enacting this section and amending section 1031 of this title and section 742a of Title 31] shall be effective for taxable years ending after the date of enactment of this Act [Sept. 22, 1959]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 454, 1031 of this title.

§ 1038. Certain reacquisitions of real property.

(a) General rule.

If—

(1) a sale of real property gives rise to indebtedness to the seller which is secured by the real property sold, and

(2) the seller of such property reacquires such property in partial or full satisfaction of such indebtedness,

then, except as provided in subsections (b) and (d), no gain or loss shall result to the seller from such reacquisition, and no debt shall become worthless or partially worthless as a result of such reacquisition.

(b) Amount of gain resulting.

(1) In general.

In the case of a reacquisition of real property to which subsection (a) applies, gain shall result from such reacquisition to the extent that—

(A) the amount of money and the fair market value of other property (other than obligations of the purchaser) received, prior to such reacquisition, with respect to the sale of such property, exceeds

(B) the amount of the gain on the sale of such property returned as income for periods prior to such reacquisition.

(2) Limitation.

The amount of gain determined under paragraph (1) resulting from a reacquisition during any taxable year beginning after the date of the enactment of this section shall not exceed the amount by which the price at which the real property was sold exceeded its adjusted basis, reduced by the sum of—

(A) the amount of the gain on the sale of such property returned as income for periods prior to the reacquisition of such property, and

(B) the amount of money and the fair market value of other property (other than obligations of the purchaser received with respect to the sale of such property) paid or transferred by the seller in connection with the reacquisition of such property.

For purposes of this paragraph, the price at which real property is sold is the gross sales price reduced by the selling commissions, legal fees, and other expenses incident to the sale of such property which are properly taken into account in determining gain or loss on such sale.

(3) Gain recognized.

Except as provided in this section, the gain determined under this subsection resulting from a reacquisition to which subsection (a) applies shall be recognized, notwithstanding any other provision of this subtitle.

(c) Basis of reacquired real property.

If subsection (a) applies to the reacquisition of any real property, the basis of such property upon such reacquisition shall be the adjusted basis of the indebtedness to the seller secured by such property (determined as of the date of reacquisition), increased by the sum of—

(1) the amount of the gain determined under subsection (b) resulting from such reacquisition, and

(2) the amount described in subsection (b)(2)(B).

If any indebtedness to the seller secured by such property is not discharged upon the reacquisition of such property, the basis of such indebtedness shall be zero.

(d) Indebtedness treated as worthless prior to reacquisition.

If, prior to a reacquisition of real property to which subsection (a) applies, the seller has treated indebtedness secured by such property as having become worthless or partially worthless—

(1) such seller shall be considered as receiving, upon the reacquisition of such property, an amount equal to the amount of such indebtedness treated by him as having become worthless, and

(2) the adjusted basis of such indebtedness shall be increased (as of the date of reacquisition) by an amount equal to the amount so considered as received by such seller.

(e) Principal residences.

If—

(1) subsection (a) applies to a reacquisition of real property with respect to the sale of which—

(A) an election under section 121 (relating to gain from sale or exchange of residence of an individual who has attained age 65) is in effect, or

(B) gain was not recognized under section 1034 (relating to sale or exchange of residence); and

(2) within one year after the date of the reacquisition of such property by the seller, such property is resold by him,

then, under regulations prescribed by the Secretary or his delegate, subsections (b), (c), and (d) of this section shall not apply to the reacquisition of such property and, for purposes of applying sections 121 and 1034, the resale of such property shall be treated as a part of the transaction constituting the original sale of such property.

(f) Reacquisitions by domestic building and loan associations.

This section shall not apply to a reacquisition of real property by an organization described in section 593(a) (relating to domestic building and loan associations, etc.). (Added Pub. L. 88–570, § 2(a), Sept. 2, 1964, 78 Stat. 854.)

EFFECTIVE DATE; ELECTION TO APPLY TO TAXABLE YEARS BEGINNING AFTER DEC. 31, 1957

Section 2(c) of Pub. L. 88–570 provided that:

"(1) The amendments made by this section [adding this section] shall apply to taxable years beginning after the date of the enactment of this Act [Sept. 2, 1964].

"(2) If the taxpayer makes an election under this paragrapb, the amendments made by this section [adding this section] shall also apply to taxable years beginning after December 31, 1957, except that such amendments shall not apply with respect to any reacquisition of real property in a taxable year for which the assessment of a deficiency, or the credit or refund of an overpayment, is

prevented on the date of the enactment of this Act [Sept. 2, 1964] by the operation of any law or rule of law. An election under this paragraph shall be made within one year after the date of the enactment of this Act [Sept. 2, 1964] and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations.

"(3) If an election is made by the taxpayer under paragraph (2), and if the assessment of a deficiency, or the credit or refund of an overpayment, for any taxable year to which such election applies is not prevented on the date of the enactment of this Act [Sept. 2, 1964] by the operation of any law or rule of law—

"(A) the period within which a deficiency for such taxable year may be assessed (to the extent such deficiency is attributable to the application of the amendments made by this section) shall not expire prior to one year after the date of such election; and

"(B) the period within which a claim for credit or refund of an overpayment for such taxable year may be filed (to the extent such overpayment is attributable to the application of such amendments) shall not expire prior to one year after the date of such election.

No interest shall be payable with respect to any deficiency attributable to the application of such amendments, and no interest shall be allowed with respect to any credit or refund of any overpayment attributable to the application of such amendments, for any period prior to the date of the enactment of this Act [Sept. 2, 1964]. An election by a taxpayer under paragraph (2) shall be deemed a consent to the application of this paragraph."

§ 1039. Certain sales of low-income housing projects.

(a) Nonrecognition of gain.

If—

(1) a qualified housing project is sold or disposed of by the taxpayer in an approved disposition, and

(2) within the reinvestment period the taxpayer constructs, reconstructs, or acquires another qualified housing project,

then, at the election of the taxpayer, gain from such approved disposition shall be recognized only to the extent that the net amount realized on such approved disposition exceeds the cost of such other qualified housing project. An election under this subsection shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

(b) Definitions.

For purposes of this section—

(1) Qualified housing project.

The term "qualified housing project" means a project to provide rental or cooperative housing for lower income families—

(A) with respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, and

(B) with respect to which the owner is, under such sections or regulations issued thereunder—

(i) limited as to the rate of return on his investment in the project, and

(ii) limited as to rentals or occupancy charges for units in the project.

(2) Approved disposition.

The term "approved disposition" means a sale or other disposition of a qualified housing project to the tenants or occupants of units in such project, or to a cooperative or other nonprofit organization formed solely for the benefit of such tenants or occupants, which sale or disposition is approved by the Secretary of Housing and Urban Development under section 221(d)(3) or 236 of the National Housing Act or regulations issued under such sections.

(3) Reinvestment period.

The reinvestment period, with respect to an approved disposition of a qualified housing project, is the period beginning one year before the date of such approved disposition and ending—

(A) one year after the close of the first taxable year in which any part of the gain from such approved disposition is realized, or

(B) subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

(4) Net amount realized.

The net amount realized on an approved disposition of a qualified housing project is the amount realized reduced by—

(A) the expenses paid or incurred which are directly connected with such approved disposition, and

(B) the amount of taxes (other than income taxes) paid or incurred which are attributable to such approved disposition.

(c) Special rules.

For purposes of applying subsection (a)(2) with respect to an approved disposition—

(1) no property acquired by the taxpayer before the date of the approved disposition shall be taken into account unless such property is held by the taxpayer on such date, and

(2) no property acquired by the taxpayer shall be taken into account unless, except as provided in subsection (d), the unadjusted basis of such property is its cost within the meaning of section 1012.

(d) Basis of other qualified housing project.

If the taxpayer makes an election under subsection (a) with respect to an approved disposition, the basis of the qualified housing project described in subsection (a)(2) shall be its cost reduced by an amount equal to the amount of gain not recognized by reason of the application of subsection (a).

(e) Assessment of deficiencies.

(1) Deficiency attributable to gain.

If the taxpayer has made an election under subsection (a) with respect to an approved disposition—

(A) the statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain on such approved disposition is realized, attributable to the gain on such approved disposition shall not expire prior to the expiration of 3 years from the date the Secretary or his delegate is notified by the taxpayer (in such manner as the Secretary or his delegate may by regulations prescribe) of the construction, reconstruction, or acquisition of another

qualified housing project or of the failure to construct, reconstruct, or acquire another qualified housing project, and

(B) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of section 6212(c) or the provision of any other law or rule of law which would otherwise prevent such assessment.

(2) Time for assessment of other deficiencies attributable to election.

If a taxpayer has made an election under subsection (a) with respect to an approved disposition and another qualified housing project is constructed, reconstructed, or acquired before the beginning of the last taxable year in which any part of the gain upon such approved disposition is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last taxable year may be assessed (notwithstanding the provisions of section 6212 (c) or 6501 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

(Added Pub. L. 91–172, title IX, § 910(a), Dec. 30, 1969, 83 Stat. 718.)

EFFECTIVE DATE

Section 910(d) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section and amending section 1250 of this title] shall apply to approved dispositions of qualified housing projects (within the meaning of section 1039 of the Internal Revenue Code of 1954 as added by subsection (a) [subsec. (a) of this section]) after October 9, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1250 of this title.

PART IV.—SPECIAL RULES

Sec.
1051. Property acquired during affiliation.
1052. Basis established by the Revenue Act of 1932 or 1934 or by the Internal Revenue Code of 1939.
1053. Property acquired before March 1, 1913.
1054. Certain stock of Federal National Mortgage Association.
1055. Redeemable ground rents.
1056. Cross references.

AMENDMENTS

1963—Pub. L. 88–9, § 1(d), Apr. 10, 1963, 77 Stat. 8, added item 1055 and renumbered former item 1055 as 1056.

1960—Pub. L. 86–779, § 8(c), Sept. 14, 1960, 74 Stat. 1003, renumbered former item 1054 as 1055 and added new item 1054.

§ 1051. Property acquired during affiliation.

In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Secretary or his delegate, without regard to inter-company transactions in respect of which gain or loss was not recognized. For purposes of this section, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928. The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return was made by such corporation under chapter 6 of this subtitle (sec. 1501 and following) or under section 141 of the Internal Revenue Code of 1939 or of the Revenue Act of 1938, 1936, 1934, 1932, or 1928 shall be determined in accordance with regulations prescribed under section 1502 or in accordance with regulations prescribed under the appropriate section 141, as the case may be. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return was made by such corporation under chapter 6 of this subtitle or such section 141 shall be adjusted in respect of any items relating to such period, in accordance with regulations prescribed under section 1502 or in accordance with regulations prescribed under the appropriate section 141, as the case may be. (Aug. 16, 1954, ch. 736, 68A Stat. 310.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 615, 617 of this title.

§ 1052. Basis established by the Revenue Act of 1932 or 1934 or by the Internal Revenue Code of 1939.

(a) Revenue Act of 1932.

If the property was acquired, after February 28, 1913, in any taxable year beginning before January 1, 1934, and the basis thereof, for purposes of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7), or (9) of such Act (47 Stat. 199), then for purposes of this subtitle the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

(b) Revenue Act of 1934.

If the property was acquired, after February 28, 1913, in any taxable year beginning before January 1, 1936, and the basis thereof, for purposes of the Revenue Act of 1934, was prescribed by section 113 (a) (6), (7), or (8) of such Act (48 Stat. 706), then for purposes of this subtitle the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934.

(c) Internal Revenue Code of 1939.

If the property was acquired, after February 28, 1913, in a transaction to which the Internal Revenue Code of 1939 applied, and the basis thereof, for purposes of the Internal Revenue Code of 1939, was prescribed by section 113 (a) (6), (7), (8), (13), (15), (18), (19), or (23) of such code, then for purposes of this subtitle the basis shall be the same as the basis therein prescribed in the Internal Revenue Code of 1939. (Aug. 16, 1954, ch. 736, 68A Stat. 310.)

CROSS REFERENCES

Basis of—
- Property contributed to partnership, see section 723 of this title.
- Property received in corporate liquidations, see section 334 of this title.
- Stock and stock rights acquired in corporate distributions, see section 307 of this title.

Basis to—
- Corporations in corporate organizations and reorganizations, see section 362 of this title.

Distributees in corporate organizations and reorganizations, see section 358 of this title.
Partner of distributed property other than money, see section 732 of this title.
Exchange of property held for productive use or investment, basis, see section 1031 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1223 of this title.

§ 1053. Property acquired before March 1, 1913.

In the case of property acquired before March 1, 1913, if the basis otherwise determined under this subtitle, adjusted (for the period before March 1, 1913) as provided in section 1016, is less than the fair market value of the property as of March 1, 1913, then the basis for determining gain shall be such fair market value. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date. (Aug. 16, 1954, ch. 736, 68A Stat. 311; Sept. 2, 1958, Pub. L. 85–866, title I, § 47, 72 Stat. 1642.)

AMENDMENTS

1958—Pub. L. 85–866 substituted "subtitle" for "part".

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

CROSS REFERENCES

Basis—
Adjustments to, see section 1016 of this title.
Cost, see section 1012 of this title.
Distributed property other than money in partnerships, see section 732 of this title.
Distributees in certain corporate organization or reorganization, see section 358 of this title.
Exchange not solely in kind, see section 1031 (d) of this title.
Gift or transfer in trust after Jan. 1, 1921, see section 1015 (c) of this title.
Gifts after Dec. 31, 1920, see section 1015 (a) of this title.
Property acquired after Feb. 28, 1913, see section 1052 of this title.
Property acquired from decedent, see section 1014 of this title.
Property included in inventory, see section 1013 of this title.
Property received in corporate liquidations, see section 334 of this title.
Stock and stock right acquired in corporate distributions, see section 307 of this title.
Transfer in trust after Dec. 31, 1920, see section 1015 (b) of this title.
Fair market value of property received as amount realized on gain, see section 1001 (b) of this title.

§ 1054. Certain stock of Federal National Mortgage Association.

In the case of a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718), the basis of such share in the hands of the initial holder shall be an amount equal to the capital contributions evidenced by such share reduced by the amount (if any) required by section 162(d) to be treated (with respect to such share) as ordinary and necessary expenses paid or incurred in carrying on a trade or business. (Added Pub. L. 86–779, § 8(b), Sept. 14, 1960, 74 Stat. 1003.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1959, see section 8(d) of Pub. L. 86–779, set out as a note under section 162 of this title.

§ 1055. Redeemable ground rents.

(a) Character.

For purposes of this subtitle—

(1) a redeemable ground rent shall be treated as being in the nature of a mortgage, and

(2) real property held subject to liabilities under a redeemable ground rent shall be treated as held subject to liabilities under a mortgage.

(b) Application of subsection (a).

(1) In general.

Subsection (a) shall take effect on the day after the date of the enactment of this section and shall apply with respect to taxable years ending after such date of enactment.

(2) Basis of holder.

In determining the basis of real property held subject to liabilities under a redeemable ground rent, subsection (a) shall apply whether such real property was acquired before or after the enactment of this section.

(3) Basis of reserved redeemable ground rent.

In the case of a redeemable ground rent reserved or created on or before the date of the enactment of this section in connection with a transfer of the right to hold real property subject to liabilities under such ground rent, the basis of such ground rent after such date in the hands of the person who reserved or created the ground rent shall be the amount taken into account in respect of such ground rent for Federal income tax purposes as consideration for the disposition of such real property. If no such amount was taken into account, such basis shall be determined as if this section had not been enacted.

(c) Redeemable ground rent defined.

For purposes of this subtitle, the term "redeemable ground rent" means only a ground rent with respect to which—

(1) there is a lease of land which is assignable by the lessee without the consent of the lessor and which (together with periods for which the lease may be renewed at the option of the lessee) is for a term in excess of 15 years,

(2) the leaseholder has a present or future right to terminate, and to acquire the entire interest of of the lessor in the land, by payment of a determined or determinable amount, which right exists by virtue of State or local law and not because of any private agreement or privately created condition, and

(3) the lessor's interest in the land is primarily a security interest to protect the rental payments to which the lessor is entitled under the lease.

(d) Cross reference

For treatment of rentals under redeemable ground rents as interest, see section 163(c).

(Added Pub. L. 88–9, § 1(b), Apr. 10, 1963, 77 Stat. 7.)

REFERENCES IN TEXT

Date of the enactment of this section, referred to in subsec. (b) (1), (3), means Apr. 10, 1963, the date of approval of Pub. L. 88–9.

EFFECTIVE DATE

Section 2 of Pub. L. 88–9 provided that: "The amendments made by subsection (a) of the first section of this Act [to section 163 of this title] shall take effect as of January 1, 1962, and shall apply with respect to taxable years ending on or after such date. The amendments made by subsection (b) of the first section of this Act [adding this section] shall take effect on the day after the date of the enactment of this Act [Apr. 10, 1963] and shall apply with respect to taxable years ending after such date of enactment [Apr. 10, 1963]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 7701 of this title.

§ 1056. Cross references.

(1) For nonrecognition of gain in connection with the transfer of obsolete vessels to the Maritime Administration under section 510 of the Merchant Marine Act, 1936, see subsection (e) of that section, as amended August 4, 1939 (46 U. S. C. 1160).

(2) For recognition of gain or loss in connection with the construction of new vessels, see section 511 of such Act, as amended (46 U. S. C. 1161).

(3) For nonrecognition of gain in connection with vessels exchanged with the Maritime Administration under section 8 of the Merchant Ship Sales Act of 1946, see subsection (a) of that section (50 U. S. C. App. 1741).

(Aug. 16, 1954, ch. 736, 68A Stat. 311, § 1056, formerly § 1054, renumbered § 1055, Sept. 14, 1960, Pub. L. 86–779, § 8(b), 74 Stat. 1003; renumbered § 1056, Apr. 10, 1963, Pub. L. 88–9, § 1(b), 77 Stat. 7.)

PART V.—CHANGES TO EFFECTUATE F. C. C. POLICY

Sec.

1071. Gain from sale or exchange to effectuate policies of F. C. C.

§ 1071. Gain from sale or exchange to effectuate policies of F. C. C.

(a) Nonrecognition of gain or loss.

If the sale or exchange of property (including stock in a corporation) is certified by the Federal Communications Commission to be necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion of such property within the meaning of section 1033. For purposes of such section as made applicable by the provisions of this section, stock of a corporation operating a radio broadcasting station, whether or not representing control of such corporation, shall be treated as property similar or related in service or use to the property so converted. The part of the gain, if any, on such sale or exchange to which section 1033 is not applied shall nevertheless not be recognized, if the taxpayer so elects, to the extent that it is applied to reduce the basis for determining gain or loss on sale or exchange of property, of a character subject to the allowance for depreciation under section 167, remaining in the hands of the taxpayer immediately after the sale or exchange, or acquired in the same taxable year. The manner and amount of such reduction shall be determined under regulations prescribed by the Secretary or his delegate. Any election made by the taxpayer under this section shall be made by a statement to that effect in his return for the taxable year in which the sale or exchange takes place, and such election shall be binding for the taxable year and all subsequent taxable years.

(b) Basis.

For basis of property acquired on a sale or exchange treated as an involuntary conversion under subsection (a), see section 1033 (c).

(Aug. 16, 1954, ch. 736, 68A Stat. 311; Sept. 2, 1958, Pub. L. 85–866, title I, § 48(a), 72 Stat. 1642.)

AMENDMENTS

1958—Subsec. (a). Pub. L. 85–866 substituted "to effectuate a change in a policy of, or the adoption of a new policy by, the Commission" for "to effectuate the policies of the Commission".

EFFECTIVE DATE OF 1958 AMENDMENT

Section 48 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (a) of this section] shall apply with respect to any sale or exchange after December 31, 1957."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1245, 1250 of this title.

PART VI.—EXCHANGES IN OBEDIENCE TO S. E. C. ORDERS

Sec.

1081. Nonrecognition of gain or loss on exchanges or distributions in obedience to orders of S. E. C.

1082. Basis for determining gain or loss.

1083. Definitions.

§ 1081. Nonrecognition of gain or loss on exchanges or distributions in obedience to orders of S. E. C.

(a) Exchanges of stock or securities only.

No gain or loss shall be recognized to the transferor if stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are transferred to such corporation or to an associate company thereof which is a registered holding company or a majority-owned subsidiary company solely in exchange for stock or securities (other than stock or securities which are nonexempt property), and the exchange is made by the transferee corporation in obedience to an order of the Securities and Exchange Commission.

(b) Exchanges and sales of property by corporations.

(1) General rule.

No gain shall be recognized to a transferor corporation which is a registered holding company or an associate company of a registered holding company, if such corporation, in obedience to an order of the Securities and Exchange Commission, transfers property in exchange for property, and such order recites that such exchange by the transferor corporation is necessary or appropriate to the integration or simplification of the holding company system of which the transferor corporation is a member. Any gain, to the extent that it cannot be applied in reduction of basis under section 1082 (a) (2), shall be recognized.

(2) Nonexempt property.

If any such property so received is nonexempt property, gain shall be recognized unless such nonexempt property or an amount equal to the fair market value of such property at the time of the transfer is, within 24 months of the transfer, under regulations prescribed by the Secretary or his delegate, and in accordance with an order of the Securities and Exchange Commission, expended for property other than nonexempt property or is invested as a contribution to the capital, or as paid-in surplus, of another corporation, and

such order recites that such expenditure or investment by the transferor corporation is necessary or appropriate to the integration or simplification of the holding company system of which the transferor corporation is a member. If the fair market value of such nonexempt property at the time of the transfer exceeds the amount expended and the amount invested, as required in the preceding sentence, the gain, if any, to the extent of such excess, shall be recognized.

(3) Cancellation or redemption of stock or securities.

For purposes of this subsection, a distribution in cancellation or redemption (except a distribution having the effect of a dividend) of the whole or a part of the transferor's own stock (not acquired on the transfer) and a payment in complete or partial retirement or cancellation of securities representing indebtedness of the transferor or a complete or partial retirement or cancellation of such securities which is a part of the consideration for the transfer shall be considered an expenditure for property other than nonexempt property, and if, on the transfer, a liability of the transferor is assumed, or property of the transferor is transferred subject to a liability, the amount of such liability shall be considered to be an expenditure by the transferor for property other than nonexempt property.

(4) Consents.

This subsection shall not apply unless the transferor corporation consents, at such time and in such manner as the Secretary or his delegate may by regulations prescribe to the regulations prescribed under section 1082 (a) (2) in effect at the time of filing its return for the taxable year in which the transfer occurs.

(c) Distribution of stock or securities only.

(1) In general.

If there is distributed, in obedience to an order of the Securities and Exchange Commission, to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company, stock or securities (other than stock or securities which are nonexempt property), without the surrender by such shareholder of stock or securities in such corporation, no gain to the distributee from the receipt of the stock or securities so distributed shall be recognized.

(2) Special rule.

If—

(A) there is distributed to a shareholder in a corporation rights to acquire common stock in a second corporation without the surrender by such shareholder of stock in the first corporation,

(B) such distribution is in accordance with an arrangement forming a ground for an order of the Securities and Exchange Commission issued pursuant to section 3 of the Public Utility Holding Company Act of 1935 (49 Stat. 810; 15 U. S. C. 79c) that such corporation is exempt from any provision or provisions of such Act, and

(C) before January 1, 1958, the first corporation disposes of all of the common stock in the second corporation which it owns,

then no gain to the distributee from the receipt of the rights so distributed shall be recognized. If the first corporation does not, before January 1, 1958, dispose of all of the common stock which it owns in the second corporation, then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment or the collection by levy or a proceeding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting solely from the receipt of such rights to acquire stock, include one year immediately following the date on which the first corporation notifies the Secretary or his delegate whether or not the requirements of subparagraph (C) of the preceding sentence have been met; and such assessment and collection may be made notwithstanding any provision of law or rule of law which would otherwise prevent such assessment and collection.

(d) Transfers within system group.

(1) General rule.

No gain or loss shall be recognized to a corporation which is a member of a system group—

(A) if such corporation transfers property to another corporation which is a member of the same system group in exchange for other property, and the exchange by each corporation is made in obedience to an order of the Securities and Exchange Commission, or

(B) if there is distributed to such corporation as a shareholder in a corporation which is a member of the same system group, property, without the surrender by such shareholder of stock or securities in the corporation making the distribution, and the distribution is made and received in obedience to an order of the Securities and Exchange Commission.

If an exchange by or a distribution to a corporation with respect to which no gain or loss is recognized under any of the provisions of this paragraph may also be considered to be within the provisions of subsection (a), (b), or (c), then the provisions of this paragraph only shall apply.

(2) Sales of stock or securities.

If the property received on an exchange which is within any of the provisions of paragraph (1) consists in whole or in part of stock or securities issued by the corporation from which such property was received, and if in obedience to an order of the Securities and Exchange Commission such steck or securities (other than stock which is not preferred as to both dividends and assets) are sold and the proceeds derived therefrom are applied in whole or in part in the retirement or cancellation of stock or of securities of the recipient corperation outstanding at the time of such exchange, no gain or loss shall be recognized to the recipient corporation on the sale of the stock or securities with respect to which such order was made; except that if any part of the proceeds derived from the sale of such stock or securities is not so applied, or if the amount of such proceeds is in excess of the fair market value of such stock

or securities at the time of such exchange, the gain, if any, shall be recognized, but in an amount not in excess of the proceeds which are not so applied, or in an amount not more than the amount by which the proceeds derived from such sale exceed such fair market value, whichever is the greater.

(e) Exchanges not solely in kind.

(1) General rule.

If an exchange (not within any of the provisions of subsection (d)) would be within the provisions of subsection (a) if it were not for the fact that property received in exchange consists not only of property permitted by such subsection to be received without the recognition of gain or loss, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property, and the loss, if any, to the recipient shall not be recognized.

(2) Distribution treated as dividend.

If an exchange is within the provisions of paragraph (1) and if it includes a distribution which has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under such paragraph as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(f) Conditions for application of section.

Except in the case of a distribution described in subsection (c) (2), the provisions of this section shall not apply to an exchange, expenditure, investment, distribution, or sale unless—

(1) the order of the Securities and Exchange Commission in obedience to which such exchange, expenditure, investment, distribution, or sale was made recites that such exchange, expenditure, investment, distribution, or sale is necessary or appropriate to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935 (49 Stat. 820; 15 U. S. C. 79k (b)),

(2) such order specifies and itemizes the stock and securities and other property which are ordered to be acquired, transferred, received, or sold on such exchange, acquisition, expenditure, distribution, or sale, and, in the case of an investment, the investment to be made, and

(3) such exchange, acquisition, expenditure, investment, distribution, or sale was made in obedience to such order, and was completed within the time prescribed therefor.

(g) Nonapplication of other provisions.

If a distribution described in subsection (c) (2), or an exchange or distribution made in obedience to an order of the Securities and Exchange Commission, is within any of the provisions of this part and may also be considered to be within any of the other provisions of this subchapter or subchapter C (sec. 301 and following, relating to corporate distributions and adjustments), then the provisions of this part only shall apply. (Aug. 16, 1954, ch. 736, 68A Stat. 312.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1082, 1223, 1245, 1250 of this title.

§ 1082. Basis for determining gain or loss.

(a) Exchanges generally.

(1) Exchanges subject to the provisions of section 1081 (a) or (e).

If the property was acquired on an exchange subject to the provisions of section 1081 (a) or (e), or the corresponding provisions of prior internal revenue laws, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer, and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 1081 (a) to be received without the recognition of gain or loss, and in part of nonexempt property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such nonexempt property (other than money) an amount equivalent to its fair market value at the date of the exchange. This subsection shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

(2) Exchanges subject to the provisions of section 1081 (b).

The gain not recognized on a transfer by reason of section 1081 (b) or the corresponding provisions of prior internal revenue laws shall be applied to reduce the basis for determining gain or loss on sale or exchange of the following categories of property in the hands of the transferor immediately after the transfer, and property acquired within 24 months after such transfer by an expenditure or investment to which section 1081 (b) relates on account of the acquisition of which gain is not recognized under such subsection, in the following order:

(A) property of a character subject to the allowance for depreciation under section 167;

(B) property (not described in subparagraph (A)) with respect to which a deduction for amortization is allowable under section 168, 169, 184, 185, or 187;

(C) property with respect to which a deduction for depletion is allowable under section 611 but not allowable under section 613;

(D) stock and securities of corporations not members of the system group of which the transferor is a member (other than stock or securities of a corporation of which the transferor is a subsidiary);

(E) securities (other than stock) of corporations which are members of the system group of which the transferor is a member (other than securities of the transferor or of a corporation of which the transferor is a subsidiary);

(F) stock of corporations which are members of the system group of which the transferor is a member (other than stock of the transferor or of a corporation of which the transferor is a subsidiary);

(G) all other remaining property of the transferor (other than stock or securities of the transferor or of a corporation of which the transferor is a subsidiary).

The manner and amount of the reduction to be applied to particular property within any of the categories described in subparagraphs (A) to (G), inclusive, shall be determined under regulations prescribed by the Secretary or his delegate.

(3) Basis in case of pre-1942 acquisition.

Notwithstanding the provisions of paragraph (1) or (2), if the property was acquired in a taxable year beginning before January 1, 1942, in any manner described in section 372 of the Internal Revenue Code of 1939 before its amendment by the Revenue Act of 1942, the basis shall be that prescribed in such section (before its amendment by such Act) with respect to such property.

(b) Transfers to corporations.

If, in connection with a transfer subject to the provisions of section 1081 (a), (b), or (e) or the corresponding provisions of prior internal revenue laws, the property was acquired by a corporation, either as paid-in surplus or as a contribution to capital, or in consideration for stock or securities issued by the corporation receiving the property (including cases where part of the consideration for the transfer of such property to the corporation consisted of property or money in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor on such transfer under the law applicable to the year in which the transfer was made.

(c) Distributions of stock or securities.

If the stock or securities were received in a distribution subject to the provisions of section 1081 (c) or the corresponding provisions of prior internal revenue laws, then the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under regulations prescribed by the Secretary or his delegate, between such stock and the stock or securities distributed.

(d) Transfers within system group.

If the property was acquired by a corporation which is a member of a system group on a transfer or distribution described in section 1081 (d) (1), then the basis shall be the same as it would be in the hands of the transferor; except that if such property is stock or securities issued by the corporation from which such stock or securities were received and they were issued—

(1) as the sole consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either—

(A) the same as in the case of the property transferred therefor, or

(B) the fair market value of such stock or securities at the time of their receipt, whichever is the lower; or

(2) as part consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either—

(A) an amount which bears the same ratio to the basis of the property transferred as the fair market value of such stock or securities at the time of their receipt bears to the total fair market value of the entire consideration received, or

(B) the fair market value of such stock or securities at the time of their receipt, whichever is the lower.

(Aug. 16, 1954, ch. 736, 68A Stat. 315; Dec. 30, 1969, Pub. L. 91–172, title VII, § 704(b)(3), 83 Stat. 699.)

AMENDMENTS

1969—Subsec. (f). Pub. L. 91–172 inserted reference to sections 184, 185 and 187 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1968, see section 704(c) of Pub. L. 91–172, set out as a note under section 169 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 615, 617, 1081, 4382 of this title.

§ 1083. Definitions.

(a) Order of Securities and Exchange Commission.

For purposes of this part, the term "order of the Securities and Exchange Commission" means an order issued after May 28, 1938, by the Securities and Exchange Commission which requires, authorizes, permits, or approves transactions described in such order to effectuate section 11 (b) of the Public Utility Holding Company Act of 1935 (49 Stat. 820; 15 U. S. C. 79k (b)), which has become or becomes final in accordance with law.

(b) Registered holding company; holding company system; associate company.

For purposes of this part, the terms "registered holding company", "holding company system", and "associate company" shall have the meanings assigned to them by section 2 of the Public Utility Holding Company Act of 1935 (49 Stat. 804; 15 U. S. C. 79b (a)).

(c) Majority-owned subsidiary company.

For purposes of this part, the term "majority-owned subsidiary company" of a registered holding company means a corporation, stock of which, representing in the aggregate more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote (not including stock which is entitled to vote only on default or nonpayment of dividends or other special circumstances) is owned wholly by such registered holding company, or partly by such registered holding company and partly by one or more majority-

owned subsidiary companies thereof, or by one or more majority-owned subsidiary companies of such registered holding company.

(d) System group.

For purposes of this part, the term "system group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) at least 90 percent of each class of the stock (other than (A) stock which is preferred as to both dividends and assets, and (B) stock which is limited and preferred as to dividends but which is not preferred as to assets but only if the total value of such stock is less than 1 percent of the aggregate value of all classes of stock which are not preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) the common parent corporation owns directly at least 90 percent of each class of the stock (other than stock, which is preferred as to both dividends and assets) of at least one of the other corporations; and

(3) each of the corporations is either a registered holding company or a majority-owned subsidiary company.

(e) Nonexempt property.

For purposes of this part, the term "nonexempt property" means—

(1) any consideration in the form of evidences of indebtedness owed by the transferor or a cancellation or assumption of debts or other liabilities of the transferor (including a continuance of encumbrances subject to which the property was transferred);

(2) short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace;

(3) securities issued or guaranteed as to principal or interest by a government or subdivision thereof (including those issued by a corporation which is an instrumentality of a government or subdivision thereof);

(4) stock or securities which were acquired from a registered holding company or an associate company of a registered holding company which acquired such stock or securities after February 28, 1938, unless such stock or securities (other than obligations described as nonexempt property in paragraph (1), (2), or (3)) were acquired in obedience to an order of the Securities and Exchange Commission or were acquired with the authorization or approval of the Securities and Exchange Commission under any section of the Public Utility Holding Company Act of 1935 (49 Stat. 820; 15 U. S. C. 79k (b));

(5) money, and the right to receive money not evidenced by a security other than an obligation described as nonexempt property in paragraph (2) or (3).

(f) Stock or securities.

For purposes of this part, the term "stock or securities" means shares of stock in any corporation, certificates of stock or interest in any corporation, notes, bonds, debentures, and evidences of indebtedness (including any evidence of an interest in or right to subscribe to or purchase any of the foregoing). (Aug. 16, 1954, ch. 736, 68A Stat. 317.)

CROSS REFERENCES

Exemptions from documentary stamp tax, see section 4382 of this title.

PART VII.—WASH SALES OF STOCK OR SECURITIES

Sec.
1091. Loss from wash sales of stock or securities.

§ 1091. Loss from wash sales of stock or securities.

(a) Disallowance of loss deduction.

In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange on which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 165 (c) (2); nor shall such deduction be allowed a corporation under section 165 (a) unless it is a dealer in stocks or securities, and the loss is sustained in a transaction made in the ordinary course of its business.

(b) Stock acquired less than stock sold.

If the amount of stock or securities acquired (or covered by the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under regulations prescribed by the Secretary or his delegate.

(c) Stock acquired not less than stock sold.

If the amount of stock or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility of the loss shall be determined under regulations prescribed by the Secretary or his delegate.

(d) Unadjusted basis in case of wash sale of stock.

If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under this section or corresponding provisions of prior internal revenue laws) of the loss from the sale or other disposition of substantially identical stock or securities, then the basis shall be the basis of the stock or securities so sold or disposed of, increased or decreased, as the case may be, by the difference, if any, between the price at which the property was acquired and the price at which such substantially identical stock or securities were sold or otherwise disposed of. (Aug. 16, 1954, ch. 736, 68A Stat. 319.)

CROSS REFERENCES

Losses between related taxpayers, see section 267 (d) of this title.

Losses deductible from gross income by corporations and individuals, see section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1223 of this title.

PART VIII.—DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

Sec.

1101. Distributions pursuant to Bank Holding Company Act of 1956.
1102. Special rules.
1103. Definitions.

§ 1101. Distributions pursuant to Bank Holding Company Act of 1956.

(a) Distributions of certain non-banking property.

(1) Distributions of prohibited property.

If—

(A) a qualified bank holding corporation distributes prohibited property (other than stock received in an exchange to which subsection (c) (2) applies)—

(i) to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) to a shareholder, in exchange for its preferred stock; or

(iii) to a security holder, in exchange for its securities; and

(B) the Board has, before the distribution, certified that the distribution of such prohibited property is necessary or appropriate to effectuato section 4 of the Bank Holding Company Act of 1956,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) Distributions of stock and securities received in an exchauge to which subsection (c) (2) applies.

If—

(A) a qualified bank holding corporation distributes—

(i) common stock received in an exchange to which subsection (c) (2) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) common stock received in an exchange to which subsection (c) (2) applies to a shareholder, in exchange for its common stock; or

(iii) preferred stock or common stock received in an exchange to whlch subsection (c) (2) applies to a shareholder, in exchange for its preferred stock; or

(iv) securities or preferred or common stock received in an exchange to which subsection (c) (2) applies to a security holder, in exchange for its securities; and

(B) any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) Non pro rata distributions.

Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) Exception.

This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (b).

(5) Distributions involving gift or compensation.

In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) results in a gift, see section 2501, and following, or

(B) has the effect of the payment of compensation, see section 61 (a) (1).

(b) Corporation ceasing to be a bank holding company.

(1) Distributions of property which cause a corporation to be a bank bolding company.

If—

(A) a qualified bank holding corporation distributes property (other than stock received in an exchange to which subsection (c) (3) applies)—

(i) to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) to a shareholder, in exchange for its preferred stock; or

(iii) to a security holder, in exchange for its securities; and

(B) the Board has, before the distribution, certified that—

(i) such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2 (a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under this subsection or exchanged under subsection (c) (3); and

(ii) the distribution is necessary or appropriate to effectuato the policies of such Act,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) Distributions of stock and securities received in an exchange to whicb subsection (c) (3) applies.

If—

(A) a qualified bank holding corporation distributes—

(i) common stock received in an exchange to which subsection (c) (3) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) common stock received in an exchange to which subsection (c) (3) applies to a shareholder, in exchange for its common stock; or

(iii) preferred stock or common stock received in an exchange to which subsection (c) (3) applies to a shareholder, in exchange for its preferred stock; or

(iv) securities or preferred or common stock received in an exchange to which subsection (c) (3) applies to a security holder, in exchange for its securities; and

(B) any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) Non pro rata distributions.

Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) Exception.

This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (a).

(5) Distributions involving gift or compensation.

In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) results in a gift, see section 2501, and following, or

(B) has the effect of the payment of compensation, see section 61 (a) (1),

(c) Property acquired after May 15, 1955.

(1) In general.

Except as provided in paragraphs (2) and (3), subsection (a) or (b) shall not apply to—

(A) any property acquired by the distributing corporation after May 15, 1955, unless (i) gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b), or (ii) such property was received by it in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) such property was acquired by the distributing corporation in a transaction in which gain was not recognized under section 305 (a) or section 332, or under section 354 with respect to a reorganization described in section 368 (a) (1) (E) or (F), or

(B) any property which was acquired by the distributing corporation in a distribution with respect to stock acquired by such corporation after May 15, 1955, unless such stock was acquired by such corporation (i) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b), or (ii) in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) in a transaction in which gain was not recognized under section 305 (a) or section 332, or under section 354 with respect to a reorganization described in section 368 (a) (1) (E) or (F), or

(C) any property acquired by the distributing corporation in a transaction in which gain was not recognized under section 332, unless such property was acquired from a corporation which, if it had been a qualified bank holding corporation, could have distributed such property under subsection (a) (1) or (b) (1).

(2) Exchanges involving prohibited property.

If—

(A) Any qualified bank holding corporation exchanges (i) property, which, under subsection (a) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except property described in subsection (b) (1) (B) (i)), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (a) (2) (A); and

(C) before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (a) (1) such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that the exchange and distribution are necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956,

then paragraph (1) shall not apply with respect to such distribution.

(3) Exchanges involving interests in banks.

If—

(A) any qualified bank holding corporation exchanges (i) property which, under subsection (b) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except prohibited property), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (b) (2) (A); and

(C) before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (b) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that—

(i) such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2 (a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a

bank holding company before any property of the same kind was distributed under subsection (b) (1) or exchanged under this paragraph; and

(ii) the exchange and distribution are necessary or appropriate to effectuate the policies of such Act,

then paragraph (1) shall not apply with respect to such distribution.

(d) Distributions to avoid Federal income tax.

(1) Prohibited property.

Subsection (a) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than prohibited property) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(2) Banking property.

Subsection (b) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than property described in subsection (b) (1) (B) (i) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(3) Certain contributions to capital.

In the case of a distribution a portion of which is attributable to a transfer which is a contribution to the capital of a corporation, made after May 15, 1955, and prior to the date of the enactment of this part, if subsection (a) or (b) would apply to such distribution but for the fact that, under paragraph (1) or (2) (as the case may be) of this subsection, such contribution to capital is part of a plan one of the principal purposes of which is to distribute the earnings and profits of any corporation, then, notwithstanding paragraph (1) or (2), subsection (a) or (b) (as the case may be) shall apply to that portion of such distribution not attributable to such contribution to capital, and shall not apply to that portion of such distribution attributable to such contribution to capital.

(e) Final certification.

(1) For subsection (a).

Subsection (a) shall not apply with respect to any distribution by a corporation unless the Board certifies that, before the expiration of the period permitted under section 4 (a) of the Bank Holding Company Act of 1956 (including any extensions thereof granted to such corporation under such section 4 (a)), the corporation has disposed of all the property the disposition of which is necessary or appropriate to effectuate section 4 of such Act (or would have been so necessary or appropriate if the corporation had continued to be a bank holding company).

(2) For subsection (b).

(A) Subsection (b) shall not apply with respect to any distribution by any corporation unless the Board certifies that, before the expiration of the period specified in subparagraph (B), the corporation has ceased to be a bank holding company.

(B) The period referred to in subparagraph (A) is the period which expires 2 years after the date of the enactment of this part or 2 years after the date on which the corporation becomes a bank holding company, whichever date is later. The Board is authorized, on application by any corporation, to extend such period from time to time with respect to such corporation for not more than one year at a time if, in its judgment, such an extension would not be detrimental to the public interest; except that such period may not in any case be extended beyond the date 5 years after the date of the enactment of this part or 5 years after the date on which the corporation becomes a bank holding company, whichever date is later.

(f) Certain exchanges of securities.

In the case of an exchange described in subsection (a) (2) (A) (iv) or subsection (b) (2) (A) (iv), subsection (a) or subsection (b) (as the case may be) shall apply only to the extent that the principal amount of the securities received does not exceed the principal amount of the securities exchanged. (Added May 9, 1956, ch. 240, § 10 (a), 70 Stat. 139.)

REFERENCES IN TEXT

The Banking Holding Company Act of 1956, referred to in the text, is classified to chapter 17 of Title 12, Banks and Banking.

Section 4 of the Bank Holding Company Act of 1956, referred to in subsecs. (a), (c) and (e), is classified to section 1843 of Title 12, Banks and Banking.

Section 2 (a) of the Bank Holding Company Act of 1956, referred to in subsec. (c) (3), is classified to section 1841 (a) of Title 12, Banks and Banking.

"Such Act", referred to in subsec. (c) (3) (C) (ii), means the Banking Holding Company Act of 1956.

"The date of enactment of this part", referred to in subsecs. (d) (3) and (e) (2), is May 9, 1956.

EFFECTIVE DATE

Section 10(c) of act May 9, 1956, provided that sections 1101–1103 of this title shall apply with respect to taxable years ending after May 9, 1956.

SAVINGS CLAUSE

See section 11 of act May 9, 1956, set out as a note under section 1841 of Title 12, Banks and Banking.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1102, 1103 of this title.

§ 1102. Special rules.

(a) Basis of property acquired in distributions.

If, by reason of section 1101, gain is not recognized with respect to the receipt of any property, then, under regulations prescribed by the Secretary or his delegate—

(1) if the property is received by a shareholder with respect to stock, without the surrender by such shareholder of stock, the basis of the property received and of the stock with respect to which it is distributed shall, in the distributee's hands, be determined by allocating between such property and such stock the adjusted basis of such stock; or

(2) if the property is received by a shareholder in exchange for stock or by a security holder in exchange for securities, the basis of the property received shall, in the distributee's hands, be the same as the adjusted basis of the stock or securities exchanged, increased by—

(A) the amount of the property received which was treated as a dividend, and

(B) the amount of gain to the taxpayer recognized on the property received (not including any portion of such gain which was treated as a dividend).

(b) Periods of limitation.

The periods of limitation provided in section 6501 (relating to limitations on assessment and collection) shall not expire, with respect to any deficiency (including interest and additions to the tax) resulting solely from the receipt of property by shareholders in a distribution which is certified by the Board under subsection (a), (b), or (c) of section 1101, until five years after the distributing corporation notifies the Secretary or his delegate (in such manner and with such accompanying information as the Secretary or his delegate may by regulations prescribe) that the period (including extensions thereof) prescribed in section 4 (a) of the Bank Holding Company Act of 1956, or section 1101 (e) (2) (B), whichever is applicable, has expired; and such assessment may be made notwithstanding any provision of law or rule of law which would otherwise prevent such assessment.

(c) Allocation of earnings and profits.

(1) Distribution of stock in a controlled corporation.

In the case of a distribution by a qualified bank holding corporation under section 1101 (a) (1) or (b) (1) of stock in a controlled corporation, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation shall be made under regulations prescribed by the Secretary or his delegate.

(2) Exchanges described in section 1101 (c) (2) or (3).

In the case of any exchange described in section 1101 (c) (2) or (3), proper allocation with respect to the earnings and profits of the corporation transferring the property and the corporation receiving such property shall be made under regulations prescribed by the Secretary or his delegate.

(3) Definition of controlled corporation.

For purposes of paragraph (1), the term "controlled corporation" means a corporation with respect to which at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock is owned by the distributing qualified bank holding corporation.

(d) Itemization of property.

In any certification under this part, the Board shall make such specification and itemization of property as may be necessary to carry out the provisions of this part.

(e) Certain bank holding companies.

This part shall apply in respect of any company which becomes a bank holding company as a result of the enactment of the Act entitled "An Act to amend the Bank Holding Company Act of 1956", approved July 1, 1966 (Public Law 89–485), with the following modifications:

(1) Subsections (a) (3) and (b) (3) of section 1101 shall not apply.

(2) Subsections (a) (1) and (2) and (b) (1) and (2) of section 1101 shall apply in respect of distributions to shareholders of the distributing bank holding corporation only if all distributions to each class of shareholders which are made—

(A) after April 12, 1965, and

(B) on or before the date on which the Board of Governors of the Federal Reserve System makes its final certification under section 1101 (e),

are pro rata. For purposes of the preceding sentence, any redemption of stock made in whole or in part with property other than money shall be treated as a distribution.

(3) In applying subsections (c) and (d) of section 1101 and subsection (b) of section 1103, the date "April 12, 1965" shall be substituted for the date "May 15, 1955".

(4) In applying subsection (d) (3) of section 1101, the date of the enactment of this subsection shall be treated as being the date of the enactment of this part.

(5) In applying subsection (b) (2) (A) of section 1103, the reference to the Bank Holding Company Act of 1956 shall be treated as referring to such Act as amended by Public Law 89–485.

(Added May 9, 1956, ch. 240, § 10(a), 70 Stat. 143, and amended Dec. 27, 1967, Pub. L. 90–225, § 1, 81 Stat. 730.)

REFERENCES IN TEXT

Section 4 (a) of the Bank Holding Company Act of 1956, referred to in subsec. (b), is classified to section 1843 (b) of Title 12, Banks and Banking.

The Act entitled "An Act to amend the Bank Holding Company Act of 1956", approved July 1, 1966 (Public Law 89–485), referred to in subsec. (e), is Pub. L. 89–485, July 1, 1966, 80 Stat. 236, classified to sections 1841—1843, 1848, and 1849 of Title 12, Banks and Banking.

The date of enactment of this part, referred to in subsec. (e) (4), is May 9, 1956.

The Bank Holding Company Act of 1956, referred to in subsec. (e) (5), is classified to chapter 17 of Title 12, Banks and Banking.

AMENDMENTS

1967—Subsec. (e). Pub. L. 90–225 added subsec. (e).

EFFECTIVE DATE OF 1967 AMENDMENT

Section 1 of Pub. L. 90–225 provided in part that: "The amendment made by this section [which added subsec. (e) of this section] shall apply with respect to distributions made after the date of the enactment of this Act [Dec. 27, 1967] in taxable years ending after such date."

EFFECTIVE DATE

See note under section 1101 of this title.

SAVINGS CLAUSE

See section 11 of act May 9, 1956, set out as a note under section 1841 of Title 12, Banks and Banking.

§ 1103. Definitions.

(a) Bank holding company.

For purposes of this part, the term "bank holding company" has the meaning assigned to such term by section 2 of the Bank Holding Company Act of 1956.

(b) Qualified bank holding corporation.

(1) In general.

Except as provided in paragraph (2), for purposes of this part the term "qualified bank holding corporation" means any corporation (as defined in section 7701 (a) (3)) which is a bank holding company and which holds prohibited property acquired by it—

(A) on or before May 15, 1955,

(B) in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, or

(C) in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (c) (3).

(2) Limitations.

(A) A bank holding company shall not be a qualified bank holding corporation, unless it would have been a bank holding company on May 15, 1955, if the Bank Holding Company Act of 1956 had been in effect on such date, or unless it is a bank holding company determined solely by reference to—

(i) property acquired by it on or before May 15, 1955,

(ii) property acquired by it in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, and

(iii) property acquired by it in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (3).

(B) A bank holding company shall not be a qualified bank holding corporation by reason of property described in subparagraph (B) of paragraph (1) or clause (ii) of subparagraph (A) of this paragraph, unless such property was acquired in a distribution with respect to stock, which stock was acquired by such bank holding company—

(i) on or before May 15, 1955,

(ii) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b) of section 1101, or

(iii) in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (3).

(C) A corporation shall be treated as a qualified bank holding corporation only if the Board certifies that it satisfies the foregoing requirements of this subsection.

(c) Prohibited property.

For the purposes of this part, the term "prohibited property" means, in the case of any bank holding company, property (other than nonexempt property) the disposition of which would be necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956 if such company continued to be a bank holding company beyond the period (including any extensions thereof) specified in subsection (a) of such section or in section 1101 (e) (2) (B) of this part, as the case may be. The term "prohibited property" does not include shares of any company held by a bank holding company to the extent that the prohibitions of section 4 of the Bank Holding Company Act of 1956 do not apply to the ownership by such bank holding company of such property by reason of subsection (c) (5) of such section.

(d) Nonexempt property.

For purposes of this part, the term "nonexempt property" means—

(1) obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace;

(2) securities issued by or guaranteed as to principal or interest by a government or subdivision thereof or by any instrumentality of a government or subdivision; or

(3) money, and the right to receive money not evidenced by a security or obligation (other than a security or obligation described in paragraph (1) or (2)).

(e) Board.

For purposes of this part, the term "Board" means the Board of Governors of the Federal Reserve System. (Added May 9, 1956, ch. 240, § 10 (a), 70 Stat. 144.)

REFERENCES IN TEXT

Section 2 of the Bank Holding Company Act of 1956, referred to in subsec. (a), is classified to section 1841 of Title 12, Banks and Banking.

The Bank Holding Company Act of 1956, referred to in subsec. (b), is classified to chapter 17 of Title 12, Banks and Banking.

Section 4 of the Bank Holding Company Act of 1956, referred to in subsec. (c), is classified to section 1843 of Title 12, Banks and Banking.

EFFECTIVE DATE

See note under section 1101 of this title.

SAVINGS CLAUSE

See section 11 of act May 9, 1956, set out as a note under section 1841 of Title 12, Banks and Banking.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1102 of this title.

PART IX.—DISTRIBUTIONS PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

Sec.

1111. Distribution of stock pursuant to order enforcing the antitrust laws.

§ 1111. Distribution of stock pursuant to order enforcing the antitrust laws.

(a) General rule.

Notwithstanding sections 301, 312, and 316, a distribution of divested stock (as defined in subsection

(e)), to a qualifying shareholder (as defined in subsection (b)), to which section 301(c)(1) would, but for this section, apply, shall be a distribution which is not out of the earnings and profits of the distributing corporation for purposes of this subtitle.

(b) Qualifying shareholder.

For purposes of this section, the term "qualifying shareholder" means any shareholder other than a corporation which may be allowed a deduction under section 243, 244, or 245 with respect to dividends received.

(c) Special rules.

(1) Distributions to avoid federal income tax.

Subsection (a) shall not apply to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or of the corporation whose stock is distributed, or both.

(2) Stock.

For purposes of this section, the term "stock" includes rights to fractional shares.

(d) Definition of antitrust order.

For purposes of this section, the term "antitrust order" means, in the case of any corporation, a final judgment rendered after January 1, 1961, by a court with respect to such corporation in a court proceeding under the Sherman Act (26 Stat. 209; 15 U.S.C. 1—7) or the Clayton Act (38 Stat. 730; 15 U.S.C. 12—27), or both, to which the United States is a party, if such proceeding was commenced on or before January 1, 1959.

(e) Definition of divested stock.

For purposes of this section, the term "divested stock" means stock meeting the following requirements:

(1) the stock is the subject of an antitrust order entered after January 1, 1961, which—

(A) directs the distributing corporation to divest itself of such stock by distributing it to its shareholders (or requires such distribution as an alternative to other action by any person);

(B) specifies and itemizes the stock to be divested; and

(C) fixes the period of time within which the distributing corporation must divest itself of all stock to be disposed of by it by reason of the suit, and such period expires not later than 3 years from the date on which such order becomes final (appeal time having run or appeal having been completed); and

(2) the court finds—

(A) that the divestiture of such stock, in the manner described in paragraph (1)(A), is necessary or appropriate to effectuate the policies of the Sherman Act, or the Clayton Act, or both;

(B) that the application of subsection (a) is required to reach an equitable antitrust order in such suit or proceeding; and

(C) that the period of time for the complete divestiture fixed in the order is the shortest period within which such divestiture can be executed with due regard to the circumstances of the particular case;

but no stock shall be divested stock if the court finds that its divestiture is required because of an intentional violation of the Sherman Act, or the Clayton Act, or both.

(Added Pub. L. 87-403, § 1(a), Feb. 2, 1962, 76 Stat. 4.)

EFFECTIVE DATE

Section 1(c) of Pub. L. 87-403 provided that: "The amendments made by this section [adding this section] shall apply only with respect to distributions made after the date of the enactment of this Act [Feb. 2, 1962]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 301, 535, 543, 545, 553, 556 of this title.

Subchapter P.—Capital Gains and Losses

Part
I. Treatment of capital gains.
II. Treatment of capital losses.
III. General rules for determining capital gains and losses.
IV. Special rules for determining capital gains and losses.

SUBCHAPTER REFERRED TO IN OTHER SECTIONS

This subchapter is referred to in sections 822, 832 of this title.

PART I.—TREATMENT OF CAPITAL GAINS

Sec.
1201. Alternative tax.
1202. Deduction for capital gains.

§ 1201. Alternative tax.

(a) Corporations.

If for any taxable year a corporation has a net section 1201 gain, then, in lieu of the tax imposed by sections 11, 511, 821 (a) or (c), and 831(a), there is hereby imposed a tax (if such tax is less than the tax unposed by such sections) which shall consist of the sum of a tax computed on the taxable income reduced by the amount of the net section 1201 gain, at the rates and in the manner as if this subsection had not been enacted, plus—

(1) in the case of a taxable year beginning before January 1, 1975—

(A) a tax of 25 percent of the lesser of—

(i) the amount of the subsection (d) gain, or

(ii) the amount of the net seetion 1201 gain, and

(B) a tax of 30 percent (28 percent in the case of a taxable year begining after December 31, 1969, and before January 1, 1971) of the excess (if any) of the net section 1201 gain over the subsection (d) gain; and

(2) in the case of a taxable year beginning after December 31, 1974, a tax of 30 percent of the net section 1201 gain.

(b) Other taxpayers.

If for any taxable year a taxpayer other than a corporation has a net section 1201 gain, then, in lieu of the tax imposed by sections 1 and 511, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a tax computed on the taxable income reduced by an amount equal to 50 percent of the net section 1201 gain, at the rates and in the manner as if this subsection had not been enacted,

(2) a tax of 25 percent of the lesser of—

(A) the amount of the subsection (d) gain, or

(B) the amount of the net section 1201 gain, and

(3) if the amount of the net section 1201 gain exceeds the amount of the subsection (d) gain, a tax computed as provided in subsection (c) on such excess.

(c) Computation of tax on capital gain in excess of subsection (d) gain.

(1) In general.

The tax computed for purposes of subsection (b)(3) shall be the amount by which a tax determined under section 1 or 511 on an amount equal to the taxable income (but not less than 50 percent of the net section 1201 gain) for the taxable year exceeds a tax determined under section 1 or 511 on an amount equal to the sum of (A) the amount subject to tax under subsection (b)(1) plus (B) an amount equal to 50 percent of the subsection (d) gain.

(2) Limitation.

Notwithstanding paragraph (1), the tax computed for purposes of subsection (b)(3) shall not exceed an amount equal to the following percentage of the excess of the net section 1201 gain over the subsection (d) gain:

(A) 29½ percent, in the case of a taxable year beginning after December 31, 1969, and before January 1, 1971, or

(B) 32½ percent, in the case of a taxable year beginning after December 31, 1970, and before January 1, 1972.

(d) Subsection (d) gain defined.

For purposes of this section, the term "subsection (d) gain" means the sum of the long-term capital gains for the taxable year arising—

(1) in the case of amounts received before January 1, 1975, from sales or other dispositions pursuant to binding contracts (other than any gain from a transaction described in section 631 or 1235) entered into on or before October 9, 1969, including sales or other dispositions the income from which is returned on the basis and in the manner prescribed in section 453(a)(1),

(2) in respect of distributions from a corporation made prior to October 10, 1970, which are pursuant to a plan of complete liquidation adopted on or before October 9, 1969, and

(3) in the case of a taxpayer other than a corporation, from any other source, but the amount taken into account from such other sources for the purposes of this paragraph shall be limited to an amount equal to the excess (if any) of $50,000 ($25,000 in the case of a married individual filing a separate return) over the sum of the gains to which paragraphs (1) and (2) apply.

(e) Cross references.

For computation of the alternative tax—

(1) in the case of life insurance companies, see section 802(a)(2);

(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3) (A) and (D); and

(3) in the case of real estate investment trusts, see section 857(b)(3)(A).

(Aug. 16, 1954, ch. 736, 68A Stat. 320; Mar. 13, 1956, ch. 83, § 5(7), 70 Stat. 49; June 25, 1959, Pub. L. 86-69, § 3(f)(2), 73 Stat. 140; Oct. 16, 1962, Pub. L. 87-834, § 8(g)(3), 76 Stat. 999; Dec. 30, 1969, Pub. L. 91-172, title V, § 511(b), 83 Stat. 635.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91-172 substituted reference to net section 1201 gain for reference to the excess of the net long-term capital gain of a corporation over the net short-term capital loss, substituted "a tax computed on the taxable income reduced by the amount of the net section 1201 gain" for "a partial tax computed on the taxable income reduced by the taxable income reduced by the amount of such excess," struck out reference to tax of an amount equal to 25 percent of excess or in the case of a taxable year beginning before Apr. 1, 1954 an amount equal to 26 percent of such excess without regard to section 21 of this title, and added in the case of a taxable year beginning Jan. 1, 1975 a tax of 25 percent of the lesser of the amount of the subsec. (d) gain, or the amount of the net section 1201 gain, and a tax of 30 percent (23 percent in the case of a taxable year beginning after Dec. 31,1969 and before Jan. 1, 1971) of the excess (if any) of the net section 1201 gain over the subsec. (d) gain, and in case of a taxable year beginning after Dec. 31, 1974, a tax of 30 percent of the net section 1201 gain.

Subsec. (b). Pub. L. 91-172 substituted reference to net section 1201 gain for reference to the excess of the net long-term capital gain over the net short-term capital loss, substituted "a tax computed on the taxable income reduced by an amount equal to 50 percent of the net section 1201 gain" for "a partial tax computed on the taxable income reduced by an amount equal to 50 percent of such excess," struck out reference to tax of an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss, and added reference to a tax of 25 percent of the lesser of the amount of the subsec. (d) gain, or the amount of the net section 1201 gain, and if the amount of the net section 1201 gain exceeds the amount of the subsec. (d) gain, a tax computed as provided in subsec. (c) on such excess.

Subsec. (c). Pub. L. 91-172 added subsec. (c). Former subsec. (c) was redesignated as subsec. (e)(1).

Subsec (d). Pub. L. 91-172 added subsec. (d).

Subsec. (e). Pub. L. 91-172 redesignated former subsec. (c) as par. (1) and added pars. (2) and (3).

1962—Subsec. (a). Pub. L. 87-834 substituted "section 821 (a) or (c)" for section 821 (a)(1) or (b)."

1959—Subsec. (a). Pub. L. 86-69 eliminated reference to section 802(a).

Subsec. (c). Pub. L. 86-69 added subsec. (c).

1956—Subsec. (a). Act Mar. 13, 1956, inserted reference to section 802(a).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 511(d) of Pub L. 91-172 provided that: "The amendments made by this section [amending this section and sections 802, 852, 857 and 1378 of this title] shall apply to taxable years beginning after December 31, 1969."

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86-69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 801 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956, applicable only to taxable years beginning after Dec. 31, 1954, see note set out under section 321 of this title.

CROSS REFERENCES

Alternative tax for mutual savings banks, see section 594 (a) of this title.

Corporate estimated tax defined, see sections 6154 and 6655(e) of this title.

Definitions—

Net long term capital gain, see section 1222 (7) of this title.

Net short term capital loss, see section 1222 (6) of this title.

Normal tax and surtax on corporations, see section 11 of this title.

Rates of income tax on individuals, see section 1 of this title.

Tax or nonresident alien individuals, see section 871 (b) (1) of this title.

Unincorporated business enterprises subject to this section, see section 1361 (h) (3) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 5, 57, 163, 594, 802, 822, 852, 857, 871, 877, 882, 1304, 1378, 1381, 6016, 6154, 6425, 6655 of this title.

§ 1202. Deduction for capital gains.

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital asets. (Aug. 16, 1954, ch. 736, 68A Stat. 320.)

CROSS REFERENCES

Adjusted gross income as gross income minus, among others, deduction for capital gains, see section 62 of this title.

Corporations not allowed deduction under this section for net operating loss deduction, see section 172 (d) (2) (B) of this title.

Deductions from gross income for individuals generally, see section 141 et seq. of this title.

Estates and trusts allowed benefit of this section, see section 642 (c) of this title.

Gains derived from dealings in property as gross income, see section 61 (a) (3) of this title.

Nonresident alien's gains not subject to this section, see section 871 (a) (2) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 62, 163, 172, 642, 643, 665, 871 of this title.

PART II.—TREATMENT OF CAPITAL LOSSES

Sec.

1211. Limitation on capital losses.

1212. Capital loss carrybacks and carryovers.

AMENDMENTS

1969—Pub. L. 91–172, title V, § 512(f) (2), Dec. 30, 1969, 83 Stat. 641, substituted "carrybacks and carryovers" for "carryover" in item 1212.

§ 1211. Limitation on capital losses.

(a) Corporations.

In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(b) Other taxpayers.

(1) In general.

In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) whichever of the following is smallest:

(A) the taxable income for the taxable year,

(B) $1,000, or

(C) the sum of—

(i) the excess of the net short-term capital loss over the net long-term capital gain, and

(ii) one-half of the excess of the net long-term capital loss over the net short-term capital gain.

(2) Married individuals.

In the case of a husband or wife who files a separate return, the amount specified in paragraph (1) (B) shall be $500 in lieu of $1,000.

(3) Computation of taxable income.

For purposes of paragraph (1), taxable income shall be computed without regard to gains or losses from sales or exchanges of capital assets and without regard to the deductions provided in section 151 (relating to personal exemptions) or any deduction in lieu thereof. If the taxpayer elects to pay the optional tax imposed by section 3, "taxable income" as used in this subsection shall read as "adjusted gross income".

(Aug. 16, 1954, ch. 736, 68A Stat. 321; Dec. 30, 1969, Pub. L. 91–172, title V, § 513(a), 83 Stat. 642.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91–172 provided for only 50 percent of an individual's long-term capital losses to be offset against his ordinary income up to the $1,000 limit although short-term capital losses continue to be fully deductible within the $1,000 limit and the deduction of capital losses against ordinary income for married persons filing separate returns to be limited to $500 for each spouse rather than the $1,000 formerly allowed.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 513(d) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and sections 1212 and 1222 of this title] shall apply to taxable years beginning after December 81, 1969."

CROSS REFERENCES

Capital losses—

Allowed to certain insurance companies, see section 832 (c) (5) of this title.

Deductible from gross income, see section 165 (f) of this title.

Corporations improperly accumulating income, capital losses, see section 535 (b) (5) of this title.

Gross investment income defined for mutual insurance companies, see section 822 (b) of this title.

Losses from compulsory or involuntary conversions, see section 1231 (a) (2) of this title.

Other terms relating to capital losses, see section 1222 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 165, 535, 832, 1212, 1222, 1231 of this title.

§ 1212. Capital loss carrybacks and carryovers.

(a) Corporations.

(1) In general.

If a corporation has a net capital loss for any taxable year (hereinafter in this paragraph referred to as the "loss year"), the amount thereof shall be—

(A) a capital loss carryback to each of the 3 taxable years preceding the loss year, but only to the extent—

(i) such loss is not attributable to a foreign expropriation capital loss, and

(ii) the carryback of such loss does not increase or produce a net operating loss (as defined in section 172(c)) for the taxable year to which it is being carried back; and

(B) a capital loss carryover to each of the 5 taxable years (10 taxable years to the extent such loss is attributable to a foreign expropriation capital loss) succeeding the loss year,

and shall be treated as a short-term capital loss in each such taxable year. The entire amount of the net capital loss for any taxable year shall be carried to the earliest of the taxable years to which such loss may be carried, and the portion of such loss which shall be carried to each of the other taxable years to which such loss may be carried shall be the excess, if any, of such loss over the total of the net capital gains for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the net capital gain for any such prior taxable year shall be computed without regard to the net capital loss for the loss year or for any taxable year thereafter. In the case of any net capital loss which cannot be carried back in full to a preceding taxable year by reason of clause (ii) of subparagraph (A), the net capital gain for such prior taxable year shall in no case be treated as greater than the amount of such loss which can be carried back to such preceding taxable year upon the application of such clause (ii).

(2) Definitions and special rules.

(A) Foreign expropriation capital loss defined.

For purposes of this subsection, the term "foreign expropriation capital loss" means, for any taxable year, the sum of the losses taken into account in computing the net capital loss for such year which are—

(i) losses sustained directly by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing, or

(ii) losses (treated under section 165(g)(1) as losses from the sale or exchange of capital assets) from securities which become worthless by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing.

(B) Portion of loss attributable to foreign expropriation capital loss.

For purposes of paragraph (1), the portion of any net capital loss for any taxable year attributable to a foreign expropriation capital loss is the amount of the foreign expropriation capital loss for such year (but not in excess of the net capital loss for such year).

(C) Priority of application.

For purposes of paragraph (1), if a portion of a net capital loss for any taxable year is attributable to a foreign expropriation capital loss, such portion shall be considered to be a separate net capital loss for such year to be applied after the other portion of such net capital loss.

(3) Electing small business corporations.

Paragraph (1)(A) shall not apply to the net capital loss of a corporaton for any taxable year for which it is an electing small business corporation under subchapter S, and a net capital loss of a corporation (for a year for which it is not such an electing small business corporation) shall not be carried back under paragraph (1)(A) to a taxable year for which it is an electing small business corporation.

(4) Special rules on carrybacks.

A net capital loss of a corporation shall not be carried back under paragraph (1)(A) to a taxable year—

(A) for which it is a foreign personal holding company (as defined in section 552);

(B) for which it is a regulated investment company (as defined in section 851);

(C) for which it is a real estate investment trust (as defined in section 856); or

(D) for which an election made by it under section 1247 is applicable (relating to election by foreign investment companies to distribute income currently).

(b) Other taxpayers.

(1) In general.

If a taxpayer other than a corporation has a net capital loss for any taxable year—

(A) the excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss in the succeeding taxable year, and

(B) the excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss in the succeeding taxable year.

(2) Special rules.

(A) For purposes of determining the excess referred to in paragraph (1)(A), an amount equal to the amount allowed for the taxable year under section 1211(b)(1)(A), (B), or (C) shall be treated as a short-term capital gain in such year.

(B) For purposes of determining the excess referred to in paragraph (1)(B), an amount equal to the sum of—

(i) the amount allowed for the taxable year under section 1211(b)(1)(A), (B), or (C), and

(ii) the excess of the amount described in clause (i) over the net short-term capital loss (determined without regard to this subsection) for such year,

shall be treated as a short-term capital gain in such year.

(3) Transitional rule.

In the case of any amount which, under paragraph (1) and section 1211(b) (as in effect for taxable years beginning before January 1, 1970), is treated as a capital loss in the first taxable year beginning after December 31, 1969, paragraph (1) and section 1211(b) (as in effect for taxable years

beginning before January 1, 1970) shall apply (and paragraph (1) and section 1211(b) as in effect for taxable years beginning after December 31, 1969, shall not apply) to the extent such amount exceeds the total of any net capital gains (determined without regard to this subsection) of taxable years beginning after December 31, 1969.

(Aug. 16, 1954, ch. 736, 68A Stat. 321; Feb. 26, 1964, Pub. L. 88–272, title II, § 230(a), 78 Stat. 99; Sept. 2, 1964, Pub. L. 88–571, § 7(a), 78 Stat. 860; Dec. 30, 1969, Pub. L. 91–172, title V, §§ 512 (a), (b), (f)(1), 513(b), 83 Stat. 638, 639, 641, 642.)

REFERENCES IN TEXT

Before the enactment of the Revenue Act of 1964, referred to in subsec. (b)(2), means before the enactment of Pub. L. 88–272, approved Feb. 26, 1964.

AMENDMENTS

1969—Pub. L. 91–172, § 512(f)(1), substituted "carrybacks and carryovers" for "carryover" in section catchline.

Subsec. (a)(1). Pub. L. 91–172, § 512(a), provided for a 3-year capital loss carryback for corporations, not available for foreign expropriation capital losses for which a special 10-year carryforward is presently available, in addition to the 5-year capital loss carryforward presently allowed corporations, to the extent the carryback of such loss does not increase or produce a net operating loss for the taxable year to which it is being carried back.

Subsec. (a)(3), (4). Pub. L. 91–172, § 512(b), added subsec. (a)(3), (4).

Subsec. (b). Pub. L. 91–172, § 513(b), struck out reference to Dec. 31, 1963, struck out determination of a short-term capital gain as an amount equal to the excess allowed for the taxable year under former section 1211(b) over the gains from sales or exchanges of capital assets, struck out par. (2) treating as a short-term capital loss in the first taxable year beginning after Dec. 31, 1963, any amount which is treated as a short-term capital loss in such year under this subchapter as in effect immediately before the enactment of the Revenue Act of 1964, added new par. (2) dealing with special rules for determining the excesses referred to in par. (1)(A) and par. (1)(B) and added par. (3).

1964—Subsec. (a). Pub. L. 88–571 provided that if any portion of a net capital loss is attributable to a foreign expropriation capital loss, such portion shall be a short-term capital loss in each of the 10 succeeding taxable years, defined foreign expropriation capital loss, stated what portion of loss is attributable to foreign expropriation capital loss and the priority of application of the net capital loss, and eliminated provisions that net capital losses for taxable years beginning before Oct. 20, 1951, were to be determined under the applicable law relating to the computation of capital gains and losses in effect before such date.

Pub. L. 88–272 designated existing provisions as subsec. (a), limited such subsection to corporations, and added subsec. (b).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 512(g) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and sections 246, 381, 481, 535, 1314, 6411, 6501, 6511, 6601 and 6611 of this title] shall apply with respect to net capital losses sustained in taxable years beginning after December 31, 1969."

Amendment of subsec. (b) by section 513(b) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 513(d) of Pub. L. 91–172, set out as a note under section 1211 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Section 7(b) of Pub. L. 88–571 provided that: "The amendment made by subsection (a) [to this section] shall apply with respect to net capital losses (to the extent attributable to foreign expropriation capital losses, as defined in section 1212(a)(2)(A) of the Internal Revenue Code of 1954) sustained in taxable years ending after December 31, 1958."

Section 230(c) of Pub. L. 88–272 provided that: "The amendments made by this section [to this section, and section 1222 of this title] shall apply to taxable years beginning after December 31, 1963."

ELECTION NOT TO CARRYBACK CERTAIN NET CAPITAL LOSSES

Pub. L. 91–688, § 3, Jan. 12, 1971, 84 Stat. 2073, provided that:

"(a) For purposes of applying section 1212(a) of the Internal Revenue Code of 1954 [this section] (as amended by section 512 of the Tax Reform Act of 1969) in the case of a corporation which makes an election under subsection (b), any net capital loss sustained in a taxable year beginning after December 31, 1969, may not be carried back to any taxable year beginning before January 1, 1970, for which it was subject to taxation under section 802 of such Code [section 802 of this title], if the carryback of such loss would result in an increase in such corporation's income tax liability for any such taxable year.

"(b) An election to have the provisions of subsection (a) apply shall be made by a corporation—

"(1) in such form and manner as the Secretary of the Treasury or his delegate may prescribe, and

"(2) not later than the time prescribed by law for filing a claim for credit or refund of overpayment of income tax for the first taxable year beginning after December 31, 1969, in which such corporation sustains a net capital loss.

"(c) The Secretary of the Treasury or his delegate shall prescribe such regulations as he determines necessary to carry out the purposes of this section."

CROSS REFERENCES

Accumulated taxable income of corporations improperly accumulating surplus, see section 535 (b) (6) of this title.

Adjustments required by changes in method of accounting, see section 481 (b) (3) (A) of this title.

Ascertainment of amount of adjustment, see section 1314 (a) of this title.

Capital loss carryovers of estates or trusts, see section 642 (h) (1) of this title.

Capital losses of nonresident alien not subject to this section, see section 871 (a) (2) of this title.

Net capital loss computed without regard to this section, see seotion 1222 (10) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 165, 246, 331, 481, 514, 535, 642, 822, 832, 871, 877, 1222, 1247, 1314, 1341, 1351, 6411 of this title.

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

Sec.
1221. Capital asset defined.
1222. Other items relating to capital gains and losses.
1223. Holding period of property.

§ 1221. Capital asset defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

(Aug. 16, 1954, ch. 736, 68A Stat. 321; Dec. 30, 1969, Pub. L. 91–172, title V, § 514(a), 83 Stat. 643.)

AMENDMENTS

1969—Par. (3). Pub. L. 91–172 added reference to a letter or memorandum, added subpar. (B) dealing with a letter or memorandum, and redesignated former subpar. (B) as subpar. (C).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 514(c) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and sections 341 and 1231 of this title] shall apply to sales and other dispositions occurring after July 25, 1969."

CROSS REFERENCES

Gross income defined, see section 61 of this title.

Inventory items of partnership as including stock in trade of taxpayer, see section 751 (d) (2) (A) of this title.

Sale or exchange of residence as nontaxable, see section 1034 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 341, 595, 707, 751, 817, 864, 1223, 1231, 1234, 1248 of this title.

§ 1222. Other terms relating to capital gains and losses.

For purposes of this subtitle—

(1) Short-term capital gain.

The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing gross income.

(2) Short-term capital loss.

The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent that such loss is taken into account in computing taxable income.

(3) Long-term capital gain.

The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

(4) Long-term capital loss.

The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent that such loss is taken into account in computing taxable income.

(5) Net short-term capital gain.

The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year.

(6) Net short-term capital loss.

The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year.

(7) Net long-term capital gain.

The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year.

(8) Net long-term capital loss.

The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(9) Net capital gain.

The term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.

(10) Net capital loss.

The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the sum allowed under section 1211. In the case of a corporation, for the purpose of determining losses under this paragraph, amounts which are short-term capital losses under section 1212 shall be excluded.

(11) Net section 1201 gain.

The term "net section 1201 gain" means the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.

(Aug. 16, 1954, ch. 736, 68A Stat. 322; Feb. 26, 1964, Pub. L. 88–272, title II, § 230(b), 78 Stat. 100; Dec. 30, 1969, Pub. L. 91–172, title V, §§ 511(a), 513(c), 83 Stat. 635, 643.)

AMENDMENTS

1969—Par. (9). Pub. L. 91–172, § 513(c), substituted "The" for "In the case of a corporation, the."

Par. (11). Pub. L. 91–172, § 511(a), added par. (11).

1964—Pars. (9), (10). Pub. L. 88–272 eliminated provisions from par. (9) relating to taxpayers other than corporations, and inserted "In the case of a corporation" in par. (10).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 513(c) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 513(d) of Pub. L. 91–172, set out as a note under section 1211 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 230(c) of Pub. L. 88–272, set out as a note under section 1212 of this title.

CROSS REFERENCES

Amount of deduction for long-term capital gains, see section 1202 of this title.

Gains derived from dealings in property as gross income, see section 61 (a) (3) of this title.

Limitation of capital losses, see section 1211 of this title.

Losses by corporations and individuals deductible from gross income, see section 165 of this title.

Rate of income tax on individuals, see section 1 of this title.

§ 1223. Holding period of property.

For purposes of this subtitle—

(1) In determining the period for which the taxpayer has held property received in an exchange, there shall be included the period for which he held the property exchanged if, under this chapter, the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged, and, in the case of such exchanges after March 1, 1954, the property exchanged at the time of such exchange was a capital asset as defined in section 1221 or property described in section 1231. For purposes of this paragraph—

(A) an involuntary conversion described in section 1033 shall be considered an exchange of the property converted for the property acquired, and

(B) a distribution to which section 355 (or so much of section 356 as relates to section 355) applies shall be treated as an exchange.

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(3) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain was recognized to the distributee under section 1081 (c) (or under section 112 (g) of the Revenue Act of 1928, 45 Stat. 818, or the Revenue Act of 1932, 48 Stat. 705), there shall be included the period for which he held the stock or securities in the distributing corporation before the receipt of the stock or securities on such distribution.

(4) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 1091 relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

(5) In determining the period for which the taxpayer has held stock or rights to acquire stock received on a distribution, if the basis of such stock or rights is determined under section 307 (or under so much of section 1052 (c) as refers to section 113 (a) (23) of the Internal Revenue Code of 1939), there shall (under regulations prescribed by the Secretary or his delegate) be included the period for which he held the stock in the distributing corporation before the receipt of such stock or rights upon such distribution.

(6) In determining the period for which the taxpayer has held stock or securities acquired from a corporation by the exercise of rights to acquire such stock or securities, there shall be included only the period beginning with the date on which the right to acquire was exercised.

(7) In determining the period for which the taxpayer has held a residence, the acquisition of which resulted under section 1034 in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, there shall be included the period for which such other residence had been held as of the date of such sale or exchange. For purposes of this paragraph, the term "sale or exchange" includes an involuntary conversion occurring after December 31, 1950, and before January 1, 1954.

(8) In determining the period for which the taxpayer has held a commodity acquired in satisfaction of a commodity futures contract there shall be included the period for which he held the commodity futures contract if such commodity futures contract was a capital asset in his hands.

(9) Any reference in this section to a provision of this title shall, where applicable, be deemed a reference to the corresponding provision of the Internal Revenue Code of 1939, or prior internal revenue laws.

(10) In determining the period for which the taxpayer has held trust certificates of a trust to which subsection (d) of section 1246 applies, or the period for which the taxpayer has held stock in a corporation to which subsection (d) of section 1246 applies, there shall be included the period for which the trust or corporation (as the case may be) held the stock of foreign investment companies.

(11) In the case of a person acquiring property from a decedent or to whom property passed from a decedent (within the meaning of section 1014(b)), if—

(A) the basis of such property in the hands of such person is determined under section 1014, and

(B) such property is sold or otherwise disposed of by such person within 6 months after the decedent's death,

then such person shall be considered to have held such property for more than 6 months.

(12) Cross reference.

For special holding period provision relating to certain partnership distributions, see section 735(b).

(Aug. 16, 1954, ch. 736, 68A Stat. 323; Oct. 16, 1962, Pub. L. 87-834, § 14(b)(3), 76 Stat. 1041; Dec. 31, 1970, Pub. L. 91-614, title I, § 101(g), 84 Stat. 1838.)

AMENDMENTS

1970—Par. (11). Pub. L. 91-614 added par. (11). Former par. (11) redesignated par. (12).

Par. (12). Pub. L. 91-614 redesignated former par. (11) as par. (12).

1962—Pub. L. 87-834 added par. (10) and redesignated former par. (10) as (11).

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91–614 applicable with respect to decedents dying after Dec. 31, 1970, see section 101(j) of Pub. L. 91–614, set out as a note under section 2032 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Par. (10) of this section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 14(c) of Pub. L. 87–634, set out as a note under section 1246 of this title.

CROSS REFERENCES

Short-term gains and holding periods, see section 1233 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 246, 341, 735, 1034, 1233, 1246, 1250 of this title.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

Sec.
1231. Property used in the trade or business and involuntary conversions.
1232. Bonds and other evidences of indebtedness.
1233. Gains and losses from short sales.
1234. Options to buy or sell.
1235. Sale or exchange of patents.
1236. Dealers in securities.
1237. Real property subdivided for sale.
1238. Amortization in excess of depreciation.
1239. Gain from sale of certain property between spouses or between an individual and a controlled corporation.
1240. Taxability to employee of termination payments.
1241. Cancellation of lease or distributor's agreement.
1242. Losses on small business investment company stock.
1243. Loss of small business investment company.
1244. Losses on small business stock.
1245. Gain from dispositions of certain depreciable property.
1246. Gain on foreign investment company stock.
1247. Election by foreign investment companies to distribute income currently.
1248. Gain from certain sales or exchanges of stock in certain foreign corporations.
1249. Gain from certain sales or exchanges of patents, etc., to foreign corporations.
1250. Gain from dispositions of certain depreciable realty.
1251. Gain from disposition of property used in farming where farm losses offset nonfarm income.
1252. Gain from the disposition of farm land.
1253. Transfers of franchises, trademarks, and trade names.

AMENDMENTS

1969—Pub. L. 91–172, title II, §§ 211(b)(7), 214(b), title V, § 516(c)(2)(C), Dec. 30, 1969, 83 Stat. 570, 573, 648, added items 1251 to 1253.

1964—Pub. L. 88–272, title II, § 231(b)(7), Feb. 26, 1964, 78 Stat. 105, added item 1250.

1962—Pub. L. 87–634, §§ 13(a)(2), 14(a)(2), 15(b), 16(b), Oct. 16, 1962, 76 Stat. 1033, 1040, 1044, 1045, added items 1245—1249.

1958—Pub. L. 85–866, title I, § 57(c)(3), title II, § 202(c), Sept. 2, 1958, 72 Stat. 1646, 1678, added items 1242—1244.

§ 1231. Property used in the trade or business and involuntary conversions.

(a) General rule.

If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses (including losses not compensated for by insurance or otherwise) upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of (A) property used in the trade or business or (B) capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

In the case of any involuntary conversion (subject to the provisions of this subsection but for this sentence) arising from fire, storm, shipwreck, or other casualty, or from theft, of any property used in the trade or business or of any capital asset held for more than 6 months, this subsection shall not apply to such conversion (whether resulting in gain or loss) if during the taxable year the recognized losses from such conversions exceed the recognized gains from such conversions.

(b) Definition of property used in the trade or business.

For purposes of this section—

(1) General rule.

The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not—

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

(C) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by a taxpayer described in paragraph (3) of section 1221.

(2) Timber, coal, or domestic iron ore.

Such term includes timber, coal, and iron ore with respect to which section 631 applies.

(3) Livestock.

Such term includes—

(A) cattle and horses, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him for 24 months or more from the date of acquisition, and

(B) other livestock, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him for 12 months or more from the date of acquisition.

Such term does not include poultry.

(4) Unharvested crop.

In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted) at the same time and to the same person, the crop shall be considered as "property used in the trade or business."

(Aug. 16, 1954, ch. 736, 68A Stat. 325; Sept. 2, 1958, Pub. L. 85–866, title I, § 49(a), 72 Stat. 1642; Feb. 26, 1964, Pub. L. 88–272, title II, § 227(a)(2), 78 Stat. 97; Dec. 30, 1969, Pub. L. 91–172, title II, § 212(b)(1), title V, §§ 514(b)(2), 516(b), 83 Stat. 571, 643, 646.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 516(b), provided that casualty (or theft) losses with respect to depreciable property and real estate used in trade or business and capital assets held for the production of income as well as personal assets are to be consolidated with casualty (or theft) gains with respect to this type of property and if the casualty losses exceed the casualty gains, the net loss is treated as an ordinary loss without regard to whether there may be noncasualty gains under this section, but, if the casualty gains exceed the casualty losses, the net gain is treated as a gain under this section and must be consolidated with other gains and losses under this section.

Subsec. (b)(1)(C). Pub. L. 91–172, § 514(b)(2), added reference to a letter or memorandum.

Subsec. (b)(3). Pub. L. 91–172, § 212(b)(1), redesignated existing provisions as subpar. (B) and added subpar. (A).

1964—Subsec. (b)(2). Pub. L. 88–272 inserted the reference to iron ore in the text, and to domestic iron ore, in the paragraph catchline.

1958—Subsec. (a). Pub. L. 85–866 added provisions respecting casualty losses sustained upon certain uninsured property.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (a) by section 516(b) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 516(d)(2) of Pub. L. 91–172, set out as a note under section 1001 of this title.

Amendment of subsec. (b)(1)(C) of section 514(b)(2) of Pub. L. 91–172 applicable to sales and other dispositions occurring after July 25, 1969, see section 514(c) of Pub. L. 91–172, set out as a note under section 1221 of this title.

Section 212(b)(2) of Pub. L. 91–172 provided that: "The amendments made by paragraph (1) [amending subsec. (b)(3) of this section] shall apply to livestock acquired after December 31, 1969."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable with respect to amounts received or accrued in taxable years beginning after Dec. 31, 1963, attributable to iron ore mined in such years, see section 227(c) of Pub. L. 88–272, set out as a note under section 272 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 49 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (a) of this section] shall apply to taxable years beginning after December 31, 1957."

CROSS REFERENCES

Amount of gain and recognition of gain or loss, see section 1001 of this title.

Computation of income of each partner, gains or losses described in this section, see section 702 (a) (3) of this title.

Denial of deduction attributable to production of crop, see section 268 of this title.

Disposal of coal or domestic iron ore, denial of deduction, see section 272 of this title.

Involuntary conversions as nontaxable exchange, see section 1033 of this title.

Limitation on capital losses, see section 1211 of this title.

Loss from wash sales of stock or securities, see section 1091 of this title.

Rules for allocation of basis of partnership, see section 755 (h) (1) of this title.

Sale of land with unharvested crop as nondeductible item from gross income, see section 268 of this title.

Sale or exchange of residence as nontaxable, see section 1034 of this title.

Section 341 assets as including property described in subsection (b) of this section, see section 341 (b) (3) (D) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 51, 80, 163, 170, 172, 268, 272, 341, 483, 543, 613, 617, 751, 755, 817, 1223, 1238, 1239, 1245, 1249, 1250, 1251, 1252 of this title.

§ 1232. Bonds and other evidences of indebtedness.

(a) General rule.

For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or by any government or political subdivision thereof—

(1) Retirement.

Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

(2) Sale or exchange.

(A) Corporate bonds issued after May 27, 1969.

Except as provided in subparagraph (C), on the sale or exchange of bonds or other evidences of indebtedness issued by a corporation after May 27, 1969, held by the taxpayer more than 6 months, any gain realized shall (except as provided in the following sentence) be considered gain from the sale or exchange of a capital asset held for more than 6 months. If at the time of original issue there was an intention to call the bond or other evidence of indebtedness before maturity, any gain realized on the sale or exchange thereof which does not exceed an amount equal to the original issue discount (as defined in subsection (b)) reduced by the portion of original issue discount previously includible in the gross income of any holder (as provided in paragraph (3)(B)) shall be considered as gain from the sale or exchange of property which is not a capital asset.

(B) Corporate bonds issued on or before May 27, 1969, and government bonds.

Except as provided in subparagraph (C), on the sale or exchange of bonds or other evidences of indebtedness issued by a government or political subdivision thereof after December 31, 1954, or by a corporation after December 31,

1954, and on or before May 27, 1969, held by the taxpayer more than 6 months, any gain realized which does not exceed—

(i) an amount equal to the original issue discount (as defined in subsection (b)), or

(ii) if at the time of original issue there was no intention to call the bond or other evidence of indebtedness before maturity, an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidence of indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity,

shall be considered as gain from the sale or exchange of property which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months.

(C) Exceptions.

This paragraph shall not apply to—

(i) obligations the interest on which is not includible in gross income under section 103 (relating to certain governmental obligations), or

(ii) any holder who has purchased the bond or other evidence of indebtedness at a premium.

(D) Double inclusion in income not required.

This section shall not require the inclusion of any amount previously includible in gross income.

(3) Inclusion in income of original issue discount on corporate bonds issued after May 27, 1969.

(A) General rule.

There shall be included in the gross income of the holder of any bond or other evidence of indebtedness issued by a corporation after May 27, 1969, the ratable monthly portion of original issue discount multiplied by the number of complete months (plus any fractional part of a month determined in accordance with the last sentence of this subparagraph) such holder held such bond or other evidence of indebtedness during the taxable year. Except as provided in subparagraph (B), the ratable monthly portion of original issue discount shall equal the original issue discount (as defined in subsection (b)) divided by the number of complete months from the date of original issue to the stated maturity date of such bond or other evidence of indebtedness. For purposes of this section, a complete month commences with the date of original issue and the corresponding day of each succeeding calendar month (or the last day of a calendar month in which there is no corresponding day); and, in any case where a bond or other evidence of indebtedness is acquired on any other day, the ratable monthly portion of original issue discount for the complete month in which such acquisition occurs shall be allocated between the transferor and the transferee in accordance with the number of days in such complete month each held the bond or other evidence of indebtedness.

(B) Reduction in case of any subsequent holder.

For purposes of this paragraph, the ratable monthly portion of original issue discount shall not include an amount, determined at the time of any purchase after the original issue of such bond or other evidence of indebtedness, equal to the excess of—

(i) the cost of such bond or other evidence of indebtedness incurred by such holder, over

(ii) the issue price of such bond or other evidence of indebtedness increased by the portion of original discount previously includible in the gross income of any holder (computed without regard to this subparagraph),

divided by the number of complete months (plus any fractional part of a month commencing with the date of purchase) from the date of such purchase to the stated maturity date of such bond or other evidence of indebtedness.

(C) Purchase defined.

For purposes of subparagraph (B), the term "purchase" means any acquisition of a bond or other evidence of indebtedness, but only if the basis of the bond or other evidence of indebtedness is not determined in whole or in part by reference to the adjusted basis of such bond or other evidence of indebtedness in the hands of the person from whom acquired, or under section 1014(a) (relating to property acquired from a decedent).

(D) Exceptions.

This paragraph shall not apply to any holder—

(i) who has purchased the bond or other evidence of indebtedness at a premium, or

(ii) which is a life insurance company to which section 818(b) applies.

(E) Basis adjustments.

The basis of any bond or other evidence of indebtedness in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to subparagraph (A).

(b) Definitions.

(1) Original issue discount.

For purposes of subsection (a), the term "original issue discount" means the difference between the issue price and the stated redemption price at maturity. If the original issue discount is less than one-fourth of 1 percent of the redemption price at maturity multiplied by the number of complete years to maturity, then the issue discount shall be considered to be zero. For purposes of this paragraph, the term "stated redemption price at maturity" means the amount fixed by the last modification of the purchase agreement and includes dividends payable at that time.

(2) Issue price.

In the case of issues of bonds or other evidences of indebtedness registered with the Securities and Exchange Commission, the term "issue price"

means the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such bonds or other evidences of indebtedness were sold. In the case of privately placed issues of bonds or other evidence of indebtedness, the issue price of each such bond or other evidence of indebtedness is the price paid by the first buyer of such bond increased by the amount, if any, of tax paid under section 4911 (and not credited, refunded, or reimbursed) on the acquisition of such bond or evidence of indebtedness by the first buyer. For purposes of this paragraph, the terms "initial offering price" and "price paid by the first buyer" include the aggregate payments made by the purchaser under the purchase agreement, including modifications thereof. In the case of a bond or other evidence of indebtedness and an option or other security issued together as an investment unit, the issue price for such investment unit shall be determined in accordance with the rules stated in this paragraph. Such issue price attributable to each element of the investment unit shall be that portion thereof which the fair market value of such element bears to the total fair market value of all the elements in the investment unit. The issue price of the bond or other evidence of indebtedness included in such investment unit shall be the portion so allocated to it. In the case of a bond or other evidence of indebtedness, or an investment unit as described in this paragraph (other than a bond or other evidence of indebtedness or an investment unit issued pursuant to a plan of reorganization within the meaning of section 368(a)(1) or an insolvency reorganization within the meaning of section 371, 373, or 374), which is issued for property and which—

(A) is part of an issue a portion of which is traded on an established securities market, or

(B) is issued for stock or securities which are traded on an established securities market,

the issue price of such bond or other evidence of indebtedness or investment unit, as the case may be, shall be the fair market value of such property. Except in cases to which the preceding sentence applies, the issue price of a bond or other evidence of indebtedness (whether or not issued as a part of an investment unit) which is issued for property (other than money) shall be the stated redemption price at maturity.

(3) Issue date.

In the case of issues of bonds or other evidences of indebtedness registered with the Securities and Exchange Commission, the term "date of original issue" means the date on which the issue was first sold to the public at the issue price. In the case of privately placed issues of bonds or other evidences of indebtedness, the term "date of original issue" means the date on which each such bond or other evidence of indebtedness was sold by the issuer.

(c) Bond with unmatured coupons detached.

If a bond or other evidence of indebtedness issued at any time with interest coupons—

(1) is purchased after August 16, 1954, and before January 1, 1958, and the purchaser does not receive all the coupons which first become payable more than 12 months after the date of the purchase, or

(2) is purchased after December 31, 1957, and the purchaser does not receive all the coupons which first become payable after the date of the purchase,

then the gain on the sale or other disposition of such evidence of indebtedness by such purchaser (or by a person whose basis is determined by reference to the basis in the hands of such purchaser) shall be considered as gain from the sale or exchange of property which is not a capital asset to the extent that the fair market value (determined as of the time of the purchase) of the evidence of indebtedness with coupons attached exceeds the purchase price. If this subsection and subsection (a) (2) (A) apply with respect to gain realized on the sale or exchange of any evidence of indebtedness, then subsection (a) (2) (A) shall apply with respect to that part of the gain to which this subsection does not apply.

(d) Cross reference.

For special treatment of face-amount certificates on retirement, see section 72.

(Aug. 16, 1954, ch. 736, 68A Stat. 326; Sept. 2, 1958, Pub. L. 85–866, title I, §§ 50 (a), 51, 72 Stat. 1642, 1643; June 25, 1959, Pub. L. 86–69, § 3(e), 73 Stat. 140; Sept. 2, 1964, Pub. L. 88–563, § 5, 78 Stat. 845; Dec. 30, 1969, Pub. L. 91–172, title IV, § 413 (a), (b), 83 Stat. 609, 611.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 413(a), added pars. (2)(A) and (3) and redesignated former pars. (2)(A), (B), and (C), as pars. (2)(B), (C), and (D), respectively, and in par. (2)(B), as so redesignated, extended its application to corporate bonds issued on or before May 27, 1969, and to government bonds.

Subsec. (b)(2). Pub. L. 91–172, § 413(b), added provisions for the determination of the issue price in the case of a bond or other evidence of indebtedness and an option or other security issued together as an investment unit.

1964—Subsec. (b)(2). Pub. L. 88–563 inserted provisions requiring the issue price of privately placed issues of bonds or other evidence of indebtedness to be increased by the amount, if any, of tax paid under section 4911 (and not credited, refunded, or reimbursed) on the acquisition of such bond or evidence by the first buyer.

1959—Subsec. (a)(2)(C). Pub. L. 86–69 substituted "Double inclusion in income not required" for "Election as to inclusion" in the catchline, and eliminated provisions which related to obligations with respect to which the taxpayer has made an election provided by section 454 (a) and (c) of this title.

1958—Subsec. (a) (2) (A). Pub. L. 85–866, § 50(a), substituted "which does not exceed—" for "which does not exceed", added clause (1) and designated existing provisions as clause (2), inserting the conditional clause therein.

Subsec. (c). Pub. L. 85–866, § 51, substituted "unmatured" for "excess number of" in the catchline and "sale or exchange of any evidence of indebtedness" for "retirement of any bond", consolidated formed clauses (1) and (2) into present clause (1) with limitation to purchases made before Jan. 1, 1958, added present clause (2), and inserted parenthetical phrase "(or by a person whose basis is determined by reference to the basis in the hands of such purchaser)" and the word "fair" before "market value".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 413(e) of Pub. L. 91–172 provided that: "The amendments made by this section [amending subsecs. (a) and (b) of this section and section 6049 of this title] shall apply with respect to bonds and other evidences of indebtedness issued after May 27, 1969 (other than evidences of indebtedness issued pursuant to a written commitment which was binding on May 27, 1969, and at all times thereafter)."

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment of section by Pub. L. 86–69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86–69, set out as a note under section 801 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 50 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (a) (2) (A) of this section] shall apply to taxable years ending after December 31, 1957, but only with respect to dispositions after such date."

Amendment of subsec. (c) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 249, 405, 818, 871, 881, 1037, 1351, 6049 of this title.

§ 1233. Gains and losses from short sales.

(a) Capital assets.

For purposes of this subtitle, gain or loss from the short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

(b) Short-term gains and holding periods.

If gain or loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer for not more than 6 months (determined without regard to the effect, under paragraph (2) of this subsection, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof—

(1) any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 6 months (notwithstanding the period of time any property used to close such short sale has been held); and

(2) the holding period of such substantially identical property shall be considered to begin (notwithstanding section 1223, relating to the holding period of property) on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. This paragraph shall apply to such substantially identical property in the order of the dates of the acquisition of such property, but only to so much of such property as does not exceed the quantity sold short.

For purposes of this subsection, the acquisition of an option to sell property at a fixed price shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale.

(c) Certain options to sell.

Subsection (b) shall not include an option to sell property at a fixed price acquired on the same day on which the property identified as intended to be used in exercising such option is acquired and which, if exercised, is exercised through the sale of the property so identified. If the option is not exercised, the cost of the option shall be added to the basis of the property with which the option is identified. This subsection shall apply only to options acquired after the date of enactment of this title.

(d) Long-term losses.

If on the date of such short sale substantially identical property has been held by the taxpayer for more than 6 months, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 6 months (notwithstanding the period of time any property used to close such short sale has been held, and notwithstanding section 1234).

(e) Rules for application of section.

(1) Subsection (b) (1) or (d) shall not apply to the gain or loss, respectively, on any quantity of property used to close such short sale which is in excess of the quantity of the substantially identical property referred to in the applicable subsection.

(2) For purposes of subsections (b) and (d)—

(A) the term "property" includes only stocks and securities (including stocks and securities dealt with on a "when issued" basis), and commodity futures, which are capital assets in the hands of the taxpayer;

(B) in the case of futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange, a commodity future requiring delivery in 1 calendar month shall not be considered as property substantially identical to another commodity future requiring delivery in a different calendar month; and

(C) in the case of a short sale of property by an individual, the term "taxpayer", in the application of this subsection and subsections (b) and (d), shall be read as "taxpayer or his spouse"; but an individual who is legally separated from the taxpayer under a decree of divorce or of separate maintenance shall not be considered as the spouse of the taxpayer.

(3) Where the taxpayer enters into 2 commodity futures transactions on the same day, one requiring delivery by him in one market and the other requiring delivery to him of the same (or substantially identical) commodity in the same calendar month in a different market, and the taxpayer subsequently closes both such transactions on the same day, subsections (b) and (d) shall have no application to so much of the commodity involved in either such transaction as does not exceed in quantity the commodity involved in the other.

(4) (A) In the case of a taxpayer who is a dealer in securities (within the meaning of section 1236)—

(i) if, on the date of a short sale of stock, substantially identical property which is a capital asset in the hands of the taxpayer has been held for not more than 6 months, and

(ii) if such short sale is closed more than 20 days after the date on which it was made, subsection (b) (2) shall apply in respect of the holding period of such substantially identical property.

(B) For purposes of subparagraph (A)—

(i) the last sentence of subsection (b) applies; and

(ii) the term "stock" means any share or certificate of stock in a corporation, any bond or other evidence of indebtedness which is convertible into any such share or certificate, or any evidence of an interest in, or right to subscribe to or purchase, any of the foregoing.

(f) Arbitrage operations in securities.

In the case of a short sale which had been entered in to as an arbitrage operation, to which sale the rule of subsection (b) (2) would apply except as otherwise provided in this subsection—

(1) subsection (b) (2) shall apply first to substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, and only to the extent that the quantity sold short exceeds the substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, shall the holding period of any other such identical assets held by the taxpayer be affected;

(2) in the event that assets acquired for arbitrage operations are disposed of in such manner as to create a net short position in assets acquired for arbitrage operations, such net short position shall be deemed to constitute a short sale made on that day;

(3) for the purpose of paragraphs (1) and (2) of this subsection the taxpayer will be deemed as of the close of any business day to hold property which he is or will be entitled to receive or acquire by virtue of any other asset acquired for arbitrage operations or by virtue of any contract he has entered into in an arbitrage operation; and

(4) for the purpose of this subsection arbitrage operations are transactions involving the purchase and sale of assets for the purpose of profiting from a current difference between the price of the asset purchased and the price of the asset sold, and in which the asset purchased, if not identical to the asset sold, is such that by virtue thereof the taxpayer is, or will be, entitled to acquire assets identical to the assets sold. Such operations must be clearly identified by the taxpayer in his records as arbitrage operations on the day of the transaction or as soon thereafter as may be practicable. Assets acquired for arbitrage operations will include stocks and securities and the right to acquire stocks and securities.

(g) Hedging transactions.

This section shall not apply in the case of a hedging transaction in commodity futures. (Aug. 16, 1954, ch. 736, 68A Stat. 327; Aug. 12, 1955, ch. 871, § 1, 69 Stat. 717; Sept. 2, 1958, Pub. L. 85–866, title I, § 52 (a), (b), 72 Stat. 1643, 1644.)

AMENDMENTS

1958—Subsec. (a). Pub. L. 85–866, § 52(b), deleted ", other than a hedging transaction in commodity futures," following "sale of property."

Subsec. (e)(4). Pub. L. 85–866, § 52(a), added subsec. (e)(4).

Subsec. (g). Pub. L. 85–866, § 52(b), added subsec. (g).

1955—Subsec. (f). Act Aug. 12, 1955, added subsec. (f).

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (a) of this section by Pub. L. 85–866, and subsec. (g) of this section, applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 52 (c) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [adding subsec. (e) (4) of this section] shall apply with respect to short sales made after December 31, 1957."

EFFECTIVE DATE OF 1955 AMENDMENT

Section 2 of act Aug. 12, 1955, provided that: "The amendment made by the first section of this Act [adding subsec. (f) of this section] shall apply only with respect to taxable years ending after the date of the enactment of this Act [Aug. 12, 1955] and only in the case of a short sale of property made by the taxpayer after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1234 of this title.

§ 1234. Options to buy or sell.

(a) Treatment of gain or loss.

Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, a privilege or option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the option or privilege relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him).

(b) Special rule for loss attributable to failure to exercise option.

For purposes of subsection (a), if loss is attributable to failure to exercise a privilege or option, the privilege or option shall be deemed to have been sold or exchanged on the day it expired.

(c) Special rule for grantors of straddles.

(1) Gain on lapse.

In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.

(2) Exception.

This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.

(3) Definitions.

For purposes of this subsection—

(A) The term "straddle" means a simultaneously granted combination of an option to buy, and an option to sell, the same quantity of a security at the same price during the same period of time.

(B) The term "security" has the meaning assigned to such term by section 1236(c).

(d) Non-application of section.

This section shall not apply to—

(1) a privilege or option which constitutes property described in paragraph (1) of section 1221;

(2) in the case of gain attributable to the sale or exchange of a privilege or option, any income derived in connection with such privilege or option which, without regard to this section, is treated as other than gain from the sale or exchange of a capital asset;

(3) a loss attributable to failure to exercise an option described in section 1233 (c); or

(4) gain attributable to the sale or exchange of a privilege or option acquired by the taxpayer before March 1, 1954, if in the hands of the taxpayer such privilege or option is a capital asset.

(Aug. 16, 1954, ch. 376, 68A Stat. 329; Sept. 2, 1958, Pub. L. 85–866, title I, § 53, 72 Stat. 1644; Nov. 13, 1966, Pub. L. 89–809, title II, § 210(a), 80 Stat. 1580.)

AMENDMENTS

1966—Subsec. (c). Pub. L. 89–809 added subsec. (c) and redesignated former subsec. (c) as (d).

Subsec. (d). Pub. L. 89–809 redesignated former subsec. (c) as (d).

1958—Pub. L. 85–866 amended section generally and among other changes provided in subsec. (a) that gain or loss resulting from option to buy or sell property is to be considered gain or loss arising from property which has the same character as the property underlying the option, incorporated existing provisions in subsecs. (b) and (c) (3), and added provisions set out in subsec. (c) (1), (2), (4).

EFFECTIVE DATE OF 1966 AMENDMENT

Section 210(b) of Pub. L. 89–809 provided that: "The amendments made by subsection (a) [adding subsec. (c) and redesignating former subsec. (c) as (d)] shall apply to straddle transactions entered into after January 25, 1965, in taxable years ending after such date."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c) of Pub. L. 85–866, set out as a note under section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1233 of this title.

§ 1235. Sale or exchange of patents.

(a) General.

A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—

(1) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) contingent on the productivity, use, or disposition of the property transferred.

(b) "Holder" defined.

For purposes of this section, the term "holder" means—

(1) any individual whose efforts created such property, or

(2) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creater prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(A) the employer of such creator, nor

(B) related to such creator (within the meaning of subsection (d)).

(c) Effective date.

This section shall be applicable with regard to any amounts received, or payments made, pursuant to a transfer described in subsection (a) in any taxable year to which this subtitle applies, regardless of the taxable year in which such transfer occurred.

(d) Related persons.

Subsection (a) shall not apply to any transfer, directly or indirectly, between persons specified within any one of the paragraphs of section 267 (b); except that, in applying section 267 (b) and (c) for purposes of this section—

(1) the phrase "25 percent or more" shall be substituted for the phrase "more than 50 percent" each place it appears in seetion 267 (b), and

(2) paragraph (4) of section 267 (c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

(e) Cross reference.

For special rule relating to nonresident aliens, see section 871 (a).

(Aug. 16, 1954, ch. 736, 68A Stat. 329; Sept. 2, 1958, Pub. L. 85–866, title I, § 54 (a), 72 Stat. 1644.)

AMENDMENTS

1958—Subsec. (d). Pub. L. 85–866 substituted the provisions set out as subsec. (d) for provisions reading "Subsection (a) shall not apply to any sale or exchange between an individual and any other related person (as defined in section 267 (b)), except brothers and sisters, whether by the whole or half blood."

EFFECTIVE DATE OF 1958 AMENDMENT

Section 54 (b) of Pub. L. 85–866 provided that: "The amendment made by subsection (a) [to subsec. (d) of this section] shall apply with respect to taxable years ending after the date of the enactment of this Act [Sept. 2, 1958], but only with respect to transfers after such date."

CROSS REFERENCES

Withholding tax on nonresident aliens, see section 1441 (b) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 483, 871, 1201, 1441 of this title.

§ 1236. Dealers in securities.

(a) Capital gains.

Gain by a dealer in securities from the sale or exchange of any security shall in no event be considered as gain from the sale or exchange of a capital asset unless—

(1) the seeurity was, before the expiration of the 30th day after the date of its acquisition, clearly identified in the dealer's records as a security held for investment or if acquired before October 20, 1951, was so identified before November 20, 1951; and

(2) the security was not, at any time after the expiration of such 30th day, held by such dealer primarily for sale to customers in the ordinary course of his trade or business.

(b) Ordinary losses.

Loss by a dealer in securities from the sale or exchange of any security shall, except as otherwise provided in section 582 (c), (relating to bond, etc., losses of banks), in no event be considered as loss from the sale or exchange of property which is not a capital asset if at any time after November 19, 1951, the security was clearly identified in the dealer's records as a security held for investment.

(c) Definition of security.

For purposes of this section, the term "security" means any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing. (Aug. 16, 1954, ch. 736, 68A Stat. 330.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1233, 1234 of this title.

§ 1237. Real property subdivided for sale.

(a) General.

Any lot or parcel which is part of a tract of real property in the hands of a taxpayer other than a corporation shall not be deemed to be held primarily for sale to customers in the ordinary course of trade or business at the time of sale solely because of the taxpayer having subdivided such tract for purposes of sale or because of any activity incident to such subdivision or sale, if—

(1) such tract, or any lot or parcel thereof, had not previously been held by such taxpayer primarily for sale to customers in the ordinary course of trade or business (unless such tract at such previous time would have been covered by this section) and, in the same taxable year in which the sale occurs, such taxpayer does not so hold any other real property; and

(2) no substantial improvement that substantially enhances the value of the lot or parcel sold is made by the taxpayer on such tract while held by the taxpayer or is made pursuant to a contract of sale entered into between the taxpayer and the buyer. For purposes of this paragraph, an improvement shall be deemed to be made by the taxpayer if such improvement was made by—

(A) the taxpayer or members of his family (as defined in section 267 (c) (4)), by a corporation controlled by the taxpayer, or by a partnership which included the taxpayer as a partner; or

(B) a lessee, but only if the improvement constitutes income to the taxpayer; or

(C) Federal, State, or local government, or political subdivision thereof, but only if the improvement constitutes an addition to basis for the taxpayer; and

(3) such lot or parcel, except in the case of real property acquired by inheritance or devise, is held by the taxpayer for a period of 5 years.

(b) Special rules for application of section.

(1) Gains.

If more than 5 lots or parcels contained in the same tract of real property are sold or exchanged, gain from any sale or exchange (which occurs in or after the taxable year in which the sixth lot or parcel is sold or exchanged) of any lot or parcel which comes within the provisions of paragraphs (1), (2) and (3) of subsection (a) of this section shall be deemed to be gain from the sale of property held primarily for sale to customers in the ordinary course of the trade or business to the extent of 5 percent of the selling price.

(2) Expenditures of sale.

For the purpose of computing gain under paragraph (1) of this subsection, expenditures incurred in connection with the sale or exchange of any lot or parcel shall neither be allowed as a deduction in computing taxable income, nor treated as reducing the amount realized on such sale or exchange; but so much of such expenditures as does not exceed the portion of gain deemed under paragraph (1) of this subsection to be gain from the sale of property held primarily for sale to customers in the ordinary course of trade or business shall be so allowed as a deduction, and the remainder, if any, shall be treated as reducing the amount realized on such sale or exchange.

(3) Necessary improvements.

No improvement shall be deemed a substantial improvement for purposes of subsection (a) if the lot or parcel is held by the taxpayer for a period of 10 years and if—

(A) such improvement is the building or installation of water, sewer, or drainage facilities or roads (if such improvement would except for this paragraph constitute a substantial improvement);

(B) it is shown to the satisfaction of the Secretary or his delegate that the lot or parcel, the value of which was substantially enhanced by such improvement, would not have been marketable at the prevailing local price for similar building sites without such improvement; and

(C) the taxpayer elects, in accordance with regulations prescribed by the Secretary or his delegate, to make no adjustment to basis of the lot or parcel, or of any other property owned by the taxpayer, on account of the expenditures for such improvements. Such election shall not make any item deductible which would not otherwise be deductible.

(c) Tract defined.

For purposes of this section, the term "tract of real property" means a single piece of real property, except that 2 or more pieces of real property shall be considered a tract if at any time they were contiguous in the hands of the taxpayer or if they would be contiguous except for the interposition of a road, street, railroad, stream, or similar property. If, following the sale or exchange of any lot or parcel from a tract of real property, no further sales or exchanges of any other lots or parcels from the remainder of such tract are made for a period of 5 years, such remainder shall be deemed a tract.

(d) Effective date.

This section shall apply only with respect to sales of property occurring after December 31, 1953, except that, for purposes of subsection (c) (defining tract of real property) and for determining the number of sales under paragraph (1) of subsection (b), all sales of lots and parcels from any tract of real property during the period of 5 years before December 31, 1953, shall be taken into account, except as provided in subsection (c). (Aug. 16, 1954, ch. 736, 68A Stat. 330; Apr. 27, 1956, ch. 214, §§ 1, 2, 70 Stat. 118; Sept. 2, 1958, Pub. L. 85–866, title I, § 55, 72 Stat. 1645; Jan. 12, 1971, Pub. L. 91–686, § 2 (a), 84 Stat. 2071.)

AMENDMENTS

1971—Subsec. (a). Pub. L. 91–686, § 2(a)(1), substituted "other than a corporation" for "(including corporations only if no shareholder directly or indirectly holds real property for sale to customers in the ordinary course of trade or business and only in the case of property described in the last sentence of subsection (b)(3))."

Subsec. (b). Pub. L. 91–686, § 2(a)(2), eliminated sentence which made subpars. (B) and (C) inapplicable in the case of property acquired through the foreclosure of a lien thereon which secured the payment of an indebtedness to the taxpayer or (in the case of a corporation) to a creditor who has transferred the foreclosure bid to the taxpayer in exchange for all of its stock and other consideration and in the case of property adjacent to such property if 80 percent of the real property owned by the taxpayer was property described in the first part of the sentence.

1958—Subsec. (a) (1). Pub. L. 85–866 substituted "and, in the same taxable year" for "or, in the same taxable year".

1958—Subsec. (a). Act Apr. 27, 1956, § 1, substituted for the words "other than a corporation" the parenthetical clause "(including corporations only if no shareholder directly or indirectly holds real property for sale to customers in the ordinary course of trade or business and only in the case of property described in the last sentence of subsection (b) (3))".

Subsec. (b) (3). Act Apr. 27, 1956, § 2, substituted "water, sewer, or drainage facilities" for "water or sewer facilities" in subpar. (A), and inserted at the end of said subsec. (b) (3) provision that requirements of subpars. (B) and (C) do not apply to certain specified property.

EFFECTIVE DATE OF 1971 AMENDMENT

Section 2(b) of Pub. L. 91–686 provided that: "The amendments made by subsection (a)]to subsecs. (a) and (b) of this section] shall be effective for taxable ysars beginning after the date of enactment of this Act [Jan. 12, 1971]."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (a) (1) of this section by Pub. L. 85–866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Section 3 of act Apr. 27, 1956, provided it shall apply to all taxable years beginning after Dec. 31, 1954.

SALES OR EXCHANGES BY CORPORATIONS OF REAL PROPERTY HELD MORE THAN 25 YEARS

Section 1 of Pub. L. 91–686 provided:

"That (a) for purposes of the Internal Revenue Code of 1954 any lot or parcel of real property sold or exchanged by a corporation which would, but for this Act, be treated as property held primarily for sale to customers in the ordinary course of trade or business shall not, except to the extent provided in (b), be so treated if—

"(1) no shareholder of the corporation directly or indirectly holds real property primarily for sale to customers in the ordinary course of trade or business; and

"(2)(A) such lot or parcel is a part of real property (i) held for more than twenty-five years at the time of sale or exchange, and (ii) acquired before January 1, 1934, by the corporation as a result of the foreclosure of a lien (or liens) thereon which secured the payment of indebtedness held by one or more creditors who transferred one or more foreclosure bids to the corporation in exchange for all its stock (with or without other consideration), or

"(B)(i) such lot or parcel is a part of additional real property acquired before January 1, 1957, by the corporation in the near vicinity of any real property to which subparagraph (A) applies, or

"(ii) such lot or parcel is wholly or to some extent a part of any minor acquisition made after December 31, 1956, by the corporation to adjust boundaries, to fill gaps in previously acquired property, to facilitate the installation of streets, utilities, and other public facilities, or to facilitate the sale of adjacent property, or

"(iii) such lot or parcel is wholly or to some extent a part of a reacquisition by the corporation after December 31, 1956, of property previously owned by the corporation;

but only if at least 80 percent (as measured by area) of the real property sold or exchanged by the corporation within the taxable year is property described in subparagraph (A); and

"(3) there were no acquisitions of real property by the corporation after December 31, 1956, other than—

"(A) acquisitions described in paragraph (2)(B)(ii) and reacquisitions described in paragraph (2)(B)(iii), or

"(B) acquisitions of real property used in a trade or business of the corporation or held for investment by the corporation; and

"(4) the corporation did not after December 31, 1957, sell or exchange (except in condemnation or under threat of condemnation) any residential lot or parcel on which, at the time of the sale or exchange, there existed any substantial improvements (other than improvements in existence at the time the land was acquired by the corporation) except subdivision, clearing, grubbing, and grading, building or installation of water, sewer, and drainage facilities, construction of roads, streets, and sidewalks, and installation of utilities."

In any case in which a corporation referred to in paragraphs (1), (2), (3), and (4) is a member of an affiliated group as defined in section 1504(a) of the Internal Revenue Code of 1954 [section 1504(a) of this title], such affiliated group shall, for purposes of such paragraphs, be treated as a single corporation.

"(b)(1) Gain from any sale or exchange described in subsection (a) shall be deemed, for purposes of such Code, to be gain from the sale of property held primarily for sale to customers in the ordinary course of trade or business to the extent of 5 percent of the selling price.

"(2) For the purpose of computing gain under paragraph (1), expenditures incurred in connection with the sale or exchange of any lot or parcel shall neither be allowed as a deduction in computing taxable income, nor treated as reducing the amount realized on such sale or exchange; but so much of such expenditures as does not exceed the portion of gain deemed under paragraph (1) to be gain from the sale of property held primarily for sale to customers in the ordinary course of trade or business shall be so allowed as a deduction, and the remainder, if any, shall be treated as reducing the amount realized on such sale or exchange.

"(c) The provisions of subsections (a) and (b) shall apply to taxable years beginning after December 31, 1957, and before January 1, 1984."

CROSS REFERENCES

Real property used in trade or business—
As not capital asset, see section 1221 (2) of this title.
Held for more than six months, see section 1231 (b) (1) of this title.

§ 1238. Amortization in excess of depreciation.

Gain from the sale or exchange of property, to the extent that the adjusted basis of such property is

less than its adjusted basis determined without regard to section 168 (relating to amortization deduction of emergency facilities), shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. (Aug. 16, 1954, ch. 736, 68A Stat. 332.)

§ 1239. Gain from sale of certain property between spouses or between an individual and a controlled corporation.

(a) Treatment of gain as ordinary income.

In the case of a sale or exchange, directly or indirectly, of property described in subsection (b)—

(1) between a husband and wife; or

(2) between an individual and a corporation more than 80 percent in value of the outstanding stock of which is owned by such individual, his spouse, and his minor children and minor grandchildren;

any gain recognized to the transferor from the sale or exchange of such property shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(b) Section applicable only to sales or exchanges of depreciable property.

This section shall apply only in the case of a sale or exchange by a transferor of property which in the hands of the transferee is property of a character which is subject to the allowance for depreciation provided in section 167.

(c) Section not applicable with respect to sales or exchanges made on or before May 3, 1951.

This section shall apply only in the case of a sale or exchange made after May 3, 1951. (Aug. 16, 1954, ch. 736, 68A Stat. 332; Sept. 2, 1958, Pub. L. 85–866, title I, § 56, 72 Stat. 1645.)

AMENDMENTS

1958—Subsec. (c). Pub. L. 85–866 added subsec. (c).

§ 1240. Taxability to employee of termination payments.

Amounts received from the assignment or release by an employee, after more than 20 years' employment, of all his rights to receive, after termination of his employment and for a period of not less than 5 years (or for a period ending with his death), a percentage of future profits or receipts of his employer shall be considered an amount received from the sale or exchange of a capital asset held for more than 6 months if—

(1) such rights were included in the terms of the employment of such employee for not less than 12 years,

(2) such rights were included in the terms of the employment of such employee before the date of enactment of this title, and

(3) the total of the amounts received for such assignment or release is received in one taxable year and after the termination of such employment.

(Aug. 16, 1954, ch. 736, 68A Stat. 332.)

§ 1241. Cancellation of lease or distributor's agreement.

Amounts received by a lessee for the cancellation of a lease, or by a distributor of goods for the cancellation of a distributor's agreement (if the distributor has a substantial capital investment in the distributorship), shall be considered as amounts received in exchange for such lease or agreement. (Aug. 16, 1954, ch. 736, 68A Stat. 333.)

CROSS REFERENCES

Computation for services as gross income, see section 61 (a) (1) of this title.

§ 1242. Losses on small business investment company stock.

If—

(1) a loss is on stock in a small business investment company operating under the Small Business Investment Act of 1958, and

(2) such loss would (but for this section) be a loss from the sale or exchange of a capital asset,

then such loss shall be treated as a loss from the sale or exchange of property which is not a capital asset. For purposes of section 172 (relating to the net operating loss deduction) any amount of loss treated by reason of this section as a loss from the sale or exchange of property which is not a capital asset shall be treated as attributable to a trade or business of the taxpayer. (Added Pub. L. 85–866, title I, § 57 (a), Sept. 2, 1958, 72 Stat. 1645.)

REFERENCES IN TEXT

Small Business Investment Act of 1958, referred to in clause (1), is classified to chapter 14B of Title 15, Commerce and Trade.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Sept. 2, 1958, see section 57 (d) of Pub. L. 85–866, set out as a note under section 243 of this title.

§ 1243. Loss of small business investment company.

In the case of a small business investment company operating under the Small Business Investment Act of 1958, if—

(1) a loss is on stock received pursuant to the conversion privilege of convertible debentures acquired pursuant to section 304 of the Small Business Investment Act of 1958, and

(2) such loss would (but for this section) be a loss from the sale or exchange of a capital asset,

then such loss shall be treated as a loss from the sale or exchange of property which is not a capital asset. (Added Pub. L. 85–866, title I, § 57 (a), Sept. 2, 1958, 72 Stat. 1645, and amended Pub. L. 91–172, title IV, § 433(b), Dec. 30, 1969, 83 Stat. 624.)

REFERENCES IN TEXT

Small Business Investment Act of 1958, referred to in text, is classified to chapter 14B of Title 15, Commerce and Trade.

Section 304 of the Small Business Investment Act of 1958, referred to in text, is classified to section 684 of Title 15, Commerce and Trade.

AMENDMENTS

1969—Par. (1). Pub. L. 91–172 substituted "stock received pursuant to the conversion privilege of convertible debentures" for "convertible debentures (including stock received pursuant to the conversion privilege)".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years beginning after July 11, 1969, see section 433(d) of Pub. L. 91–172, set out as a note under section 582 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Sept. 2, 1958, see section 57 (d) of Pub. L. 85-866, set out as a note under section 243 of this title.

§ 1244. Losses on small business stock.

(a) General rule.

In the case of an individual, a loss on section 1244 stock issued to such individual or to a partnership which would (but for this section) be treated as a loss from the sale or exchange of a capital asset shall, to the extent provided in this section, be treated as a loss from the sale or exchange of an asset which is not a capital asset.

(b) Maximum amount for any taxable year.

For any taxable year the aggregate amount treated by the taxpayer by reason of this section as a loss from the sale or exchange of an asset which is not a capital asset shall not exceed—

(1) $25,000, or

(2) $50,000, in the case of a husband and wife filing a joint return for such year under section 6013.

(c) Section 1244 stock defined.

(1) In general.

For purposes of this section, the term "section 1244 stock" means common stock in a domestic corporation if—

(A) such corporation adopted a plan after June 30, 1958, to offer such stock for a period (ending not later than two years after the date such plan was adopted) specified in the plan,

(B) at the time such plan was adopted, such corporation was a small business corporation,

(C) at the time such plan was adopted, no portion of a prior offering was outstanding,

(D) such stock was issued by such corporation, pursuant to such plan, for money or other property (other than stock and securities), and

(E) such corporation, during the period of its 5 most recent taxable years ending before the date the loss on such stock is sustained (or if such corporation has not been in existence for 5 taxable years ending before such date, during the period of its taxable years ending before such date, or if such corporation has not been in existence for one taxable year ending before such date, during the period such corporation has been in existence before such date), derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this subparagraph only to the extent of gains therefrom); except that this subparagraph shall not apply with respect to any corporation if, for the period referred to, the amount of the deductions allowed by this chapter (other than by sections 172, 242, 243, 244, and 245) exceed the amount of gross income.

Such term does not include stock if issued (pursuant to the plan referred to in subparagraph (A)) after a subsequent offering of stock has been made by the corporation.

(2) Small business corporation defined.

For purposes of this section, a corporation shall be treated as a small business corporation if at the time of the adoption of the plan—

(A) the sum of—

(i) the aggregate amount which may be offered under the plan, plus

(ii) the aggregate amount of money and other property (taken into account in an amount, as of the time received by the corporation, equal to the adjusted basis to the corporation of such property for determining gain, reduced by any liabilities to which the property was subject or which were assumed by the corporation at such time) received by the corporation after June 30, 1958, for stock, as a contribution to capital, and as paid-in surplus,

does not exceed $500,000; and

(B) the sum of—

(i) the aggregate amount which may be offered under the plan, plus

(ii) the equity capital of the corporation (determined on the date of the adoption of the plan),

does not exceed $1,000,000.

For purposes of subparagraph (B), the equity capital of a corporation is the sum of its money and other property (in an amount equal to the adjusted basis of such property for determining gain), less the amount of its indebtedness (other than indebtedness to shareholders).

(d) Special rules.

(1) Limitations on amount of ordinary loss.

(A) Contributions of property having basis in excess of value.

If—

(i) section 1244 stock was issued in exchange for property,

(ii) the basis of such stock in the hands of the taxpayer is determined by reference to the basis in his hands of such property, and

(iii) the adjusted basis (for determining loss) of such property immediately before the exchange exceeded its fair market value at such time,

then in computing the amount of the loss on such stock for purposes of this section the basis of such stock shall be reduced by an amount equal to the excess described in clause (lii).

(B) Increases in basis.

In computing the amount of the loss on stock for purposes of this section, any increase in the basis of such stock (through contributions to the capital of the corporation, or otherwise) shall be treated as allocable to stock which is not section 1244 stock.

(2) Recapitalizations, changes in name, etc.

To the extent provided in regulations prescribed by the Secretary or his delegate, common stock in a corporation, the basis of which (in the hands of a taxpayer) is determined in whole or in part by reference to the basis in his hands of stock in such corporation which meets the requirements of subsection (c) (1) (other than subparagraph

(E) thereof), or which is received in a reorganization described in section 368 (a) (1) (F) in exchange for stock which meets such requirements, shall be treated as meeting such requirements. For purposes of paragraphs (1) (E) and (2) (A) of subsection (c), a successor corporation in a reorganization described in section 368 (a) (1) (F) shall be treated as the same corporation as its predecessor.

(3) Relationship to net operating loss deduction.

For purposes of section 172 (relating to the net operating loss deduction), any amount of loss treated by reason of this section as a loss from the sale or exchange of an asset which is not a capital asset shall be treated as attributable to a trade or business of the taxpayer.

(4) Individual defined.

For purposes of this section, the term "individual" does not include a trust or estate.

(e) Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section. (Added Pub. L. 85–866, title II, § 202 (b), Sept. 2, 1958, 72 Stat. 1676.)

CROSS REFERENCES

Section as part of the Small Business Tax Revision Act of 1958, see section 201 of Pub. L. 85–866, set out as a note under section 165 of this title.

§ 1245. Gain from dispositions of certain depreciable property.

(a) General rule.

(1) Ordinary income.

Except as otherwise provided in this section, if section 1245 property is disposed of during a taxable year beginning after December 31, 1962, the amount by which the lower of—

(A) the recomputed basis of the property, or

(B) (i) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(ii) in the case of any other disposition, the fair market value of such property,

exceeds the adjusted basis of such property shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Recomputed basis.

For purposes of this section, the term "recomputed basis" means—

(A) with respect to any property referred to in paragraph (3) (A) or (B), its adjusted basis recomputed by adding thereto all adjustments, attributable to periods after December 31, 1961,

(B) with respect to any property referred to in paragraph (3) (C), its adjusted basis recomputed by adding thereto all adjustments, attributable to periods after June 30, 1963,

(C) with respect to livestock, its adjusted basis recomputed by adding thereto all adjustments attributable to periods after December 31, 1969, or

(D) with respect to any property referred to in paragraph (3) (D), its adjusted basis recomputed by adding thereto all adjustments attributable to periods beginning with the first month for which a deduction for amortization is allowed under section 169 or 185

reflected in such adjusted basis on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for depreciation, or for amortization under section 168, 169, 184, 185, or 187. For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for depreciation, or for amortization under section 168, 169, 184, 185, or 187, for any period was less than the amount allowable, the amount added for such period shall be the amount allowed.

(3) Section 1245 property.

For purposes of this section, the term "section 1245 property" means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 (or subject to the allowance of amortization provided in section 185) and is either—

(A) personal property,

(B) other property (not including a building or its structural components) but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in paragraph (2) for a period in which such property (or other property)—

(i) was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constituted research or storage facilities used in connection with any of the activities referred to in clause (i),

(C) an elevator or an escalator, or

(D) so much of any real property (other than any property described in subparagraph (B)) which has an adjusted basis in which there are reflected adjustments for amortization under section 169 or 185.

(b) Exceptions and limitations.

(1) Gifts.

Subsection (a) shall not apply to a disposition by gift.

(2) Transfers at death.

Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

(3) Certain tax-free transactions.

If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731, then the amount of gain taken into account by the transferor under subsection (a) (1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to a disposition to an

organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

(4) Like kind exchanges; involuntary conversions, etc.

If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (a)(1) shall not exceed the sum of—

(A) the amount of gain recognized on such disposition (determined without regard to this section), plus

(B) the fair market value of property acquired which is not section 1245 property and which is not taken into account under subparagraph (A).

(5) Sections 1071 and 1081 transactions.

Under regulations prescribed by the Secretary or his delegate, rules consistent with paragraphs (3) and (4) of this subsection shall apply in the case of transactions described in section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or section 1081 (relating to exchanges in obedience to SEC orders).

(6) Property distributed by a partnership to a partner.

(A) In general.

For purposes of this section, the basis of section 1245 property distributed by a partnership to a partner shall be deemed to be determined by reference to the adjusted basis of such property to the partnership.

(B) Adjustments added back.

In the case of any property described in subparagraph (A), for purposes of computing the recomputed basis of such property the amount of the adjustments added back for periods before the distribution by the partnership shall be—

(i) the amount of the gain to which subsection (a) would have applied if such property had been sold by the partnership immediately before the distribution at its fair market value at such time, reduced by

(ii) the amount of such gain to which section 751(b) applied.

(c) Adjustments to basis.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (a).

(d) Application of section.

This section shall apply notwithstanding any other provision of this subtitle. (Added Pub. L. 87–834, § 13(a)(1), Oct. 16, 1962, 76 Stat. 1032, and amended Pub. L. 88–272, title II, § 203(d), Feb. 26, 1964, 78 Stat. 35; Pub. L. 91–172, title II, § 212(a)(1), (2), title VII, § 704(b)(4), Dec. 30, 1969, 83 Stat. 571, 670.)

AMENDMENTS

1969—Subsec. (a)(2). Pub. L. 91–172, §§ 212(a)(1), 704(b)(4)(A), (B), added subpar. (C) and inserted references to sections 169, 185, and 137, and added subpar. (D). Subsec. (a)(3). Pub. L. 91–172, §§ 212(a)(2), 704(b)(4)(C)–(F), struck out "(other than livestock)" following "means any property" and substituted "section 167 (or subject to the allowance of amortization provided in section 185)" for "section 167" and added subpar. (D).

1964—Subsec. (a)(2), (3)(C). Pub. L. 88–272 redefined "recomputed basis" with respect to elevators or escalators in par. (2), and inserted subpar. (C) in par. (3).

EFFECTIVE DATE OF 1969 AMENDMENT

Section 212(a)(3) of Pub. L. 91–172 provided that: "The amendments made by paragraphs (1) and (2) [to this section] shall apply with respect to taxable years beginning after December 31, 1969."

Amendment of section by section 704(b)(4) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1968, see section 704(c) of Pub. L. 91–172, set out as a note under section 169 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable with respect to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 203(f)(3) of Pub. L. 88–272, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section 13(g) of Pub. L. 87–834 provided that: "The amendments made by this section [enacting this section and amending sections 167(e), 170, 301, 312, 341, 453, 613 and 751 of this title] (other than the amendments made by subsection (c) [enacting section 167(f) of this title, amending sections 179 and 642 of this title, and redesignating former subsecs. (f)—(h) of section 167 of this title as subsecs. (g)—(i)]) shall apply to taxable years beginning after December 31, 1962. The amendments made by subsection (c) shall apply to taxable years beginning after December 31, 1961, and ending after the date of the enactment of this Act [Oct. 16, 1962]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 163, 166, 170, 301, 312, 341, 453, 512, 617, 751, 1250, 1251, 1252 of this title.

§ 1246. Gain on foreign investment company stock.

(a) Treatment of gain as ordinary income.

(1) General rule.

In the case of a sale or exchange (or a distribution which, under section 302 or 331, is treated as an exchange of stock) after December 31, 1962, of stock in a foreign corporation which was a foreign investment company (as defined in subsection (b)) at any time during the period during which the taxpayer held such stock, any gain shall be treated as gain from the sale or exchange of property which is not a capital asset, to the extent of the taxpayer's ratable share of the earnings and profits of such corporation accumulated for taxable years beginning after December 31, 1962.

(2) Ratable share.

For purposes of this section, the taxpayer's ratable share shall be determined under regulations prescribed by the Secretary or his delegate, but shall include only his ratable share of the accumulated earnings and profits of such corporation—

(A) for the period during which the taxpayer held such stock, but

(B) excluding such earnings and profits attributable to any amount previously included in the gross income of such taxpayer under section 951 (but only to the extent the inclusion of such amount did not result in an exclusion of any other amount from gross income under section 959).

(3) Taxpayer to establish earnings and profits.

Unless the taxpayer establishes the amount of the accumulated earnings and profits of the foreign investment company and the ratable share thereof for the period during which the taxpayer held such stock, all the gain from the sale or exchange of stock in such company shall be considered as gain from the sale or exchange of property which is not a capital asset.

(4) Holding period of stock must be more than 6 months.

This section shall not apply with respect to the sale or exchange of stock where the holding period of such stock as of the date of such sale or exchange is 6 months or less.

(b) Definition of foreign investment company.

For purposes of this section, the term "foreign investment company" means any foreign corporation which, for any taxable year beginning after December 31, 1962, is—

(1) registered under the Investment Company Act of 1940, as amended (15 U.S.C. 80a–1 to 80b–2), either as a management company or as a unit investment trust, or

(2) engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities (within the meaning of section 3(a)(1) of such Act, as limited by paragraphs (2) through (10) (except paragraph (6)(C)) and paragraphs (12) through (15) of section 3(c) of such Act) at a time when more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or of the total value of shares of all classes of stock, was held, directly or indirectly (within the meaning of section 958(a)), by United States persons (as defined in section 7701(a)(30)).

(c) Stock having transferred or substituted basis.

To the extent provided in regulations prescribed by the Secretary or his delegate, stock in a foreign corporation, the basis of which (in the hands of the taxpayer selling or exchanging such stock) is determined by reference to the basis (in the hands of such taxpayer or any other person) of stock in a foreign investment company, shall be treated as stock of a foreign investment company and held by the taxpayer throughout the holding period for such stock (determined under section 1223).

(d) Rules relating to entities holding foreign investment company stock.

To the extent provided in regulations prescribed by the Secretary or his delegate—

(1) trust certificates of a trust to which section 677 (relating to income for benefit of grantor) applies, and

(2) stock of a domestic corporation,

shall be treated as stock of a foreign investment company and held by the taxpayer throughout the holding period for such certificates or stock (determined under section 1223) in the same proportion that the investment in stock in a foreign investment company by the trust or domestic corporation bears to the total assets of such trust or corporation.

(e) Rules relating to stock acquired from a decedent.

(1) Basis.

In the case of stock of a foreign investment company acquired by bequest, devise, or inheritance (or by the decedent's estate) from a decedent dying after December 31, 1962, the basis determined under section 1014 shall be reduced (but not below the adjusted basis of such stock in the hands of the decedent immediately before his death) by the amount of the decedent's ratable share of the earnings and profits of such company accumulated after December 31, 1962. Any stock so acquired shall be treated as stock described in subsection (c).

(2) Deduction for estate tax.

If stock to which subsection (a) applies is acquired from a decedent, the taxpayer shall, under regulations prescribed by the Secretary or his delegate, be allowed (for the taxable year of the sale or exchange) a deduction from gross income equal to that portion of the decedent's estato tax deemed paid which is attributable to the excess of (A) the value at which such stock was taken into account for purposes of determining the value of the decedent's gross estate, over (B) the value at which it would have been so taken into account if such value had been reduced by the amount described in paragraph (1).

(f) Information with respect to certain foreign investment companies.

Every United States person who, on the last day of the taxable year of a foreign investment company beginning after December 31, 1962, owns 5 percent or more in value of the stock of such company shall furnish with respect to such company such information as the Secretary or his delegate shall by regulations prescribe.

(g) Cross reference.

For special rules relating to the earnings and profits of foreign investment companies, see section 312(*l*).

(Added Pub. L. 87–834, § 14(a)(1), Oct. 16, 1962, 76 Stat. 1036.)

REFERENCES IN TEXT

Sections 3(a)(1) and 3(c) of such Act, referred to in subsec. (b), mean sections 3(a)(1) and 3(c) of the Investment Company Act of 1940, and are classified to section 80a–3(a)(1) and 80a–3(c) of Title 15, respectively.

EFFECTIVE DATE

Section 14(c) of Pub. L. 87–834 provided that: "The amendments made by this section [adding this section and section 1247 and amending sections 312, 751 and 1223 of this title] shall apply with respect to taxable years beginning after December 31, 1962."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 312, 751, 1223, 1247, 1243 of this title.

§ 1247. Election by foreign investment companies to distribute income currently.

(a) Election by foreign investment company.

(1) In general.

If a foreign investment company which is described in section 1246(b)(1) elects (in the manner provided in regulations prescribed by the Secretary or his delegate) on or before December 31, 1962, with respect to each taxable year beginning after December 31, 1962, to—

(A) distribute to its shareholders 90 percent or more of what its taxable income would be if it were a domestic corporation;

(B) designate in a written notice mailed to its shareholders at any time before the expiration of 45 days after the close of its taxable year the pro rata amount of the excess (determined as if such corporation were a domestic corporation) of the net long-term capital gain over the net short-term capital loss of the taxable year; and the portion thereof which is being distributed; and

(C) provide such information as the Secretary or his delegate deems necessary to carry out the purposes of this section,

then section 1246 shall not apply with respect to the qualified shareholders of such company during any taxable year to which such election applies.

(2) Special rules.

(A) Computation of taxable income.

For purposes of paragraph (1)(A), the taxable income of the company shall be computed without regard to—

(i) the excess of the net long-term capital gain over the net short-term capital loss referred to in paragraph (1)(B),

(ii) section 172 (relating to net operating losses), and

(iii) any deduction provided by part VIII of subchapter B (other than the deduction provided by section 248, relating to organizational expenditures).

(B) Distributions after the close of the taxable year.

For purposes of paragraph (1)(A), a distribution made after the close of the taxable year and on or before the 15th day of the third month of the next taxable year shall be treated as distributed during the taxable year to the extent elected by the company (in accordance with regulations prescribed by the Secretary or his delegate) on or before the 15th day of such third month.

(C) Carryover of capital losses from nonelection years denied.

In computing the excess of the net long-term capital gain over the net short-term capital loss referred to in paragraph (1)(B), section 1212 shall not apply to losses incurred in or with respect to taxable years before the first taxable year to which the election applies.

(b) Years to which election applies.

The election of any foreign investment company under this section shall terminate as of the close of the taxable year preceding its first taxable year in which any of the following occurs:

(1) the company fails to comply with the provisions of subparagraph (A), (B), or (C) of subsection (a)(1), unless it is shown that such failure is due to reasonable cause and not due to willful neglect,

(2) the company is a foreign personal holding company, or

(3) the company is not a foreign investment company which is described in section 1246(b)(1).

(c) Qualified shareholders.

For purposes of this section—

(1) In general.

The term "qualified shareholder" means any shareholder who is a United States person (as defined in section 7701(a)(30)), other than a shareholder described in paragraph (2).

(2) Certain United States persons excluded from definition.

A United States person shall not be treated as a qualified shareholder for the taxable year if for such taxable year (or for any prior taxable year) he did not include, in computing his long-term capital gains in his return for such taxable year, the amount designated by such company pursuant to subsection (a)(1)(B) as his share of the undistributed capital gains of such company for its taxable year ending within or with such taxable year of the taxpayer. The preceding sentence shall not apply with respect to any failure by the taxpayer to treat an amount as provided therein if the taxpayer shows that such failure was due to reasonable cause and not due to willful neglect.

(d) Treatment of distributed and undistributed capital gains by a qualified shareholder.

Every qualified shareholder of a foreign investment company for any taxable year of such company with respect to which an election pursuant to subsection (a) is in effect shall include, in computing his long-term capital gains—

(1) for his taxable year in which received, his pro rata share of the distributed portion of the excess of the net long-term capital gain over the net short-term capital loss for such taxable year of such company, and

(2) for his taxable year in which or with which the taxable year of such company ends, his pro rata share of the undistributed portion of the excess of the net long-term capital gain over the net short-term capital loss for such taxable year of such company.

(e) Adjustments.

Under regulations prescribed by the Secretary or his delegate, proper adjustments shall be made—

(1) in the earnings and profits of the electing foreign investment company and a qualified shareholder's ratable share thereof, and

(2) in the adjusted basis of stock of such company held by such shareholder,

to reflect such shareholder's inclusion in gross income of undistributed capital gains.

(f) Election by foreign investment company with respect to foreign tax credit.

A foreign investment company with respect to which an election pursuant to subsection (a) is in effect and more than 50 percent of the value (as defined in section 851(c)(4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations may, for such taxable year, elect the application of this subsection with respect to income, war profits, and excess profits taxes described in section 901(b)(1) which are paid by the foreign investment company during

such taxable year to foreign countries and possessions of the United States. If such election is made—

(1) the foreign investment company—

(A) shall compute its taxable income, for purposes of subsection (a)(1)(A), without any deductions for income, war profits, or excess profits taxes paid to foreign countries or possessions of the United States, and

(B) shall treat the amount of such taxes, for purposes of subsection (a)(1)(A), as distributed to its shareholders;

(2) each qualified shareholder of such foreign investment company—

(A) shall include in gross income and treat as paid by him his proportionate share of such taxes, and

(B) shall treat, for purposes of applying subpart A of part III of subchapter N, his proportionate share of such taxes as having been paid to the country in which the foreign investment company is incorporated, and

(C) shall treat as gross income from sources within the country in which the foreign investment company is incorporated, for purposes of applying subpart A of part III of subchapter N, the sum of his proportionate share of such taxes and any dividend paid to him by such foreign investment company.

(g) Notice to shareholders.

The amounts to be treated by qualified shareholders, for purposes of subsection (f)(2), as their proportionate share of the taxes described in subsection (f)(1)(A) paid by a foreign investment company shall not exceed the amounts so designated by the foreign investment company in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year.

(h) Manner of making election and notifying shareholders.

The election provided in subsection (f) and the notice to shareholders required by subsection (g) shall be made in such manner as the Secretary or his delegate may prescribe by regulations.

(i) Loss on sale or exchange of certain stock held less than 6 months.

If—

(1) under this section, any qualified shareholder treats any amount designated under subsection (a)(1)(B) with respect to a share of stock as long-term capital gain, and

(2) such share is held by the taxpayer for less than 6 months,

then any loss on the sale or exchange of such share shall, to the extent of the amount described in paragraph (1), be treated as loss from the sale or exchange of a capital asset held for more than 6 months. (Added Pub. L. 87–834, § 14(a)(1), Oct. 16, 1962, 76 Stat. 1037.)

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1962, see section 14(c) of Pub. L. 87–834, set out as a note under section 1246 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 951, 1212, 1248 of this title.

§ 1248. Gain from certain sales or exchanges of stock in certain foreign corporations.

(a) General rule.

If—

(1) a United States person sells or exchanges stock in a foreign corporation, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock, and

(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),

then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary or his delegate) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation.

(b) Limitation on tax applicable to individuals.

In the case of an individual, if the stock sold or exchanged is a capital asset (within the meaning of section 1221) and has been held for more than 6 months, the tax attributable to an amount included in gross income as a dividend under subsection (a) shall not be greater than a tax equal to the sum of—

(1) a pro rata share of the excess of—

(A) the taxes that would have been paid by the foreign corporation with respect to its income had it been taxed under this chapter as a domestic corporation (but without allowance for deduction of, or credit for, taxes described in subparagraph (B)), for the period or periods the stock sold or exchanged was held by the United States person in taxable years beginning after December 31, 1962, while the foreign corporation was a controlled foreign corporation, adjusted for distributions and amounts previously included in gross income of a United States shareholder under section 951, over

(B) the income, war profits, or excess profits taxes paid by the foreign corporation with respect to such income; and

(2) an amount equal to the tax that would result by including in gross income, as gain from the sale or exchange of a capital asset held for more than 6 months, an amount equal to the excess of (A) the amount included in gross income as a dividend under subsection (a), over (B) the amount determined under paragraph (1).

(c) Determination of earnings and profits.

(1) In general.

Except as provided in section 312(m)(3), for purposes of this section, the earnings and profits of any foreign corporation for any taxable

year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary or his delegate.

(2) Earnings and profits of subsidiaries of foreign corporations.

If—

(A) subsection (a) applies to a sale or exchange by a United States person of stock of a foreign corporation and, by reason of the ownership of the stock sold or exchanged, such person owned within the meaning of section 958(a)(2) stock of any other foreign corporation; and

(B) such person owned, within the meaning of section 958(a), or was considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such other foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such other foreign corporation was a controlled foreign corporation (as defined in section 957),

then, for purposes of this section, the earnings and profits of the foreign corporation the stock of which is sold or exchanged which are attributable to the stock sold or exchanged shall be deemed to include the earnings and profits of such other foreign corporation which—

(C) are attributable (under regulations prescribed by the Secretary or his delegate) to the stock of such other foreign corporation which such person owned within the meaning of section 958(a)(2) (by reason of his ownership within the meaning of section 958(a)(1)(A) of the stock sold or exchanged) on the date of such sale or exchange; and

(D) were accumulated in taxable years of such other corporation beginning after December 31, 1962, and during the period or periods—

(i) such other corporation was a controlled foreign corporation, and

(ii) such person owned within the meaning of section 958(a)(2) the stock of such other foreign corporation.

(d) Exclusions from earnings and profits.

For purposes of this section, the following amounts shall be excluded, with respect to any United States person, from the earnings and profits of a foreign corporation:

(1) Amounts included in gross income under section 951.

Earnings and profits of the foreign corporation attributable to any amount previously included in the gross income of such person under section 951, with respect to the stock sold or exchanged, but only to the extent the inclusion of such amount did not result in an exclusion of an amount from gross income under section 959.

(2) Gain realized from the sale or exchange of property in pursuance of a plan of complete liquidation.

If a foreign corporation adopts a plan of complete liquidation in a taxable year of a foreign corporation beginning after December 31, 1962, and if section 337(a) would apply if such foreign corporation were a domestic corporation, earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary or his delegate) to any net gain from the sale or exchange of property.

(3) Less developed country corporations.

Earnings and profits accumulated by a foreign corporation while it was a less developed country corporation (as defined in section 902(d)), if the stock sold or exchanged was owned for a continuous period of at least 10 years, ending with the date of the sale or exchange, by the United States person who sold or exchanged such stock. In the case of stock sold or exchanged by a corporation, if United States persons who are individuals, estates, or trusts (each of whom owned within the meaning of section 958(a), or were considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such corporation) owned, or were considered as owning, at any time during the 10-year period ending on the date of the sale or exchange more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such corporation, this paragraph shall apply only if such United States persons owned, or were considered as owning, at all times during the remainder of such 10-year period more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such corporation. For purposes of this paragraph, stock owned by a United States person who is an individual, estate, or trust which was acquired by reason of the death of the predecessor in interest of such United States person shall be considered as owned by such United States person during the period such stock was owned by such predecessor in interest, and during the period such stock was owned by any other predecessor in interest if between such United States person and such other predecessor in interest there was no transfer other than by reason of the death of an individual.

(4) United States income.

Any item includible in gross income of the foreign corporation under this chapter—

(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business within the United States, or

(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States.

This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(5) Amounts included in gross income under section 1247.

If the United States person whose stock is sold or exchanged was a qualified shareholder (as defined in section 1247(c)) of a foreign corporation

which was a foreign investment company (as described in section 1246(b)(1)), the earnings and profits of the foreign corporation for taxable years in which such person was a qualified shareholder.

(e) Sales or exchanges of stock in certain domestic corporations.

Under regulations prescribed by the Secretary or his delegate, if—

(1) a United States person sells or exchanges stock of a domestic corporation, or receives a distribution from a domestic corporation which, under section 302 or 331, is treated as an exchange of stock, and

(2) such domestic corporation was formed or availed of principally for the holding, directly or indirectly, of stock of one or more foreign corporations,

such sale or exchange shall, for purposes of this section, be treated as a sale or exchange of the stock of the foreign corporation or corporations held by the domestic corporation.

(f) Exceptions.

This section shall not apply to—

(1) distributions to which section 303 (relating to distributions in redemption of stock to pay death taxes) applies;

(2) gain realized on exchanges to which section 356 (relating to receipt of additional consideration in certain reorganizations) applies; or

(3) any amount to the extent that such amount is, under any other provision of this title, treated as—

(A) a dividend,

(B) gain from the sale of an asset which is not a capital asset, or

(C) gain from the sale of an asset held for not more than 6 months.

(g) Taxpayer to establish earnings and profits.

Unless the taxpayer establishes the amount of the earnings and profits of the foreign corporation to be taken into account under subsection (a), all gain from the sale or exchange shall be considered a dividend under subsection (a), and unless the taxpayer establishes the amount of foreign taxes to be taken into account under subsection (b), the limitation of such subsection shall not apply. (Added Pub. L. 87–834, § 15(a), Oct. 16, 1962, 76 Stat. 1041, and amended Pub. L. 89–809, title I, § 104(k), Nov. 13, 1966, 80 Stat. 1562; Pub. L. 91–172, title IV, § 442(b)(2), Dec. 30, 1969, 83 Stat. 628.)

AMENDMENTS

1969—Subsec. (c)(1). Pub. L. 91–172 added reference to the exception provided for in section 312(m)(3).

1966—Subsec. (d)(4). Pub. L. 89–809 provided that for taxable years beginning after December 31, 1966, the earnings and profits of the foreign corporation, for purposes of this section, is not to include income effectively connected with the conduct of a trade or business within the United States, and added provision that the exclusion does not apply to income which is exempt from tax or subject to a reduced rate of tax pursuant to a treaty.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsec. (d)(4) of this section by Pub. L. 89–809 applicable with respect to sales or exchanges occurring after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section 15(c) of Pub. L. 87–834 provided that: "The amendments made by this section [enacting this section] shall apply with respect to sales or exchanges occurring after December 31, 1962."

ECONOMICALLY LESS DEVELOPED COUNTRIES

Designation of certain foreign countries as economically less developed countries, see Ex. Ord. No. 11071, Dec. 27, 1962, 27 F.R. 12875, set out as a note under section 955 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 4916 of this title.

§ 1249. Gain from certain sales or exchanges of patents, etc., to foreign corporations.

(a) General rule.

Gain from the sale or exchange after December 31, 1962, of a patent, an invention, model, or design (whether or not patented), a copyright, a secret formula or process, or any other similar property right to any foreign corporation by any United States person (as defined in section 7701(a)(30)) which controls such foreign corporation shall, if such gain would (but for the provisions of this subsection) be gain from the sale or exchange of a capital asset or of property described in section 1231, be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(b) Control.

For purposes of subsection (a), control means, with respect to any foreign corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this subsection, the rules for determining ownership of stock prescribed by section 958 shall apply. (Added Pub. L. 87–834, § 16(a), Oct. 16, 1962, 76 Stat. 1045, and amended Pub. L. 89–809, title I, § 104(m)(3), Nov. 13, 1966, 80 Stat. 1563.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809 substituted "Gain" at the beginning of the subsec. for "Except as provided in subsection (c), gain".

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by Pub. L. 89–809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89–809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section 16(c) of Pub. L. 87–834 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1962."

§ 1250. Gain from dispositions of certain depreciable realty.

(a) General rule.

Except as otherwise provided in this section—

(1) Additional depreciation after December 31, 1969.

If section 1250 property is disposed of after December 31, 1969, the applicable percentage of the lower of—

(A) that portion of the additional depreciation (as defined in subsection (b)(1) or (4)) attributable to periods after December 31, 1969, in respect of the property, or

(B) the excess of—

(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such property (in the case of any other disposition), over

(ii) the adjusted basis of such property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(C) Applicable percentage.

For purposes of paragraph (1), the term "applicable percentage" means—

(i) in the case of section 1250 property disposed of pursuant to a written contract which was, on July 24, 1969, and at all times thereafter, binding on the owner of the property, 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 20 full months;

(ii) in the case of section 1250 property constructed, reconstructed, or acquired by the taxpayer before January 1, 1975, with respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, or housing is financed or assisted by direct loan or tax abatement under similar provisions of State or local laws, and with respect to which the owner is subject to the restrictions described in section 1039(b)(1)(B), 100 percent minus one percentage point for each full month the property was held after the date the property was held 20 full months;

(iii) in the case of residential rental property (as defined in section 167(j)(2)(B)) other than that covered by clauses (i) and (ii), 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 100 full months;

(iv) in the case of section 1250 property with respect to which a depreciation deduction for rehabilitation expenditures was allowed under section 167(k), 100 percent minus 1 percentage point for each full month in excess of 100 full months after the date on which such property was placed in service; and

(v) in the case of all other section 1250 property, 100 percent.

Clauses (i), (ii), and (iii) shall not apply with respect to the additional depreciation described in subsection (b)(4).

(2) Additional depreciation before Jannary 1, 1970.

(A) In general.

If section 1250 property is disposed of after December 31, 1963, and the amount determined under paragraph (1)(B) exceeds the amount determined under paragraph (1)(A), then the applicable percentage of the lower of—

(i) that portion of the additional depreciation attributable to periods before January 1, 1970, in respect of the property, or

(ii) the excess of the amount determined under paragraph (1)(B) over the amount determined under paragraph (1)(A),

shall also be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(B) Applicable percentage.

For purposes of subparagraph (A) the term "applicable percentage" means 100 percent minus 1 percentage point for each full month the property was held after the date on which the property was held for 20 full months.

(b) Additional depreciation defined.

For purposes of this section—

(1) In general.

The term "additional depreciation" means, in the case of any property, the depreciation adjustments in respect of such property; except that, in the case of property held more than one year, it means such adjustments only to the extent that they exceed the amount of the depreciation adjustments which would have resulted if such adjustments had been determined for each taxable year under the straight line method of adjustment. For purposes of the preceding sentence, if a useful life (or salvage value) was used in determining the amount allowed as a deduction for any taxable year, such life (or value) shall be used in determining the depreciation adjustments which would have resulted for such year under the straight line method.

(2) Property held by lessee.

In the case of a lessee, in determining the depreciation adjustments which would have resulted in respect of any building erected (or other improvement made) on the leased property, or in respect of any cost of acquiring the lease, the lease period shall be treated as including all renewal periods. For purposes of the preceding sentence—

(A) the term "renewal period" means any period for which the lease may be renewed, extended, or continued pursuant to an option exercisable by the lessee, but

(B) the inclusion of renewal periods shall not extend the period taken into account by more than ⅔ of the period on the basis of which the depreciation adjustments were allowed.

(3) Depreciation adjustments.

The term "depreciation adjustments" means, in respect of any property, all adjustments attributable to periods after December 31, 1963, reflected in the adjusted basis of such property on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for exhaustion, wear and tear, obsolescene, or amortization (other than amortization under section 168, 169, or 185). For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed as a deduction for any period was less than the amount allowable, the amount taken into account for such period shall be the amount allowed.

(4) Additional depreciation attributable to rehabilitation expenditures.

The term "additional depreciation" also means, in the case of section 1250 property with respect to which a depreciation deduction for rehabilitation expenditures was allowed under section 167(k), the depreciation adjustments allowed under such section to the extent attributable to such property, except that, in the case of such property held for more than one year after the rehabilitation expenditures so allowed were incurred, it means such adjustments only to the extent that they exceed the amount of the depreciation adjustments which would have resulted if such adjustments had been determined under the straight line method of adjustment without regard to the useful life permitted under section 167(k).

(c) Section 1250 property.

For purposes of this section, the term "section 1250 property" means any real property (other than section 1245 property, as defined in section 1245(a)(3)) which is or has been property of a character subject to the allowance for depreciation provided in section 167.

(d) Exceptions and limitations.

(1) Gifts.

Subsection (a) shall not apply to a disposition by gift.

(2) Transfers at death.

Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

(3) Certain tax-free transactions.

If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731, then the amount of gain taken into account by the transferor under subsection (a) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

(4) Like kind exchanges; involuntary conversions, etc.

(A) Recognition limit.

If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (a) shall not exceed the greater of the following:

(i) the amount of gain recognized on the disposition (determined without regard to this section), increased as provided in subparagraph (B), or

(ii) the amount determined under subparagraph (C).

(B) Increase for certain stock.

With respect to any transaction, the increase provided by this subparagraph is the amount equal to the fair market value of any stock purchased in a corporation which (but for this paragraph) would result in nonrecognition of gain under section 1033(a)(3)(A).

(C) Adjustment where insufficient section 1250 property is acquired.

With respect to any transaction, the amount determined under this subparagraph shall be the excess of—

(i) the amount of gain which would (but for this paragraph) be taken into account under subsection (a), over

(ii) the fair market value (or cost in the case of a transaction described in section 1033(a)(3)) of the section 1250 property acquired in the transaction.

(D) Basis of property acquired.

In the case of property purchased by the taxpayer in a transaction described in section 1033(a)(3), in applying the last sentence of section 1033(c), such sentence shall be applied—

(i) first solely to section 1250 properties and to the amount of gain not taken into account under subsection (a) by reason of this paragraph, and

(ii) then to all purchased properties to which such sentence applies and to the remaining gain not recognized on the transaction as if the cost of the section 1250 properties were the basis of such properties computed under clause (i).

In the case of property acquired in any other transaction to which this paragraph applies, rules consistent with the preceding sentence shall be applied under regulations prescribed by the Secretary or his delegate.

(E) Additional depreciation with respect to property disposed of.

In the case of any transaction described in section 1031 or 1033, the additional depreciation in respect of the section 1250 property acquired which is attributable to the section 1250 property disposed of shall be an amount equal to the amount of the gain which was not taken into account under subsection (a) by reason of the application of this paragraph.

(5) Section 1071 and 1081 transactions.

Under regulations prescribed by the Secretary or his delegate, rules consistent with paragraphs (3) and (4) of this subsection and with subsections (e) and (f) shall apply in the case of transactions described in section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or section 1081 (relating to exchanges in obedience to SEC orders).

(6) Property distributed by a partnership to a partner.

(A) In general.

For purposes of this section, the basis of section 1250 property distributed by a partnership to a partner shall be deemed to be determined by reference to the adjusted basis of such property to the partnership.

(B) Additional depreciation.

In respect of any property described in subparagraph (A), the additional depreciation at-

tributable to periods before the distribution by the partnership shall be—

(i) the amount of the gain to which subsection (a) would have applied if such property had been sold by the partnership immediately before the distribution at its fair market value at such time and the applicable percentage for the property had been 100 percent, reduced by

(ii) if section 751(b) applied to any part of such gain, the amount of such gain to which section 751(b) would have applied if the applicable percentage for the property had been 100 percent.

(7) Disposition of principal residence.

Subsection (a) shall not apply to a disposition of—

(A) property to the extent used by the taxpayer as his principal residence (within the meaning of section 1034, relating to sale or exchange of residence), and

(B) property in respect of which the taxpayer meets the age and ownership requirements of section 121 (relating to gains from sale or exchange of residence of individual who has attained the age of 65) but only to the extent that he meets the use requirements of such section in respect of such property.

(8) Disposition of qualified low-income housing.

If section 1250 property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1039, then—

(A) Recognition limit.

The amount of gain recognized by the transferor under subsection (a) shall not exceed the greater of—

(i) the amount of gain recognized on the disposition (determined without regard to this section), or

(ii) the amount determined under subparagraph (B).

(B) Adjustment where insufficient section 1250 property is acquired.

With respect to any transaction, the amount determined under this subparagraph shall be the excess of—

(i) the amount of gain which would (but for this paragraph) be taken into account under subsection (a), over

(ii) the cost of the section 1250 property acquired in the transaction.

(C) Basis of property acquired.

The basis of property acquired by the taxpayer, determined under section 1039(d), shall be allocated—

(i) first to the section 1250 property described in subparagraph (E)(i), in the amount determined under such subparagraph, reduced by the amount of gain not recognized attributable to the section 1250 property disposed of,

(ii) then to any property (other than section 1250 property) to which section 1039 applies, in the amount of its cost, reduced by the amount of gain not recognized except to the extent taken into account under clause (i), and

(iii) then to the section 1250 property described in subparagraph (E)(ii), in the amount determined thereunder, reduced by the amount of gain not recognized except to the extent taken into account under classes (i) and (ii).

(D) Additional depreciation with respect to property disposed of.

The additional depreciation with respect to any property acquired shall include the additional depreciation with respect to the corresponding section 1250 property disposed of, reduced by the amount of gain recognized attributable to such property.

(E) Property consisting of more than one element.

There shall be treated as a separate element of section 1250 property—

(i) that portion of the section 1250 property acquired the cost of which does not exceed the net amount realized (as defined in section 1039(b)) attributable to the section 1250 property disposed of, reduced by the amount of gain recognized (if any) attributable to such property, and

(ii) that portion of the section 1250 property acquired the cost of which exceeds the net amount realized (as defined in section 1039(b)) attributable to the section 1250 property disposed of.

(F) Allocation rules.

For purposes of this paragraph—

(i) the amount of gain recognized attributable to the section 1250 property disposed of shall be the net amount realized wtih respect to such property, reduced by the greater of the adjusted basis of the section 1250 property disposed of or the cost of the section 1250 property acquired, but shall not exceed the gain recognized in the transaction, and

(ii) if any section 1250 property is treated as consisting of more than one element by reason of the application of subparagraph (E) to a prior transaction, then the amount of gain recognized, the net amount realized, and the additional depreciation, with respect to each such element shall be allocated in accordance with regulations prescribed by the Secretary or his delegate.

(e) Holding period.

For purposes of determining the applicable percentage under this section, the provisions of section 1223 shall not apply, and the holding period of section 1250 property shall be determined under the following rules:

(1) Beginning of holding period.

The holding period of section 1250 property shall be deemed to begin—

(A) in the case of property acquired by the taxpayer, on the day after the date of acquisition, or

(B) in the case of property constructed, reconstructed, or erected by the taxpayer, on the first day of the month during which the property is placed in service.

(2) Property with transferred basis.

If the basis of property acquired in a transaction described in paragraph (1), (2), (3), or (5) of subsection (d) is determined by reference to its basis in the hands of the transferor, then the holding period of the property in the hands of the transferee shall include the holding period of the property in the hands of the transferor.

(3) Principal residence.

If the basis of property acquired in a transaction described in paragraph (7) of subsection (d) is determined by reference to the basis in the hands of the taxpayer of other property, then the holding period of the property acquired shall include the holding period of such other property.

(4) Qualified low-income housing.

The holding period of any section 1250 property acquired which is described in subsection (d)(8)(E)(i) shall include the holding period of the corresponding element of section 1250 property disposed of.

(f) Special rules for property which is substantially improved.

(1) Amount treated as ordinary income.

If, in the case of a disposition of section 1250 property, the property is treated as consisting of more than one element by reason of paragraph (3), then the amount taken into account under subsection (a) in respect of such section 1250 property as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 shall be the sum of the amounts determined under paragraph (2).

(2) Ordinary income attributable to an element.

For purposes of paragraph (1), the amount taken into account for any element shall be the sum of—

(A) the amount (if any) determined by multiplying—

(i) the amount which bears the same ratio to the lower of the amounts specified in subparagraph (A) or (B) of subsection (a)(1) for the section 1250 property as the additional depreciation for such element attributable to periods after December 31, 1969, bears to the sum of the additional depreciation for all elements attributable to periods after December 31, 1969, by

(ii) the applicable percentage for such element, and

(B) the amount (if any) determined by multiplying—

(i) the amount which bears the same ratio to the lower of the amounts specified in subsection (a)(2)(A)(i) or (ii) for the section 1250 property as the additional depreciation for such element attributable to periods before January 1, 1970, bears to the sum of the additional depreciation for all elements attributable to periods before January 1, 1970, by

(ii) the applicable percentage for such element.

For purposes of this paragraph, determinations with respect to any element shall be made as if it were a separate property.

(3) Property consisting of more than one element.

In applying this subsection in the case of any section 1250 property, there shall be treated as a separate element—

(A) each separate improvement,

(B) if, before completion of section 1250 property, units thereof (as distinguished from improvements) were placed in service, each such unit of section 1250 property, and

(C) the remaining property which is not taken into account under subparagraphs (A) and (B).

(4) Property which is substantially improved.

For purposes of this subsection—

(A) In general.

The term "separate improvement" means each improvement added during the 36-month period ending on the last day of any taxable year to the capital account for the property, but only if the sum of the amounts added to such account during such period exceeds the greatest of—

(i) 25 percent of the adjusted basis of the property,

(ii) 10 percent of the adjusted basis of the property, determined without regard to the adjustments provided in paragraphs (2) and (3) of section 1016(a), or

(iii) $5,000.

For purposes of clauses (i) and (ii), the adjusted basis of the property shall be determined as of the beginning of the first day of such 36-month period, or of the holding period of the property (within the meaning of subsection (e)), whichever is the later.

(B) Exception.

Improvements in any taxable year shall be taken into account for purposes of subparagraph (A) only if the sum of the amounts added to the capital account for the property for such taxable year exceeds the greater of—

(i) $2,000, or

(ii) one percent of the adjusted basis referred to in subparagraph (A)(ii), determined, however, as of the beginning of such taxable year.

For purposes of this section, if the amount added to the capital account for any separate improvement does not exceed the greater of clause (i) or (ii), such improvement shall be treated as placed in service on the first day, of a calendar month, which is closest to the middle of the taxable year.

(C) Improvement.

The term "improvement" means, in the case of any section 1250 property, any addition to capital account for such property after the initial acquisition or after completion of the property.

(g) Special rules for qualified low-income housing.

(1) Amount treated as ordinary income.

If, in the case of a disposition of section 1250 property, the property is treated as consisting of more than one element by reason of the application of subsection (d)(8)(E), and gain is recognized in whole or in part, then the amount taken into account under subsection (a) as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 shall be the sum of the amounts determined under paragraph (2).

(2) Ordinary income attributable to an element.

For purposes of paragraph (1), the amount taken into account for any element shall be the amount determined by multiplying—

(A) the amount which bears the same ratio to the lower of the additional depreciation or the gain recognized for the section 1250 property disposed of as the additional depreciation for such element bears to the sum of the additional depreciation for all elements disposed of, by

(B) the applicable percentage for such element.

For purposes of this paragraph, determinations with respect to any element shall be made as if it were a separate property.

(h) Adjustments to basis.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (a).

(i) Application of section.

This section shall apply notwithstanding any other provision of this subtitle. (Added Pub. L. 88–272, title II, § 231(a), Feb. 26, 1964, 78 Stat. 100, and amended Pub. L. 91–172, title V, § 521 (b), (c), (e), title VII, § 704(b)(5), title IX, § 910(b), Dec. 30, 1969, 83 Stat. 652, 653, 670, 720.)

REFERENCES IN TEXT

Section 221(d)(3) of the National Housing Act, referred to in subsec. (a)(1)(C)(ii), is section 221(d)(3) of act June 27, 1934, ch. 847, title II, as amended June 30, 1961, Pub. L. 87–70, 75 Stat. 150, which is classified to section 1715*l*(d)(3) of Title 12, Banks and Banking.

Section 236 of the National Housing Act, referred to in subsec. (a)(1)(C)(ii), is section 236 of act June 27, 1934, ch. 847, title II as added Aug. 1. 1968, Pub. L. 90–448, 82 Stat. 498, which is classified to section 1715z–1 of Title 12, Banks and Banking.

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 521(b), modified the recapture rules pertaining to residential housing by allowing a 1 percent per month reduction in the amount to be recaptured as ordinary income after the property has been held for 100 full months, with other real property remaining subject to full recapture, applied the existing recapture rules where the sale of property was subject to a binding contract in existence prior to July 25, 1969, provided that changes in the recapture rules are not to apply in federally assisted projects (such as programs under section 221(d)(3) or 236 of the National Housing Act) or to other publicly assisted housing programs under which the return to the investor is limited on a comparable basis, thereby rendering these projects subject to a recapture of the depreciation in full if the sale occurs in the first 12 months and for a phaseout of the recapture of the excess of accelerated over straight-line depreciation after 20 months, the recapture being reduced at the rate of 1 percent per month until 120 months after which no recapture applies, with such recapture rules to continue to apply only with respect to such property constructed, reconstructed, or acquired before Jan. 1, 1975, and applied new recapture rules to depreciation attributable to periods after Dec. 31, 1969.

Subsec. (b). Pub. L. 91–172, § 512(c), added par. (4).

Subsec. (b)(3). Pub. L. 91–172, § 704(b)(5), inserted reference to sections 169 and 185 of this title.

Subsec. (d). Pub. L. 91–172, §§ 521(e)(1), 910(b)(1), substituted "subsection (a)" for "subsection (a)(1)" wherever it appears and added par. (8).

Subsec. (e). Pub. L. 91–172, § 910(b)(2), added par. (4).

Subsec. (f)(1). Pub. L. 91–172, § 521(e)(2)(A), substituted "subsection (a)" for "subsection (a)(1)".

Subsec. (f)(2). Pub. L. 91–172, § 521(e)(2)(B), redesignated subpars. (A) and (B) as cls. (i) and (ii) of subpar. (A), respectively, and, in such cls. (i) and (ii) as so redesignated, added reference to depreciation attributable to periods after Dec. 31, 1969, and added subpar. (B).

Subsec. (g). Pub. L. 91–172, § 910(b)(3), added subsec. (g). Former subsec. (g) redesignated (h).

Subsec. (h). Pub. L. 91–172, § 910(b)(3), redesignated former subsec. (g) as (h). Former subsec. (h) redesignated (i).

Subsec. (i). Pub. L. 91–172, § 910(b)(3), redesignated former subsec. (h) as (i).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by section 521 (b), (c), and (e) of Pub. L. 91–172 applicable with respect to taxable years ending after July 24, 1969, see section 521(g) of Pub. L. 91–172, set out as a note under section 167 of this title.

Amendment of section by section 704(b)(5) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1963, see section 704(c) of Pub. L. 91–172, set out as a note under section 169 of this title.

Amendment of section by section 910(b) of Pub. L. 91–172 applicable to approved dispositions of qualified housing projects after Oct. 9, 1969, see section 910(d) of Pub. L. 91–172, set out as a note under section 1039 of this title.

EFFECTIVE DATE

Section 231(c) of Pub. L. 88–272 provided that: "The amendments made by this section [adding this section, and amending section 170, 301, 312, 341, 453(d)(4), 751, and the analysis preceding section 1231 of this title] shall apply to dispositions after December 31, 1963, in taxable years ending after such date."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 57, 163, 167, 170, 301, 312, 341, 453, 751 of this title.

§ 1251. Gain from disposition of property used in farming where farm losses offset nonfarm income.

(a) Circumstances under which section applies.

This section shall apply with respect to any taxable year only if—

(1) there is a farm net loss for the taxable year, or

(2) there is a balance in the excess deductions account as of the close of the taxable year after applying subsection (b)(3)(A).

(b) Excess deductions account.

(1) Requirement.

Each taxpayer subject to this section shall, for purposes of this section, establish and maintain an excess deductions account.

(2) Additions to account.

(A) General rule.

There shall be added to the excess deductions account for each taxable year an amount equal to the farm net loss.

(B) Exceptions.

In the case of an individual (other than a trust) and, except as provided in this subparagraph, in the case of an electing small business corporation (as defined in section 1371(b)), subparagraph (A) shall apply for a taxable year—

(i) only if the taxpayer's nonfarm adjusted gross income for such year exceeds $50,000, and

(ii) only to the extent the taxpayer's farm net loss for such year exceeds $25,000.

This subparagraph shall not apply to an electing small business corporation for a taxable year if on any day of such year a shareholder of such corporation is an individual who, for his taxable year with which or within which the taxable year of the corporation ends, has a farm net loss.

(C) Married individuals.

In the case of a husband or wife who files a separate return, the amount specified in subparagraph (B)(i) shall be $25,000 in lieu of $50,000, and in subparagraph (B)(ii) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer does not have any nonfarm adjusted gross income for the taxable year.

(D) Nonfarm adjusted gross income.

For purposes of this section, the term "nonfarm adjusted gross income" means adjusted gross income (taxable income, in the case of an electing small business corporation) computed without regard to income or deductions attributable to the business of farming.

(3) Subtractions from account.

If there is any amount in the excess deductions account at the close of any taxable year (determined before any amount is subtracted under this paragraph for such year) there shall be subtracted from the account—

(A) an amount equal to the farm net income for such year, plus the amount (determined as provided in regulations prescribed by the Secretary or his delegate) necessary to adjust the account for deductions which did not result in a reduction of the taxpayer's tax under this subtitle for the taxable year or any preceding taxable year, and

(B) after applying paragraph (2) or subparagraph (A) of this paragraph (as the case may be), an amount equal to the sum of the amounts treated, solely by reason of the application of subsection (c), as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(4) Exception for taxpayers using certain accounting methods.

(A) General rule.

Except to the extent that the taxpayer has succeeded to an excess deductions account as provided in paragraph (5), additions to the excess deductions account shall not be required by a taxpayer who elects to compute taxable income from farming (i) by using inventories, and (ii) by charging to capital account all expenditures paid or incurred which are properly chargeable to capital account (including such expenditures which the taxpayer may, under this chapter or regulations prescribed thereunder, otherwise treat or elect to treat as expenditures which are not chargeable to capital account).

(B) Time, manner, and effect of election.

An election under subparagraph (A) for any taxable year shall be filed within the time prescribed by law (including extensions thereof) for filing the return for such taxable year, and shall be made and filed in such manner as the Secretary or his delegate shall prescribe by regulations. Such election shall be binding on the taxpayer for such taxable year and for all subsequent taxable years and may not be revoked except with the consent of the Secretary or his delegate.

(C) Change of method of accounting, etc.

If, in order to comply with the election made under subparagraph (A), a taxpayer changes his method of accounting in computing taxable income from the business of farming, such change shall be treated as having been made with the consent of the Secretary or his delegate and for purposes of section 481(a)(2) shall be treated as a change not initiated by the taxpayer.

(5) Transfer of account.

(A) Certain corporate transactions.

In the case of a transfer described in subsection (d)(3) to which section 371(a), 374(a), or 381 applies, the acquiring corporation shall succeed to and take into account as of the close of the day of distribution or transfer, the excess deductions account of the transferor.

(B) Certain gifts.

If—

(i) farm recapture property is disposed of by gift, and

(ii) the potential gain (as defined in subsection (e)(5)) on farm recapture property disposed of by gift during any one-year period in which any such gift occurs is more than 25 percent of the potential gain on farm recapture property held by the donor immediately prior to the first of such gifts.

each donee of the property shall succeed (at the time the first of such gifts is made, but in an amount determined as of the close of the donor's taxable year in which the first of such gifts is made) to the same proportion of the donor's excess deductions account (determined, after the application of paragraphs (2) and (3) with respect to the donor, as of the close of such taxable year), as the potential gain on the property received by such donee bears to the aggregate potential gain on farm recapture property held by the donor immediately prior to the first of such gifts.

(6) Joint return.

In the case of an addition to an excess deductions account for a taxable year for which a joint return was filed under section 6013, for any sub-

sequent taxable year for which a separate return was filed the Secretary or his delegate shall provide rules for allocating any remaining amount of such addition in a manner consistent with the purposes of this section.

(c) Ordinary income.

(1) General rule.

Except as otherwise provided in this section, if farm recapture property (as defined in subsection (e)(1)) is disposed of during a taxable year beginning after December 31, 1969, the amount by which—

(A) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(B) in the case of any other disposition, the fair market value of such property,

exceeds the adjusted basis of such property shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Limitation.

(A) Amount in excess deductions account.

The aggregate of the amounts treated under paragraph (1) as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 for any taxable year shall not exceed the amount in the excess deductions account at the close of the taxable year after applying subsection (b)(3)(A).

(B) Dispositions taken into account.

If the aggregate of the amounts to which paragraph (1) applies is limited by the application of subparagraph (A), paragraph (1) shall apply in respect of such dispositions (and in such amounts) as provided under regulations prescribed by the Secretary or his delegate.

(C) Special rule for dispositions of land.

In applying subparagraph (A), any gain on the sale or exchange of land shall be taken into account only to the extent of its potential gain (as defined in subsection (e)(5)).

(d) Exceptions and special rules.

(1) Gifts.

Subsection (c) shall not apply to a disposition by gift.

(2) Transfer at death.

Except as provided in section 691 (relating to income in respect of a decedent), subsection (c) shall not apply to a transfer at death.

(3) Certain corporate transactions.

If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of sections 332, 351, 361, 371(a), or 374(a), then the amount of gain taken into account by the transferor under subsection (c)(1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

(4) Like kind exchanges; involuntary conversion, etc.

If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (c)(1) shall not exceed the sum of—

(A) the amount of gain recognized on such disposition (determined without regard to this section), plus

(B) the fair market value of property acquired with respect to which no gain is recognized under subparagraph (A), but which is not farm recapture property.

(5) Partnerships.

(A) In general.

In the case of a partnership, each partner shall take into account separately his distributive share of the partnership's farm net losses, gains from dispositions of farm recapture property, and other items in applying this section to the partner.

(B) Transfers to partnerships.

If farm recapture property is contributed to a partnership and gain (determined without regard to this section) is not recognized under section 721, then the amount of gain taken into account by the transferor under subsection (c)(1) shall not exceed the excess of the fair market value of farm recapture property transferred over the fair market value of the partnership interest attributable to such property. If the partnership agreement provides for an allocation of gain to the contributing partner with respect to farm recapture property contributed to the partnership (as provided in section 704(c)(2)), the partnership interest of the contributing partner shall be deemed to be attributable to such property.

(6) Property transferred to controlled corporations.

Except for transactions described in subsection (b)(5)(A), in the case of a transfer, described in paragraph (3), of farm recapture property to a corporation, stock or securities received by a transferor in the exchange shall be farm recapture property to the extent attributable to the fair market value of farm recapture property (or, in the case of land, if less, the adjusted basis plus the potential gain (as defined in subsection (e)(5)) on farm recapture property) contributed to the corporation by such transferor.

(e) Definitions.

For purposes of this section—

(1) Farm recapture property.

The term "farm recapture property" means—

(A) any property (other than section 1250 property) described in paragraph (1) (relating to business property held for more than 6 months), (3) (relating to livestock), or (4) (relating to an unharvested crop) of section

1231(b) which is or has been used in the trade or business of farming by the taxpayer or by a transferor in a transaction described in subsection (b)(5), and

(B) any property the basis of which in the hands of the taxpayer is determined with reference to the adjusted basis of property which was farm recapture property in the hands of the taxpayer within the meaning of subparagraph (A).

(2) Farm net loss.

The term "farm net loss" means the amount by which—

(A) the deductions allowed or allowable by this chapter which are directly connected with the carrying on of the trade or business of farming, exceed

(B) the gross income derived from such trade or business.

Gains and losses on the disposition of farm recapture property referred to in section 1231(a) (determined without regard to this section or section 1245(a)) shall not be taken into account.

(3) Farm net income.

The term "farm net income" means the amount by which the amount referred to in paragraph (2)(B) exceeds the amount referred to in paragraph (2)(A).

(4) Trade or business of farming.

(A) Horse racing.

In the case of a taxpayer engaged in the raising of horses, the term "trade or business of farming" includes the racing of horses.

(B) Several businesses of farming.

If a taxpayer is engaged in more than one trade or business of farming, all such trades and businesses shall be treated as one trade or business.

(5) Potential gain.

The term "potential gain" means an amount equal to the excess of the fair market value of property over its adjusted basis, but limited in the case of land to the extent of the deductions allowable in respect to such land under sections 175 (relating to soil and water conservation expenditures) and 182 (relating to expenditures by farmers for clearing land) for the taxable year and the 4 preceding taxable years.

(Added Pub. L. 91–172, title II, § 211(a), Dec. 30, 1969, 83 Stat. 566.)

EFFECTIVE DATE

Section 211(c) of Pub. L. 91–172 provided that: "The amendments made by this section [adding this section and amending sections 301 (b), (d)(2), 312(c)(3), 341(e)(12), 453(d)(4)(B), and 751(c) of this title] shall apply to taxable years beginning after December 31, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 301, 312, 341, 453, 751, 1252 of this title.

§ 1252. Gain from disposition of farm land.

(a) General rule.

(1) Ordinary income.

Except as otherwise provided in this section, if farm land which the taxpayer has held for less than 10 years is disposed of during a taxable year beginning after December 31, 1969, the lower of—

(A) the applicable percentage of the aggregate of the deductions allowed under sections 175 (relating to soil and water conservation expenditures) and 182 (relating to expenditures by farmers for clearing land) for expenditures made by the taxpayer after December 31, 1969, with respect to the farm land or

(B) the excess of—

(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of the farm land (in the case of any other disposition), over

(ii) the adjusted basis of such land,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle, except that this section shall not apply to the extent section 1251 applies to such gain.

(2) Farm land.

For purposes of this section, the term "farm land" means any land with respect to which deductions have been allowed under sections 175 (relating to soil and water conservation expenditures) or 182 (relating to expenditures by farmers for clearing land).

(3) Applicable percentage.

For purposes of this section—

If the farm land is disposed of—	The applicable percentage is—
Within 5 years after the date it was acquired	100 percent.
Within the sixth year after it was acquired	80 percent.
Within the seventh year after it was acquired.	60 percent.
Within the eighth year after it was acquired	40 percent.
Within the ninth year after it was acquired	20 percent.
10 years or more years after it was acquired	0 percent.

(b) Special rules.

Under regulations prescribed by the Secretary or his delegate, rules similar to the rules of section 1245 shall be applied for purposes of this section. (Added Pub. L. 91–172, title II, § 214(a), Dec. 30, 1969, 83 Stat. 572.)

EFFECTIVE DATE

Section 214(c) of Pub. L. 91–172 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1969."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 170, 301, 312, 341, 453, 751 of this title.

§ 1253. Transfers of franchises, trademarks, and trade names.

(a) General rule.

A transfer of a franchise, trademark, or trade name shall not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest with respect to the subject matter of the franchise, trademark, or trade name.

(b) Definitions.

For purposes of this section—

(1) Franchise.

The term "franchise" includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area.

(2) Significant power, right, or continuing interest.

The term "significant power, right, or continuing interest" includes, but is not limited to, the following rights with respect to the interest transferred:

(A) A right to disapprove any assignment of such interest, or any part thereof.

(B) A right to terminate at will.

(C) A right to prescribe the standards of quality of products used or sold, or of services furnished, and of the equipment and facilities used to promote such products or services.

(D) A right to require that the transferee sell or advertise only products or services of the transferor.

(E) A right to require that the transferee purchase substantially all of his supplies and equipment from the transferor.

(F) A right to payments contingent on the productivity, use, or disposition of the subject matter of the interest transferred, if such payments constitute a substantial element under the transfer agreement.

(3) Transfer.

The term "transfer" includes the renewal of a franchise, trademark, or trade name.

(c) Treatment of contingent payments by transferor.

Amounts received or accrued on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name which are contingent on the productivity, use, or disposition of the franchise, trademark, or trade name transferred shall be treated as amounts received or accrued from the sale or other disposition of property which is not a capital asset.

(d) Treatment of payments by transferee.

(1) Contingent payments.

Amounts paid or incurred during the taxable year on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name which are contingent on the productivity, use, or disposition of the franchise, trademark, or trade name transferred shall be allowed as a deduction under section 162(a) (relating to trade or business expenses).

(2) Other payments.

If a transfer of a franchise, trademark, or trade name is not (by reason of the application of subsection (a)) treated as a sale or exchange of a capital asset, any payment not described in paragraph (1) which is made in discharge of a principal sum agreed upon in the transfer agreement shall be allowed as a deduction—

(A) in the case of a single payment made in discharge of such principal sum, ratably over the taxable years in the period beginning with the taxable year in which the payment is made and ending with the ninth succeeding taxable year or ending with the last taxable year beginning in the period of the transfer agreement, whichever period is shorter;

(B) in the case of a payment which is one of a series of approximately equal payments made in discharge of such principal sum, which are payable over—

(i) the period of the transfer agreement, or

(ii) a period of more than 10 taxable years,

whether ending before or after the end of the period of the transfer agreement,

in the taxable year in which the payment is made; and

(C) in the case of any other payment, in the taxable year or years specified in regulations prescribed by the Secretary or his delegate, consistently with the preceding provisions of this paragraph.

(e) Exception.

This section shall not apply to the transfer of a franchise to engage in professional football, basketball, baseball, or other professional sport. (Added Pub. L. 91–172, title V, § 516(c)(1), Dec. 30, 1969, 83 Stat. 647.)

EFFECTIVE DATE

Section applicable to transfers after Dec. 31, 1969, except that subsec. (d)(1) shall, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate may by regulations prescribe), apply to transfers before Jan. 1, 1970, but only with respect to payments made in taxable years ending after Dec. 31, 1969, and beginning before Jan. 1, 1980, see section 516(d)(3) of Pub. L. 91–172, set out as a note under section 1001 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1016 of this title.

Subchapter Q.—Readjustment of Tax Between Years and Special Limitations

Part

I. Income averaging.
II. Mitigation of effect of limitations and other provisions.
III. Involuntary liquidation and replacement of LIFO inventories.
IV. War loss recoveries.
V. Claim of right.
VI. Other limitations.
VII. Recoveries of foreign expropriation losses.

AMENDMENTS

1966—Pub. L. 89-384, § 1(g)(1), Apr. 8, 1966, 80 Stat. 104, added item VII.

1964—Pub. L. 88-272, title II, § 232(f)(3), Feb. 26, 1964, 78 Stat. 112, substituted "averaging" for "attributable to several taxable years" in the heading to Part I.

PART I.—INCOME AVERAGING

Sec.

1301. Limitation on tax.
1302. Definition of averagable income; related definitions.
1303. Eligible individuals.
1304. Special rules.
1305. Regulations.

§ 1301. Limitation on tax.

If an eligible individual has averagable income for the computation year, and if the amount of such income exceeds $3,000, then the tax imposed by section 1 for the computation year which is attributable to averagable income shall be 5 times the

increase in tax under such section which would result from adding 20 percent of such income to 120 percent of average base period income. (Added Pub. L. 88–272, title II, § 232(a) Feb. 26, 1964, 78 Stat. 106, and amended Pub. L. 91–172, title III § 311(a), Dec. 30, 1969, 83 Stat. 586.)

CODIFICATION

A prior section 1301, act Aug. 16, 1954, ch. 736, 68A Stat. 334, related to compensation from an employment, defined "an employment" and stated the rule with respect to partners. See Effective Date note set out under this section.

AMENDMENTS

1969—Pub. L. 91–172 substituted "20 percent of such income to 120 percent of average base period income" for "20 percent of such income to the sum of—

"(1) 133⅓ percent of average base period income, and

"(2) the amount (if any) of the average base period capital gain net income."

EFFECTIVE DATE OF 1969 AMENDMENT

Section 311(e) of Pub. L. 91–172 provided that: "The amendments made by this section [to this section and sections 1302, 1303(c)(2), 1304(b)(5), (6), (c)-(g) and 6511(d)(2)(B) of this title] shall apply with respect to computation years (within the meaning of section 1302(c)(1) of the Internal Revenue Code of 1954) beginning after December 31, 1969, and to base period years (within the meaning of section 1302(c)(3) of such Code) applicable to such computation years."

EFFECTIVE DATE

Section 232(g) of Pub. L. 88–272 provided that:

"(1) *General rule.*—Except as provided in paragraph (2), the amendments made by this section [adding sections 1301–1305, amending sections 4, 5, 72, 144, 402, 403, 6511, and omitting former sections 1301–1307 of this title] shall apply with respect to taxable years beginning after December 31, 1963.

"(2) *Income from an employment.*—If, in a taxable year beginning after December 31, 1963, an individual or partnership receives or accrues compensation from an employment (as defined by section 1301(b) of the Internal Revenue Code of 1954 as in effect immediately before the enactment of this Act [Feb. 26, 1964] and the employment began before February 6, 1963, the tax attributable to such compensation may, at the election of the taxpayer, be computed under the provisions of sections 1301 and 1307 of such Code as in effect immediately before the enactment of this Act. If a taxpayer so elects (at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes), he may not choose for such taxable year the benefits provided by part I of subchapter Q of chapter 1 of such Code (relating to income averaging) as amended by this Act and (if he elects to have subsection (e) of such section 1307 apply) section 170(b)(5) of such Code as amended by this Act shall not apply to charitable contributions paid in such taxable year.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 5, 1301 of this title.

§ 1302. Definition of averagable income; related definitions.

(a) Averagable income.

(1) In general.

For purposes of this part, the term "averagable income" means the amount by which taxable income for the computation year (reduced as provided in paragraph (2)) exceeds 120 percent of average base period income.

(2) Reductions.

The taxable income for the computation year shall be reduced by—

(A) the amount (if any) to which section 72(m)(5) applies, and

(B) the amounts included in the income of a beneficiary of a trust under section 668(a).

(b) Average base period income.

For purposes of this part—

(1) In general.

The term "average base period income" means one-fourth of the sum of the base period incomes for the base period.

(2) Base period income.

The base period income for any taxable year is the taxable income for such year—

(A) increased by an amount equal to the excess of—

(i) the amount excluded from gross income under section 911 (relating to earned income from sources without the United States) and subpart D of part III of subchapter N (sec. 931 and following, relating to income from sources within possessions of the United States), over

(ii) the deductions which would have been properly allocable to or chargeable against such amount but for the exclusion of such amount from gross income; and

(B) decreased by the amounts included in the income of a beneficiary of a trust under section 668(a).

(c) Other related definitions.

For purposes of this part—

(1) Computation year.

The term "computation year" means the taxable year for which the taxpayer chooses the benefits of this part.

(2) Base period.

The term "base period" means the 4 taxable years immediately preceding the computation year.

(3) Base period year.

The term "base period year" means any of the 4 taxable years immediately preceding the computation year.

(4) Joint return.

The term "joint return" means the return of a husband and wife made under section 6013.

(Added Pub. L. 88–272, title II, § 232(a), Feb. 26, 1964, 78 Stat. 106, and amended Pub. L. 91–172, title III, § 311(b), Dec. 30, 1969, 83 Stat. 586.)

CODIFICATION

A prior section 1302, act Aug. 16, 1964, ch. 736, 68A Stat. 335, related to income from an invention or artistic work.

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172 substituted in par. (1) "amount by which taxable income for the computation year (reduced as provided in paragraph (2)) exceeds 120 percent of average base period income" for "amount (if any) by which adjusted taxable income exceeds 133⅓ percent of average base period income" and substituted in par. (2) provisions respecting reductions for prior provisions for adjustment in certain cases for capital gains.

Subsec. (b). Pub. L. 91–172, in redesignating former subsec. (c) as (b), reenacted par. (1) and amended par. (2), eliminating "first increased and then decreased (but

not below zero) in the following order" following "such year" in the introductory text, eliminating "Taxable income shall be" preceding "increased" in subpar. (A), substituting subpar. (B) reading "decreased by the amounts included in the income of a beneficiary of a trust under section 668(a)" for "Taxable income shall be decreased by the capital gain net income", and eliminating subpar. (C) reading "If the decrease provided by paragraph (2) of subsection (b) applies to the computation year, the taxable income shall be decreased under the rules of such paragraph (2) (other than the limitation contained in subparagraph (C) thereof)." Former subsec. (b) defined "adjusted taxable income" as the taxable income decreased by capital gain net income for the computation year in former par. (1); income attributable to gifts, bequests, etc., in former par. (2), subpar. (A) prescribing the general rule, subpar. (B) amount of net income, subpar. (C) limitation provision, and subpar. (D) net income provision; wagering income in former par. (3) and certain amounts received by owner-employees in former par. (4).

Subsec. (c). Pub. L. 91–172 redesignated former subsec. (e) as (c). Former subsec. (c) was redesignated (b).

Subsec. (d). Pub. L. 91–172, in the general amendment of this section, eliminated definition in former par. (1) of "capital gain net income" and in former par. (2) of "average base period capital gain net income."

Subsec. (e). Pub. L. 91–172 redesignated former subsec. (e) as (c).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by Pub. L. 91–172 applicable with respect to computation years (within the meaning of subsec. (c)(1) of this section) beginning after Dec. 31, 1969, and to base period years (within the meaning of subsec. (c)(3) of this section) applicable to such computation years, see section 311(e) of Pub. L. 91–172, set out as a note under section 1301 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 6511 of this title.

§ 1303. Eligible individuals.

(a) General rule.

Except as otherwise provided in this section, for purposes of this part the term "eligible individual" means any individual who is a citizen or resident of the United States throughout the computation year.

(b) Nonresident alien individuals.

For purposes of this part, an individual shall not be an eligible individual for the computation year if, at any time during such year or the base period, such individual was a nonresident alien.

(c) Individuals receiving support from others.

(1) In general.

For purposes of this part, an individual shall not be an eligible individual for the computation year if, for any base period year, such individual (and his spouse) furnished less than one-half of his support.

(2) Exceptions.

Paragraph (1) shall not apply to any computation year if—

(A) such year ends after the individual attained the age of 25 and, during at least 4 of his taxable years beginning after he attained age 21 and ending with his computation year, he was not a full-time student,

(B) more than one-half of the individual's taxable income for the computation year is attributable to work performed by him in substantial part during 2 or more of the base period years, or

(C) the individual makes a joint return for the computation year and not more than 25 percent of the aggregate adjusted gross income of such individual and his spouse for the computation year is attributable to such individual.

In applying subparagraph (C), amounts which constitute earned income (within the meaning of section 911(b)) and are community income under community property laws applicable to such income shall be taken into account as if such amounts did not constitute community income.

(d) Student defined.

For purposes of this section, the term "student" means, with respect to a taxable year, an individual who during each of 5 calendar months during such taxable year—

(1) was a full-time student at an educational institution (as defined in section 151(e)(4)); or

(2) was pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution (as defined in section 151(e)(4)) or of a State or political subdivision of a State.

(Added Pub. L. 88–272, title II, § 232(a), Feb. 26, 1964, 78 Stat. 107, and amended Pub. L. 91–172, title III, § 311(d)(1), Dec. 30, 1969, 83 Stat. 587.)

CODIFICATION

A prior section 1303, acts Aug. 16, 1954, ch. 736, 68A Stat. 335, Sept. 22, 1961, Pub. L. 87–293, title II, § 201(b), 75 Stat. 625, related to income from back pay.

AMENDMENTS

1969—Subsec. (c)(2)(B). Pub. L. 91–172 struck out "adjusted" preceding "taxable income".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by Pub. L. 91–172 applicable with respect to computation years (within the meaning of section 1302(c)(1) of this title) beginning after Dec. 31, 1969, and to base period years (within the meaning of section 1302(c)(3) of this title) applicable to such computation years, see section 311(e) of Pub. L. 91–172, set out as a note under section 1301 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

REPEALS; AMENDMENTS AND APPLICATION OF AMENDMENTS UNAFFECTED

Section 201(b) of Pub. L. 87–293 repealed by Pub. L. 89–572, § 5(a), Sept. 13, 1966, 80 Stat. 765. Such repeal not deemed to affect amendments to this section contained in such provisions, and continuation in full force and effect until modified by appropriate authority of all determinations, authorization, regulations, orders, contracts, agreements, and other actions issued, undertaken, or entered into under authority of the repealed provisions, see section 5(b) of Pub. L. 89–572, set out as a note under former section 2515 of Title 22, Foreign Relations and Intercourse.

§ 1304. Special rules.

(a) Taxpayer must choose benefits.

This part shall apply to the taxable year only if the taxpayer chooses to have the benefits of this part for such taxable year. Such choice may be made or

changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for the taxable year.

(b) Certain provisions inapplicable.

If the taxpayer chooses the benefits of this part for the taxable year, the following provisions shall not appiy to him for such year:

(1) section 3 (relating to optional tax),

(2) section 72(n)(2) (relating to limitation of tax in case of total distribution),

(3) section 911 (relating to earned income from sources without the United States),

(4) subpart D of part III of subchapter N (sec. 931 and following, relating to Income from sources within possessions of the United States),

(5) section 1201(b) (relating to alternative capital gains tax), and

(6) section 1348 (relating to 50-percent maximum rate on earned income).

(c) Failure or certain married individuals to make joint return, etc.

(1) Application of subsection.

Paragraphs (2) and (3) of this subsection shall apply in the case of any individual who was married for any base period year or the computation year; except that—

(A) such paragraphs shall not apply in respect of a base period year if—

(i) such individual and his spouse make a joint return, or such individual makes a return as a surviving spouse (as defined in section 2(b)), for the computation year, and

(ii) such individual was not married to any other spouse for such base period year, and

(B) paragraph (3) shall not apply in respect of the computation year If the individual and hls spouse make a joint return for such year.

(2) Minimum base period income.

For purposes of this part, the base period income of an individual for any base period year shall not be less than 50 percent of the base period income which would result from combining his income and deductions for such year—

(A) with the income and deductions for such year of the individual who is his spouse for the computation year, or

(B) if greater, with the income and deductions for such year of the individual who was his spouse for such base period year.

(3) Community income attributable to services.

In the case of amounts which constitute earned income (within the meaning of section 911(b)) and are community income under community property laws applicable to such income—

(A) the amount taken into account for any base period year for purposes of determining base period income shall not be less than the amount which would be taken into account if such amounts did not constitute community income, and

(B) the amount taken into account for purposes of determining taxable income for the computation year shall not exceed the amount which would be taken into account if such amounts did not constitute community income.

(4) Marital status.

For purposes of this subsection, section 143(a) shall apply in determining whether an individual is married for any taxable year.

(d) Dollar limitations in case of joint returns.

In the case of a joint return, the $3,000 figure contained in section 1301 shall be applied to the aggregate averagable income.

(e) Treatment of certain other items.

(1) Section 72(m)(5).

Section 72(m)(5) (relating to penalties applicable to certain amounts received by owner-employees) shall be applied as if this part had not been enacted.

(2) Other items.

Except as otherwise provided in this part, the order and manner in which items of income or limitations on tax shall be taken into account in computing the tax imposed by this chapter on the income of any eligible individual to whom section 1301 applies for any computation year shall be determined under regulations prescribed by the Secretary or his delegate.

(f) Short taxable years.

In the case of any computation year or base period year which is a short taxable year, this part shall be applied in the manner provided in regulations prescribed by the Secretary or his delegate. (Added Pub. L. 88–272, title II, § 232(a), Feb. 26, 1964, 78 Stat. 108, and amended Pub. L. 91–172, title III, § 311(c), (d)(2), title V, § 515(c)(4), title VIII, §§ 802(c)(5), 803(d)(8), Dec. 30, 1969, 83 Stat. 587, 646, 678, 684.)

CODIFICATION

A prior section 1304, act Aug. 11, 1965, ch. 804, § 1(a), 69 Stat. 688, related to compensatory damages for patent infringement.

AMENDMENTS

1969—Subsec. (b)(1). Pub, L. 91–172, § 803(d)(8), struck out "if adjusted gross income is less than $5,000" in the parenthetical material.

Subsec. (b)(2). Pub. L. 91–172, § 515(c)(4), substituted "(relating to limitation of tax in case of total distribution)" for "(relating to limitation of tax in case of certain distributions with respect to contributions by self employed indlviduals)."

Subsec. (b)(5), (6). Pub. L. 91–172, § 311(c), added pars. (5) and (6).

Subsec. (c)(1). Pub. L. 91–172, § 311(d)(2)(B), (C), deleted reference to par. (4) in the text preceding subpar. (A) and substituted par. "3" for "4" in subpar. (B), respectively.

Subsec. (c)(3) to (5). Pub. L. 91–172, § 311(d)(2)(A), (D), struck out par. (3) describing minimum base period capital gain net income and redesignated former pars. (4) and (5) as (3) and (4), and struck out in subpar. (B) of redesignated par. (3) "adjusted" preceding "taxable income", respectively.

Subsec. (c)(4). Pub. L. 91–172, § 802(c)(5), substituted reference to section 143(a) for reference to section 143.

Subsec. (d). Pub. L. 91–172, § 311(d)(2)(E), struck out ", and the $3,000 figure contained in section 1302(b)(2)(C) shall be applied to the aggregate net income" following "aggregate averagable income".

Subsec. (e). Pub. L. 91–172, § 311(d)(2)(F), redesignated former subsec. (f) as (e), deleting former par. (1) provisions respecting treatment of gift or wagering income and redesignating former pars. (2) and (3) as (1) and (2), respectively, and struck out former subsec. (e) which prescribed special rules where there are capital gains, providing in former par. (1) for treatment of capital gains in computation year and in former par. (2) for computation of alternative tax.

Subsec. (f). Pub. L. 91–172, § 311(d)(2)(G), redesignated former subsec. (g) as (f). Former subsec. (f) redesignated (e).

Subsec. (g). Pub. L. 91–172, § 311(d)(2)(G), redesignated subsec. (g) as (f).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of subsec. (b)(1) by section 803(d)(8) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

Amendment of subsec (b)(2) by section 515(c)(4) of Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 515(d) of Pub. L. 91–172, set out as a note under section 402 of this title.

Amendment of subsecs. (b)(5), (6) and (c) to (g) of this section by section 311(c), (d)(2) of Pub. L. 91–172 applicable with respect to computation years (within the meaning of section 1302(c)(1) of this title) beginning after Dec. 31, 1969, and to base period years (within the meaning of section 1302(c)(3) of this title) applicable to such computation years, see section 311(e) of Pub. L. 91–172, set out as a note under section 1301 of this title.

Amendment of subsec. (c)(4) of this section by section 802(c)(5) of Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1969, see section 802(d) of Pub. L. 91–172, set out as a note under section 4 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

§ 1305. Regulations.

The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this part. (Added Pub. L. 88–272, title II, § 232(a), Feb. 26, 1964, 78 Stat. 110.)

CODIFICATION

A prior section 1305, act Aug. 26, 1957, Pub. L. 85–165, § 1, 71 Stat. 413, related to damages for breach of contract or fiduciary duty.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Dec. 31, 1963, see section 232(g) of Pub. L. 88–272, set out as a note under section 1301 of this title.

PART II.—MITIGATION OF EFFECT OF LIMITATIONS AND OTHER PROVISIONS

Sec.
1311. Correction of error.
1312. Circumstances of adjustment.
1313. Definitions.
1314. Amount and method of adjustment.
1315. Effective date.

§ 1311. Correction of error.

(a) General rule.

If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) Conditions necessary for adjustment.

(1) Maintenance of an inconsistent position.

Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if—

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary or his delegate, or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made,

and the position maintained by the Secretary or his delegate in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

(2) Correction not barred at time of erroneous action.

(A) Determination described in section 1312 (3)(B).

In the case of a determination described in section 1312 (3)(B) (relating to certain exclusions from income), adjustment shall be made under this part only if assessment of a deficiency for the taxable year in which the item is includible or against the related taxpayer was not barred, by any law or rule of law, at the time the Secretary or his delegate first maintained, in a notice of deficiency sent pursuant to section 6212 or before the Tax Court of the United States, that the item described in section 1312 (3)(B) should be included in the gross income of the taxpayer for the taxable year to which the determination relates.

(B) Determination described in section 1312 (4).

In the case of a determination described in section 1312 (4) (relating to disallowance of certain deductions and credits), adjustment shall be made under this part only if credit or refund of the overpayment attributable to the deduction or credit described in such section which should have been allowed to the taxpayer or related taxpayer was not barred, by any law or rule of law, at the time the taxpayer first maintained before the Secretary or his delegate or before the Tax Court of the United States, in writing, that he was entitled to such deduction or credit for the taxable year to which the determination relates.

(3) Existence of relationship.

In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312 (3)(B)), the adjustment shall not be made

with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court of the United States for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(Aug. 16, 1954, ch. 736, 68A Stat. 337.)

CROSS REFERENCES

Mitigation of effect of renegotiation of government contracts, see section 1481 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1312, 1314, 1481 of this title.

§ 1312. Circumstances of adjustment.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

(1) Donble inclusion of an item of gross income.

The determination requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

(2) Double allowance of a deduction or credit.

The determination allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer.

(3) Double exclusion of an item of gross income.

(A) Items included in income.

The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer; or

(B) Items not included in income.

The determination requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

(4) Double disallowance of a deduction or credit.

The determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer.

(5) Correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs.

The determination allows or disallows any of the additional deductions allowable in computing the taxable income of estates or trusts, or requires or denies any of the inclusions in the computation of taxable income of beneficiaries, heirs, or legatees, specified in subparts A to E, inclusive (secs. 641 and following, relating to estates, trusts, and beneficiaries) of part I of subchapter J of this chapter, or corresponding provisions of prior internal revenue laws, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer.

(6) Correlative deductions and credits for certain related corporations.

The determination allows or disallows a deduction (including a credit) in computing the taxable income (or, as the case may be, net income, normal tax net income, or surtax net income) of a corporation, and a correlative deduction or credit has been erroneously allowed, omitted, or disallowed, as the case may be, in respect of a related taxpayer described in section 1313 (c) (7).

(7) Basis of property after erroneous treatment of a prior transaction.

(A) General rule.

The determination determines the basis of property, and in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis, there occurred, with respect to a taxpayer described in subparagraph (B) of this paragraph, any of the errors described in subparagraph (C) of this paragraph.

(B) Taxpayers with respect to whom the erroneous treatment occurred.

The taxpayer with respect to whom the erroneous treatment occurred must be—

(i) the taxpayer with respect to whom the determination is made,

(ii) a taxpayer who acquired title to the property in the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, or

(iii) a taxpayer who had title to the property at the time of the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015 (a) (relating to the basis of property acquired by gift).

(C) Prior erroneous treatment.

With respect to a taxpayer described in subparagraph (B) of this paragraph—

(i) there was an erroneous inclusion in, or omission from, gross income,

(ii) there was an erroneous recognition, or nonrecognition, of gain or loss, or

(iii) there was an erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible.

(Aug. 16, 1954, ch. 736, 68A Stat. 338; Sept. 2, 1958, Pub. L. 85-866, title I, § 59 (a), 72 Stat. 1647.)

AMENDMENTS

1958—Par. (6) Pub. L. 85-866 added par. (6) and redesignated former par. (6) as (7).

Par. (7). Pub. L. 85-866 redesignated former par. (6) as (7).

EFFECTIVE DATE OF 1958 AMENDMENT

Section 59 (c) of Pub. L. 85-866 provided that: "The amendments made by subsections (a) and (b) [to pars. (6) and (7) of this section and section 1314 (c) of this title] shall apply to determinations (as defined in section 1313 (a)) made after November 14, 1954."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1311, 1333 of this title.

§ 1313. Definitions.

(a) Determination.

For purposes of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement made under section 7121;

(3) a final disposition by the Secretary or his delegate of a claim for refund. For purposes of this part, a claim for refund shall be deemed finally disposed of by the Secretary or his delegate—

(A) as to items with respect to which the claim was allowed, on the date of allowance of refund or credit or on the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(B) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Secretary or his delegate in reduction of the refund or credit, on expiration of the time for instituting suit with respect thereto (unless suit is instituted before the expiration of such time); or

(4) under regulations prescribed by the Secretary or his delegate, an agreement for purposes of this part, signed by the Secretary or his delegate and by any person, relating to the liability of such person (or the person for whom he acts) in respect of a tax under this subtitle for any taxable period.

(b) Taxpayer.

Notwithstanding section 7701 (a) (14), the term "taxpayer" means any person subject to a tax under the applicable revenue law.

(c) Related taxpayer.

For purposes of this part, the term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

(1) husband and wife,

(2) grantor and fiduciary,

(3) grantor and beneficiary,

(4) fiduciary and beneficiary, legatee, or heir,

(5) decedent and decedent's estate,

(6) partner, or

(7) member of an affiliated group of corporations (as defined in section 1504).

(Aug. 16, 1954, ch. 736, 68A Stat. 339.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1312, 1314, 1315 of this title.

§ 1314. Amount and method of adjustment.

(a) Ascertainment of amount of adjustment.

In computing the amount of an adjustment under this part there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be the excess of—

(1) the sum of—

(A) the amount shown as the tax by the taxpayer on his return (determined as provided in section 6211 (b) (1), (3), and (4), relating to the definition of deficiency), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in section 6211 (b) (2), made.

There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle). A similar computation shall be made for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryback or carryover (as defined in section 1212), determined with reference to the taxable year with respect to which the error was made. The amount so ascertained (together with any amounts wrongfully collected as additions to the tax or interest, as a result of such error) for each taxable year shall be the amount of the adjustment for that taxable year.

(b) Method of adjustment.

The adjustment authorized in section 1311 (a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year or years. If, as a result of a determination described in section 1313 (a) (4), an adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be redetermined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such redetermination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss or net capital loss which is carried back to the year of adjustment, interest shall not be collected or paid

for any period prior to the close of the taxable year in which the net operating loss or net capital loss arises.

(c) Adjustment unaffected by other items.

The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment. The amount of the adjustment under this part, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item other than the one which was the subject of the adjustment.

(d) Periods for which adjustments may be made.

No adjustment shall be made under this part in respect of any taxable year beginning prior to January 1, 1932.

(e) Taxes imposed by subtitle C.

This part shall not apply to any tax imposed by subtitle C (sec. 3101 and following relating to employment taxes). (Aug. 16, 1954, ch. 736, 68A Stat. 340; Sept. 2, 1958, Pub. L. 85–866, title I, § 59(b), 72 Stat. 1647; June 21, 1965, Pub. L. 89–44, title VIII, § 809(d)(5)(B), 79 Stat. 168; Dec. 30, 1969, Pub. L. 91–172, title V, § 512(f)(7), (8), 83 Stat. 641, 642.)

AMENDMENTS

1969—Subsec. (a). Pub. L. 91–172, § 512(f)(7), substituted "capital loss carryback or carryover" for "capital loss carryover."

Subsec. (b). Pub. L. 91–172, § 512(f)(8), added reference to net capital loss.

1965—Subsec. (a)(1)(A). Pub. L. 89–44 struck out "(b) (1) and (3)" and inserted in lieu thereof "(b) (1), (3), and (4)".

1958—Subsec. (c). Pub. L. 85–866 substituted in the second sentence "The" for "Other than in the case of an adjustment resulting from a determination under section 1313 (a) (4), the".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by Pub. L. 91–172 applicable with respect to net capital losses sustained in taxable years beginning after Dec. 31, 1969, see section 512(g) of Pub. L. 91–172, set out as a note under section 1212 of this title.

EFFECTIVE DATE OF 1965 AMENDMENT

Amendment of subsec. (a)(1)(A) by Pub. L. 89–44 applicable to taxable years beginning on or after July 1, 1965, see section 809(f) of Pub. L. 89–44, set out as a note under section 6420 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment by Pub. L. 85–866 effective with respect to determinations made after Nov. 14, 1954, see note set out under section 1312 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 481, 1311, 1333, 1351, 6164, 6411 of this title.

§ 1315. Effective date.

(a) In general.

This part shall apply only to determinations (as defined in section 1313 (a)) made after the 90th day after the date of enactment of this title.

(b) Transitional provision.

Notwithstanding any other provision of this title, section 3801 of the Internal Revenue Code of 1939 shall apply to determinations (as defined in subsection (a) of such section) made on or before such 90th day as if this title had not been enacted. (Aug. 16, 1954, ch. 736, 68A Stat. 341.)

PART III.—INVOLUNTARY LIQUIDATION AND REPLACEMENT OF LIFO INVENTORIES

Sec.
1321. Involuntary liquidation of LIFO inventories.

§ 1321. Involuntary liquidation of LIFO inventories.

(a) Adjustment of taxable income and resulting tax.

If, for any taxable year ending after June 30, 1950, and before January 1, 1955, the closing inventory of a taxpayer inventorying goods under the method provided in section 22 (d) of the Internal Revenue Code of 1939 reflects a decrease from the opening inventory of such goods for such year, and if the taxpayer elects, at such time and in such manner and subject to such regulations as the Secretary or his delegate may prescribe, to have this section apply, and if it is established to the satisfaction of the Secretary or his delegate, in accordance with such regulations, that such decrease is attributable to the involuntary liquidation of such inventory as defined in section 22 (d) (6) (B) of the Internal Revenue Code of 1939 (as modified by subsection (b) of this section), and if the closing inventory of a subsequent taxable year, ending before January 1, 1956, reflects a replacement, in whole or in part, of the goods so previously liquidated, then the taxable income of the taxpayer otherwise determined for the year of such involuntary liquidation shall be increased by an amount equal to the excess, if any, of the aggregate cost of such goods reflected in the opening inventory of the year of involuntary liquidation over the aggregate replacement cost, or decreased by an amount equal to the excess, if any, of the aggregate replacement cost of such goods over the aggregate cost thereof reflected in the opening inventory of the year of the involuntary liquidation. The taxes imposed by this chapter (and by chapters 1 and 2 of the Internal Revenue Code of 1939) for the year of such liquidation, for preceding taxable years, and for all taxable years intervening between the year of liquidation and the year of replacement shall be redetermined, giving effect to such adjustments. Any increase in such taxes resulting from such adjustments shall be assessed and collected as a deficiency but without interest, and any overpayment so resulting shall be credited or refunded to the taxpayer without interest.

(b) Definitions.

For purposes of this section, the term "involuntary liquidation" shall have the meaning given to it in section 22 (d) (6) (B) of the Internal Revenue Code of 1939 and, in addition, it shall mean a failure, as referred to in that section, on the part of the taxpayer due, directly and exclusively, to disruption of normal trade relations between countries. For purposes of this section, the words "enemy" and "war", as used in such section 22 (d) (6) (B), shall be interpreted, pursuant to regulations prescribed by the Secretary or his delegate, in such a way as to apply to circumstances, occurrences and conditions, lacking a state of war, which are similar, by reason of a state of national preparedness, to those which would exist under a state of war.

(c) Special rules.

Subparagraphs (C) and (E) of section 22 (d) (6) of the Internal Revenue Code of 1939, to the extent that they refer to any taxpayer subject to subparagraph (A) of such section or to the adjustments specified in or resulting from the effect of subparagraph (A) of such section, shall apply to a taxpayer subject to this section or to adjustments specified in or resulting from the effect of this section as though they specifically referred to this section. If, for any taxable year ending after June 30, 1950, and before January 1, 1953, subparagraph (C) of such section 22 (d) (6) applies with respect to involuntary liquidations of goods of the same class subject to both subparagraph (A) of such section and to this section, the involuntary liquidations of such goods subject to this section shall be considered for the purpose of such subparagraph (C) as having occurred before the involuntary liquidations of such goods subject to subparagraph (A) of such section 22 (d) (6). For the purpose of this subsection, and with respect to the taxable years covered by this section, the reference in subparagraph (E) of such section 22 (d) (6) to section 734 (d) shall be taken as a reference to section 452 (d) of the Internal Revenue Code of 1939, and, with respect to any taxable year to which any provision of the Internal Revenue Code of 1939 may not be applicable, references in such subparagraph to such provision shall, where applicable, be deemed a reference to the corresponding provision of the Internal Revenue Code of 1954. (Aug. 16, 1954, ch. 736, 68A Stat. 342.)

CROSS REFERENCES

Last-in, first-out inventories, see section 472 of this title.
Limitations on credit or refund generally, see section 6511 et seq. of this title.

PART IV.—WAR LOSS RECOVERIES

Sec.
1331. War loss recoveries.
1332. Inclusion in gross income of war loss recoveries.
1333. Tax adjustment measured by prior benefits.
1334. Restoration of value of investments referable to destroyed or seized property.
1335. Election by taxpayer for application of section 1333.
1336. Basis of recovered property.
1337. Applicable rules.

§ 1331. War loss recoveries.

On the recovery in the taxable year of any money or property in respect of property considered under section 127 (a) of the Internal Revenue Code of 1939, as destroyed or seized, the amount of such recovery shall be included in gross income to the extent provided in section 1332, unless section 1333 applies to the taxable year pursuant to an election made by the taxpayer under section 1335. (Aug. 16, 1954, ch. 736, 68A Stat. 343.)

§ 1332. Inclusion in gross income of war loss recoveries.

(a) Amount of recovery.

The amount of the recovery of any money or property in respect of property considered under section 127 (a) of the Internal Revenue Code of 1939, as destroyed or seized, shall be an amount equal to the aggregate of such money and the fair market value of such property, determined as of the date of the recovery.

(b) Amount of gain includible.

(1) Portion excluded from gross income.

To the extent that the amount of the recovery plus the aggregate of the amounts of previous such recoveries do not exceed that part of the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in such section 127 (a) which did not result in a reduction of any tax of the taxpayer under chapter 1 or 2 of the Internal Revenue Code of 1939, such amount shall not be includible in gross income and shall not be deemed gain on the involuntary conversion of property as a result of its destruction or seizure.

(2) Portion treated as ordinary income.

To the extent that such amount plus the aggregate of the amounts of previous such recoveries exceed that part of the aggregate of such deductions, which did not result in a reduction of any tax of the taxpayer under such chapters and do not exceed that part of the aggregate of such deductions which did result in a reduction of any tax of the taxpayer under such chapters, such amount shall be included in gross income but shall not be deemed a gain on the involuntary conversion of property as a result of its destruction or seizure.

(3) Portion treated as gain on involuntary conversion.

To the extent that such amount plus the aggregate of the amounts of previous such recoveries exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in such section 127 (a), such amount shall be considered a gain on the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 1033 (relating to involuntary conversions).

(4) Obligations not discharged.

If for any previous taxable year the taxpayer chose under section 127 (b) of the Internal Revenue Code of 1939 to treat any obligations and liabilities as discharged or satisfied out of the property or interest described in such section 127 (a), and if such obligations and liabilities were not so discharged or satisfied, the amount of such obligations and liabilities treated as discharged or satisfied under such section 127 (b) shall be considered for purposes of this part as a deduction by reason of such section 127 (a) which did not result in a reduction of any tax of the taxpayer under such chapters 1 or 2.

(5) Allowable deduction not allowed.

For purposes of this subsection, an allowable deduction for any taxable year on account of the destruction or seizure of property described in such section 127 (a) shall, to the extent not allowed in computing the tax of the taxpayer for such taxable year, be considered an allowable deduction which did not result in a reduction of any tax of the taxpayer under such chapters 1 or 2.

(Aug. 16, 1954, ch. 736, 68A Stat. 343.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1331, 1336 of this title.

§ 1333. Tax adjustment measured by prior benefits.

If this section applies to the taxable year pursuant to an election made by the taxpayer under section 1335 or section 127 (c) (5) of the Internal Revenue Code of 1939—

(1) Amount of recovery.

The amount of the recovery in the taxable year of any money or property in respect of property considered under section 127 (a) of the Internal Revenue Code of 1939 as destroyed or seized, shall be an amount equal to the aggregate of such money and the fair market value of such property, determined as of the date of the recovery. For purposes of this section, in the case of the recovery of the same property or interest considered under such section 127 (a) as destroyed or seized, the fair market value of such property or interest shall, at the option of the taxpayer, be considered an amount equal to the adjusted basis (for determining loss) of such property or interest in the hands of the taxpayer on the date such property or interest was considered under such section 127 (a) as destroyed or seized. The amount of the recovery determined under this paragraph shall be reduced for purposes of paragraphs (2) and (3) by the amount of the obligations or liabilities with respect to the property considered under such section 127 (a) as destroyed or seized in respect of which the recovery was received, if the taxpayer for any previous taxable year chose under section 127 (b) (2) of such code to treat such obligations or liabilities as discharged or satisfied out of such property, and such obligations or liabilities were not so discharged or satisfied before the date of the recovery.

(2) Adjustment for prior tax benefits.

That part of the amount of the recovery, in respect of any property considered under such section 127 (a) as destroyed or seized, which is not in excess of the allowable deductions in prior taxable years on account of such destruction or seizure of the property (the amount of such allowable deductions being first reduced by the aggregate amount of any prior recoveries in respect of the same property) shall be excluded from gross income for the taxable year of the recovery for purposes of computing the tax under this subtitle; but there shall be added to, and assessed and collected as a part of, the tax under this subtitle for the taxable year of the recovery the total increase in the tax under chapters 1 and 2 of the Internal Revenue Code of 1939 for all taxable years which would result by decreasing, in an amount equal to such part of the recovery so excluded, such deductions allowable in the prior taxable years with respect to the destruction or seizure of the property. Such increase in the tax for each such year so resulting shall be computed in accordance with regulations prescribed by the Secretary or his delegate. Such regulations shall give effect to previous recoveries of any kind (including recoveries described in section 111, relating to recovery of bad debts, etc.) with respect to any prior year, and shall provide for the case where there was no tax for the prior year, but shall otherwise treat the tax previously determined for any year in accordance with the principles set forth in section 1314 (a) (relating to corrections of errors). All credits allowable against the tax for any year and all carryovers and carrybacks affected by so decreasing the allowable deductions shall be taken into account in computing the increase in the tax, except that the computation of the excess profits credit under chapter 2E of such code for any taxable year shall not be affected.

(3) Gain on recovery.

The amount of any recovery or part thereof, in respect of property considered under such section 127 (a) as destroyed or seized, which is not excluded from gross income under paragraph (2), shall be considered for the taxable year of the recovery as gain on the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 1033.

(4) Recoveries treated as gross income for certain purposes.

For purposes of section 6012 (relating to persons required to make income tax returns) and section 1312 (relating to circumstances of adjustment), the recovery in the taxable year of any money or property in respect of property considered under such section 127 (a) as destroyed or seized in any prior taxable year shall be deemed to be an item includible in gross income for the taxable year in which the recovery is made.

(Aug. 16, 1954, ch. 736, 68A Stat. 344.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 901, 1331, 1334, 1335, 1336 of this title.

§ 1334. Restoration of value of investments referable to destroyed or seized property.

For purposes of this part, the restoration in whole or in part of the value of any interest described in section 127 (a) (3) of the Internal Revenue Code of 1939 by reason of any recovery of money or property in respect of property to which such interest related and which was considered under subsection (a) (1) or (2) of such section 127 as destroyed or seized shall be deemed a recovery of property in respect of property considered under such section 127 (a) as destroyed or seized. In applying section 1333, such restoration shall be treated as the recovery of the same interest considered under such section 127 (a) as destroyed or seized. (Aug. 16, 1954, ch. 736, 68A Stat. 346.)

§ 1335. Election by taxpayer for application of section 1333.

If the taxpayer elects to have section 1333 apply to any taxable year in which he recovered any money or property in respect of property considered under section 127 (a) of the Internal Revenue Code of 1939, as destroyed or seized, section 1333 shall apply to all taxable years of the taxpayer beginning after December 31, 1941, and such election, once made, shall be irrevocable. The election shall be made in

such manner and at such time as the Secretary or his delegate may by regulations prescribe, except that no election under this section may be made unless the taxpayer recovers money or property (in respect of property considered under such section 127 (a) as destroyed or seized) during the taxable year for which the election is made. If pursuant to such election section 1333 applies to any taxable year—

(1) the period of limitations provided in chapter 66 on the making of assessments and the beginning of distraint or a proceeding in court for collection shall not, with respect to—

(A) the amount to be added to the tax for such taxable year under section 1333, and

(B) any deficiency for such taxable year or for any other taxable year, to the extent attributable to the basis of the recovered property being determined under section 1336 (b),

expire before the expiration of 2 years following the date of the making of such election, and such amount and such deficiency may be assessed at any time before the expiration of such period notwithstanding any law or rule of law which would otherwise prevent such assessment and collection, and

(2) in case refund or credit of any overpayment resulting from the application of section 1333 to such taxable year is prevented on the date of the making of such election, or within one year from such date, by the operation of any law or rule of law (other than section 7122, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year from such date.

In the case of any taxable year ending before the date of the making by the taxpayer of an election under this section, no interest shall be paid on any overpayment resulting from the application of section 1333 to such taxable year, and no interest shall be assessed or collected with respect to any amount or any deficiency specified in paragraph (1) for any period before the expiration of 6 months following the date of the making of such election by the taxpayer. (Aug. 16, 1954, ch. 736, 68A Stat. 346.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1331, 1336 of this title.

§ 1336. Basis of recovered property.

(a) In general.

The unadjusted basis of property recovered in respect of property considered as destroyed or seized under section 127 (a) of the Internal Revenue Code of 1939 shall be determined under this section. Such basis shall be an amount equal to the fair market value of such property, determined as of the date of the recovery, reduced by an amount equal to the excess of the aggregate of such fair market value and the amounts of previous recoveries of money or property in respect of property considered under such section 127 (a) as destroyed or seized over the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in such section 127 (a), and increased by that portion of the amount of the recovery which under section 1332 is treated as a recognized gain from the involuntary conversion of property. On application of the taxpayer, the aggregate of the bases (determined under the preceding sentence) of any properties recovered in respect of properties considered under such section 127 (a) as destroyed or seized may be allocated among the properties so recovered in such manner as the Secretary or his delegate may determine under regulations prescribed by the Secretary or his delegate, and the amounts so allocated to any such property so recovered shall be the unadjusted basis of such property in lieu of the unadjusted basis of such property determined under the preceding sentence.

(b) Property recovered in taxable year to which section 1333 applies.

In the case of a taxpayer who has made an election under section 1335, the basis of property recovered shall be an amount equal to the value at which such property is included in the amount of the recovery under section 1333 (1) (determined without regard to the last sentence thereof), reduced by such part of the gain under section 1333 (3) which is not recognized as provided in section 1033. (Aug. 16, 1954, ch. 736, 68A Stat. 347.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1335 of this title.

§ 1337. Applicable rules.

(a) Determination of tax benefits.

The determination as to whether and to what extent an allowable deduction on account of the destruction or seizure of property described in section 127 (a) of the Internal Revenue Code of 1939 did or did not result in a reduction of any tax of the taxpayer under chapter 1 or 2 of such code shall be made in accordance with regulations prescribed by the Secretary or his delegate.

(b) Partial worthlessness of certain investments treated as war losses under 1939 Code.

The part of the stock or other interest of the taxpayer treated under subsection (e) of such section 127 as property described in subsection (a) (3) of such section shall be treated in the same manner for purposes of this part. (Aug. 16, 1954, ch. 736, 68A Stat. 347.)

PART V.—CLAIM OF RIGHT

Sec.

1341. Computation of tax where taxpayer restores substantial amount held under claim of right.

1342. Computation of tax where taxpayer recovers substantial amount held by another under claim of right.[1]

§ 1341. Computation of tax where taxpayer restores substantial amount held under claim of right.

(a) General rule.

If—

(1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;

(2) a deduction is allowable for the taxable

[1] Item supplied by Editor.

year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item; and

(3) the amount of such deduction exceeds $3,000,

then the tax imposed by this chapter for the taxable year shall be the lesser of the following:

(4) the tax for the taxable year computed with such deduction; or

(5) an amount equal to—

(A) the tax for the taxable year computed without such deduction, minus

(B) the decrease in tax under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion of such item (or portion thereof) from gross income for such prior taxable year (or years).

For purposes of paragraph (5) (B), the corresponding provisions of the Internal Revenue Code of 1939 shall be chapter 1 of such code (other than subchapter E, relating to self-employment income) and subchapter E of chapter 2 of such code.

(b) Special rules.

(1) If the decrease in tax ascertained under subsection (a) (5) (B) exceeds the tax imposed by this chapter for the taxable year (computed without the deduction) such excess shall be considered to be a payment of tax on the last day prescribed by law for the payment of tax for the taxable year, and shall be refunded or credited in the same manner as if it were an overpayment for such taxable year.

(2) Subsection (a) does not apply to any deduction allowable with respect to an item which was included in gross income by reason of the sale or other disposition of stock in trade of the taxpayer (or other property of a kind which would properly have been included in the inventory of the taxpayer if on hand at the close of the prior taxable year) or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. This paragraph shall not apply if the deduction arises out of refunds or repayments with respect to rates made by a regulated public utility (as defined in section 7701(a)(33) without regard to the limitation contained in the last two sentences thereof) if such refunds or repayments are required to be made by the Government, political subdivision, agency, or instrumentality referred to in such section, or by an order of a court, or are made in settlement of litigation or under threat or imminence of litigation. This paragraph shall not apply if the deduction arises out of payments or repayments made pursuant to a price redetermination provision in a subcontract entered into before January 1, 1958, between persons other than those bearing the relationship set forth in section 267 (b), if the subcontract containing the price redetermination provision is subject to statutory renegotiation and section 1481 (relating to mitigation of effect of renegotiation of Government contracts) does not apply to such payment or repayment solely because such payment or repayment is not paid or repaid to the United States or any agency thereof.

(3) If the tax imposed by this chapter for the taxable year is the amount determined under subsection (a) (5), then the deduction referred to in subsection (a) (2) shall not be taken into account for any purpose of this subtitle other than this section.

(4) For purposes of determining whether paragraph (4) or paragraph (5) of subsection (a) applies—

(A) in any case where the deduction referred to in paragraph (4) of subsection (a) results in a net operating loss, such loss shall, for purposes of computing the tax for the taxable year under such paragraph (4), be carried back to the same extent and in the same manner as is provided under section 172; and

(B) in any case where the exclusion referred to in paragraph (5)(B) of subsection (a) results in a net operating loss or capital loss for the prior taxable year (or years), such loss shall, for purposes of computing the decrease in tax for the prior taxable year (or years) under such paragraph (5)(B), be carried back and carried over to the same extent and in the same manner as is provided under section 172 or section 1212, except that no carryover beyond the taxable year shall be taken into account.

(5) For purposes of this chapter, the net operating loss described in paragraph (4)(A) of this subsection, or the net operating loss or capital loss described in paragraph (4)(B) of this subsection, as the case may be, shall (after the application of paragraph (4) or (5)(B) of subsection (a) for the taxable year) be taken into account under section 172 or 1212 for taxable years after the taxable year to the same extent and in the same manner as—

(A) a net operating loss sustained for the taxable year, if paragraph (4) of subsection (a) applied, or

(B) a net operating loss or capital loss sustained for the prior taxable year (or years), if paragraph (5)(B) of subsection (a) applied.

(Aug. 16, 1954, ch. 736, 68A Stat. 348; Sept. 2, 1958, Pub. L. 85–866, title I, § 60(a)—(d), 72 Stat. 1647; Oct. 23, 1962, Pub. L. 87–863, § 5(a), 76 Stat. 1142; Feb. 26, 1964, Pub. L. 88–272, title II, § 234(b)(7), 78 Stat. 116.)

AMENDMENTS

1964—Subsec. (b)(2). Pub. L. 88–272 substituted "7701(a)(33) without regard to the limitation continued in the last two sentences thereof)" for "1503(c) without regard to paragraph (2) thereof)."

1962—Subsec. (b) (4), (5). Pub. L. 87–863 added pars. (4) and (5).

1958—Subsec. (a). Pub. L. 85–866, § 60(a), inserted in the last sentence "and subchapter E of chapter 2 of such code".

Subsec. (b)(2), Pub. L. 85–866, § 60 (b), (c), in second sentence inserted "with respect to rates" and added ", or by an order of a court, or are made in settlement of litigation or under threat or imminence of litigation" and added last sentence.

Subsec. (b)(3). Pub. L. 85–866, § 60(d), added subsec. (b)(3).

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of section by Pub. L. 88–272 applicable to taxable years beginning after Dec. 31, 1963, see section 234(c) of Pub. L. 88–272, set out as a note under section 1503 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Section 5(b) of Pub. L. 87–863 provided that: "The amendment made by subsection (a) [to this section] shall be effective with respect to taxable years beginning on or after January 1, 1962."

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment of subsec. (a) and the last sentence of subsec. (b) (2) of this section by Pub. L. 85–866, and subsec. (b) (3) of this section, applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85–866, set out as a note under section 165 of this title.

Section 60 (e) of Pub. L. 85–866 provided that: "The amendment made by subsection (b) [to second sentence of subsec. (b) of this section] shall apply with respect to taxable years beginning after December 31, 1957. No interest shall be allowed or paid on any overpayment resulting from the application of the amendment made by subsection (c)."

CROSS REFERENCES

Taxable year of inclusion of gross income, see section 451 (a) of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 5 of this title.

§ 1342. Computation of tax where taxpayer recovers substantial amount held by another under claim of right.

(a) General rule.

If—

(1) an item was deducted from gross income for a prior taxable year (or years) because it appeared that another person held an unrestricted right to such item as a result of a court decision in a patent infringement suit (whether or not the taxpayer is a party to such suit); and

(2) gross income is increased for the taxable year because it was established after the close of such prior taxable year (or years) that such other person did not have an unrestricted right to such item or to a portion of such item because of the subsequent reversal of such court decision on the ground that such decision was induced by fraud or undue influence; and

(3) the amount of such increase in gross income exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following:

(4) the tax for the taxable year computed with the gross income so increased; or

(5) an amount equal to—

(A) the tax for the taxable year computed without such increase in gross income, plus

(B) the increase in tax (including interest) under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the elimination of such item (or portion thereof) as a deduction from gross income for such prior taxable year (or years).

(b) Special rule.

For purposes of subsection (a) (5) (B) interest shall be computed from the due date of the return for such prior taxable year to the due date of the return for the taxable year. (Added Aug. 12, 1955, ch. 870, § 3, 69 Stat. 717.)

EFFECTIVE DATE

Section 4 of act Aug. 12, 1955, provided that: "The amendment made by section 3 of this Act [adding this section] shall apply with respect to taxable years beginning after December 31, 1954."

PART VI.—OTHER LIMITATIONS

Sec.

1346. Recovery of unconstitutional federal taxes.

1347. Claims against United States involving acquisition of property.

1348. Fifty-percent maximum rate on earned income.

AMENDMENTS

1969—Pub. L. 91–172, title VIII, § 804(b), Dec. 30, 1969, 83 Stat. 686, added item 1348.

§ 1346. Recovery of unconstitutional federal taxes.

Income (excluding interest) attributable to the recovery during the taxable year of a tax imposed by the United States which has been held unconstitutional, and in respect of which a deduction was allowed in a prior taxable year, may be excluded from gross income for the taxable year, and the deduction allowed in respect thereof in such prior taxable year treated as not having been allowable, if—

(1) the taxpayer elects in writing (at such time and in such manner as may be prescribed by regulations prescribed by the Secretary or his delegate) to treat such deduction as not having been allowable for such prior taxable year, and

(2) the taxpayer consents in writing to the assessment, within such period as may be agreed on, of any deficiency resulting from such treatment, even though the statutory period for the assessment of any such deficiency had expired before the filing of such consent.

(Aug. 16, 1954, ch. 736, 68A Stat. 349.)

§ 1347. Claims against United States involving acquisition of property.

In the case of amounts (other than interest) received by a taxpayer from the United States with respect to a claim against the United States involving the acquisition of property and remaining unpaid for more than 15 years, the tax imposed by section 1 attributable to such receipt shall not exceed 33 percent of the amount (other than interest) so received. This section shall apply only if claim was filed with the United States before January 1, 1958. (Aug. 16, 1954, ch. 736, 68A Stat. 349; Sept. 2, 1958, Pub. L. 85–866, title I, § 61(a), 72 Stat. 1648; Dec. 30, 1969, Pub. L. 91–172, title VIII, § 803(d)(5), 83 Stat. 684.)

AMENDMENTS

1969—Pub. L. 91–172 substituted "tax" for "surtax", and "33 per cent" for "30 per cent".

1958—Pub. L. 85–866 substituted "surtax" for "tax" and added sentence "this section shall apply only if claim was filed with the United States before January 1, 1958".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment of section by Pub. L. 91–172 applicable to taxable years beginning after Dec. 31, 1970, see section 803(f) of Pub. L. 91–172, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 61 (b) of Pub. L. 85-866 provided that: "The amendment made by subsection (a) (1) [to first sentence of this section] shall apply only with respect to taxable years beginning after December 31, 1957."

Last sentence of this section applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1 (c) of Pub. L. 85-866, set out as a note under section 165 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 5 of this title.

§ 1348. Fifty-percent maximum rate on earned income.

(a) General rule.

If for any taxable year an individual has earned taxable income which exceeds the amount of taxable income specified in paragraph (1), the tax imposed by section 1 for such year shall, unless the taxpayer chooses the benefits of part I (relating to income averaging), be the sum of—

(1) the tax imposed by section 1 on the lowest amount of taxable income on which the rate of tax under section 1 exceeds 50 percent,

(2) 50 percent of the amount by which his earned taxable income exceeds the lowest amount of taxable income on which the rate of tax under section 1 exceeds 50 percent, and

(3) the excess of the tax computed under section 1 without regard to this section over the tax so computed with reference solely to his earned taxable income.

In applying this subsection to a taxable year beginning after December 31, 1970, and before January 1, 1972, "60 percent" shall be substituted for "50 percent" each place it appears in paragraphs (1) and (2).

(b) Definitions.

For purposes of this section—

(1) Earned income.

The term "earned income" means any income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b), except that such term does not include any distribution to which section 72(m)(5), 72(n), 402(a)(2), or 403(a)(2)(A) applies or any deferred compensation within the meaning of section 404. For purposes of this paragraph, deferred compensation does not include any amount received before the end of the taxable year following the first taxable year of the recipient in which his right to receive such amount is not subject to a substantial risk of forfeiture (within the meaning of section 83(c)(1)).

(2) Earned taxable income.

The earned taxable income of an individual is the excess of—

(A) the amount which bears the same ratio (but not in excess of 100 percent) to his taxable income as his earned net income bears to his adjusted gross income, over

(B) the amount by which the greater of—

(i) one-fifth of the sum of the taxpayer's items of tax preference referred to in section 57 for the taxable year and the 4 preceding taxable years, or

(ii) the sum of the items of tax preference for the taxable year,

exceeds $30,000.

For purposes of subparagraph (A), the term "earned net income" means earned income reduced by any deductions allowable under section 62 which are properly allocable to or chargeable against such earned income.

(c) Married individuals.

This section shall apply to a married individual only if such individual and his spouse make a single return jointly for the taxable year. (Added Pub. L. 91-172, title VIII, § 804(a), Dec. 30, 1969, 83 Stat. 685.)

EFFECTIVE DATE

Section 804(c) of Pub. L. 91-172 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1970."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1304 of this title.

PART VII.—RECOVERIES OF FOREIGN EXPROPRIATION LOSSES

Sec.
1351. Treatment of recoveries of foreign expropriation losses.

§ 1351. Treatment of recoveries of foreign expropriation losses.

(a) Election.

(1) In general.

This section shall apply only to a recovery, by a domestic corporation subject to the tax imposed by section 11 or 802, of a foreign expropriation loss sustained by such corporation and only if such corporation was subject to the tax imposed by section 11 or 802, as the case may be, for the year of the loss and elects to have the provisions of this section apply with respect to such loss.

(2) Time, manner, and scope.

An election under paragraph (1) shall be made at such time and in such manner as the Secretary or his delegate may prescribe by regulations. An election made with respect to any foreign expropriation loss shall apply to all recoveries in respect of such loss.

(b) Definition of foreign expropriation loss.

For purposes of this section, the term "foreign expropriation loss" means any loss sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. For purposes of the preceding sentence, a debt which becomes worthless shall, to the extent of any deduction allowed under section 166(a), be treated as a loss.

(c) Amount of recovery.

(1) General rule.

The amount of any recovery of a foreign expropriation loss is the amount of money and the fair market value of other property received in respect of such loss, determined as of the date of receipt.

(2) Special rule for life insurance companies.

The amount of any recovery of a foreign expropriation loss includes, in the case of a life insur-

ance company, the amount of decrease of any item taken into account under section 810(c), to the extent such decrease is attributable to the release, by reason of such loss, of its liabilities with respect to such item.

(d) Adjustment for prior tax benefits.

(1) In general.

That part of the amount of a recovery of a foreign expropriation loss to which this section applies which, when added to the aggregate of the amounts of previous recoveries with respect to such loss, does not exceed the allowable deductions in prior taxable years on account of such loss shall be excluded from gross income for the taxable year of the recovery for purposes of computing the tax under this subtitle; but there shall be added to, and assessed and collected as a part of, the tax under this subtitle for such taxable year an amount equal to the total increase in the tax under this subtitle for all taxable years which would result by decreasing, in an amount equal to such part of the recovery so excluded; the deductions allowable in the prior taxable years on account of such loss. For purposes of this paragraph, if the loss to which the recovery relates was taken into account as a loss from the sale or exchange of a capital asset, the amount of the loss shall be treated as an allowable deduction even though there were no gains against which to allow such loss.

(2) Computation.

The increase in the tax for each taxable year referred to in paragraph (1) shall be computed in accordance with regulations prescribed by the Secretary or his delegate. Such regulations shall give effect to previous recoveries of any kind (including recoveries described in section 111, relating to recovery of bad debts, etc.) with respect to any prior taxable year, but shall otherwise treat the tax previously determined for any taxable year in accordance with the principles set forth in section 1314(a) (relating to correction of errors). Subject to the provisions of paragraph (3), all credits allowable against the tax for any taxable year, and all carryovers and carrybacks affected by so decreasing the allowable deductions, shall be taken into account in computing the increase in the tax.

(3) Foreign taxes.

For purposes of this subsection—

(A) any choice made under subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year may be changed,

(B) subject to the provisions of section 904(b), an election to have the limitation provided by section 904(a)(2) apply may be made, and

(C) notwithstanding section 904(b)(1), an election previously made to have the limitation provided by section 904(a)(2) apply may be revoked with respect to any taxable year and succeeding taxable years.

(4) Substitution of current normal tax and surtax rates.

For purposes of this subsection, the normal tax rate provided by section 11(b) and the surtax rate provided by section 11(c) which are in effect for the taxable year of the recovery shall be treated as having been in effect for all prior taxable years.

(e) Gain on recovery.

That part of the amount of a recovery of a foreign expropriation loss to which this section applies which is not excluded from gross income under subsection (d)(1) shall be considered for the taxable year of the recovery as gain on the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 1033.

(f) Basis of recovered property.

The basis of property (other than money) received as a recovery of a foreign expropriation loss to which this section applies shall be an amount equal to its fair market value on the date of receipt, reduced by such part of the gain under subsection (e) which is not recognized as provided in section 1033.

(g) Restoration of value of investments.

For purposes of this section, if the value of any interest in, or with respect to, property (including any interest represented by a security, as defined in section 165(g)(2))—

(1) which became worthless by reason of the expropriation, intervention, seizure, or similar taking of such property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing, and

(2) which was taken into account as a loss from the sale or exchange of a capital asset or with respect to which a deduction for a loss was allowed under section 165 or a deduction for a bad debt was allowed under section 166,

is restored in whole or in part by reason of any recovery of money or other property in respect of the property which became worthless, the value so restored shall be treated as property received as a recovery in respect of such loss or such bad debt.

(h) Special rule for evidences of indebtedness.

Bonds or other evidences of indebtedness received as a recovery of a foreign expropriation loss to which this section applies shall not be considered to have any original issue discount within the meaning of section 1232(a)(2).

(i) Adjustments for succeeding years.

For purposes of this subtitle, proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, in—

(1) the credit under section 33 (relating to foreign tax credit),

(2) the credit under section 38 (relating to investment credit),

(3) the net operating loss deduction under section 172, or the operations loss deduction under section 812,

(4) the capital loss carryover under section 1212(a), and

(5) such other items as may be specified by such regulations,

for the taxable year of a recovery of a foreign expropriation loss to which this section applies, and for succeeding taxable years, to take into account items changed in making the computations under

subsection (d) for taxable years prior to the taxable year of such recovery. (Added Pub. L. 89–384, § 1 (a), Apr. 8, 1966, 80 Stat. 99.)

EFFECTIVE DATE

Section 2 of Pub. L. 89–384 provided that: "The amendments made by section 1 (except subsection (b)) [adding this section and section 6167 of this title and amending sections 46, 901, 6503, and 6601 of this title] shall apply with respect to amounts received after December 31, 1964, in respect of foreign expropriation losses (as defined in section 1351(b) of the Internal Revenue Code of 1954 added by section 1(a)) [subsec. (b) of this section] sustained after December 31, 1958."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 80, 901, 6167 of this title.

§ 1361. Repealed. Pub. L. 89–389, § 4(b)(1), Apr. 14, 1966, 80 Stat. 116.

Section, acts Aug. 16, 1954, ch. 736, 68A Stat. 350; Oct. 10, 1962, Pub. L. 87–792, § 7(h), 76 Stat. 829; Feb. 26, 1964, Pub. L. 88–272, title II, § 225(k)(5), 78 Stat. 94; Apr. 14, 1966, Pub. L. 89–389, § 4(a), 80 Stat. 115, related to election of unincorporated business enterprises to be treated as domestic corporations, and provided for general rule, qualifications, applicability of corporate provisions, limitation, irrevocability of elections, change of ownership, constructive ownership, imposition of taxes, personal holding company income, computation of taxable income, distributions other than in liquidation and in liquidation, and revocation and termination of elections.

EFFECTIVE DATE OF REPEAL

Section 4(b)(1) of Pub. L. 89–389 provided for repeal of provisions effective Jan. 1, 1969.

Subchapter S.—Election of Certain Small Business Corporations as to Taxable Status

Sec.
1371. Definitions.
1372. Election by small business corporation.
1373. Corporation undistributed taxable income taxed to shareholders.
1374. Corporation net operating loss allowed to shareholders.
1375. Special rules applicable to distributions of electing small business corporations.
1376. Adjustment to basis of stock of, and indebtedness owing, shareholders.
1377. Special rules applicable to earnings and profits of electing small business corporations.
1378. Tax imposed on certain capital gains.
1379. Certain qualified pensions, etc., plans.

AMENDMENTS

1969—Pub. L. 91–172, title V, § 531(c), Dec. 30, 1969, 83 Stat. 656, added item 1379.

1966—Pub. L. 89–389, § 2(b)(1), Apr. 14, 1966, 80 Stat. 114, added item 1378.

1958—Pub. L. 85–866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1640, added subchapter S.

§ 1371. Definitions.

(a) Small business corporation.

For purposes of this subchapter, the term "small business corporation" means a domestic corporation which is not a member of an affiliated group (as defined in section 1504) and which does not—

(1) have more than 10 shareholders;

(2) have as a shareholder a person (other than an estate) who is not an individual;

(3) have a nonresident alien as a shareholder; and

(4) have more than one class of stock.

(b) Electing small business corporation.

For purposes of this subchapter, the term "electing small business corporation" means, with respect to any taxable year, a small business corporation which has made an election under section 1372 (a) which, under section 1372, is in effect for such taxable year.

(c) Stock owned by husband and wife.

For purposes of subsection (a)(1) stock which—

(1) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or

(2) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by one shareholder.

(d) Ownership of certain stock.

For purposes of subsection (a), a corporation shall not be considered a member of an affiliated group at any time during any taxable year by reason of the ownership of stock in another corporation if such other corporation—

(1) has not begun business at any time on or after the date of its incorporation and before the close of such taxable year, and

(2) does not have taxable income for the period included within such taxable year.

(Added Pub. L. 85–866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1650, and amended Pub. L. 86–376, § 2(a), Sept. 23, 1959, 73 Stat. 699; Pub. L. 88–272, title II, § 233(a), Feb. 26, 1964, 78 Stat. 112.)

AMENDMENTS

1964—Subsec. (d). Pub. L. 88–272 added subsec. (d).
1959—Subsec. (c). Pub. L. 86–376 added subsec. (c).

EFFECTIVE DATE OF 1964 AMENDMENT

Section 233(c) of Pub. L. 88–272 provided that: "The amendment made by subsection (a) [to this section] shall apply with respect to taxable years of corporations beginning after December 31, 1962. The amendment made by subsection (b) [to section 1375 of this title] shall apply with respect to taxable years of corporations beginning after December 31, 1957."

EFFECTIVE DATE OF 1959 AMENDMENT

Section 2(d) of Pub. L. 86–376 provided in part that the amendment by section 2(a) of Pub. L. 86–376 adding subsec. (c) of this section shall apply to taxable years beginning after Dec. 31, 1959.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85–866, set out as a note under section 172 of this title.

APPLICATION OF SUBSEC. (c) TO TAXABLE YEARS BEGINNING AFTER DEC. 31, 1957, AND BEFORE JAN. 1, 1960

Section 23 of Pub. L. 87–834, Oct. 16, 1962, 76 Stat. 1065, provided that:

"(a) *In general.*—Subject to the provisions of subsection (b), section 1371(c) of the Internal Revenue Code of 1954 [subsec. (c) of this section] (as added by section 2(a) of the Act entitled 'An Act to amend the Internal Revenue Code of 1954 to provide a personal exemption for children placed for adoption and to clarify certain provisions relating to the election of small business corporations as to taxable status', approved September 23, 1959 (Public Law 86–376)), shall (not withstanding the provisions of the first sentence of section 2(d) of such Act) also apply to taxable years beginning after December 31, 1957, and before January 1, 1960.

"(b) *Election and consent by corporations; consents by shareholders.*—Subsection (a) shall apply with respect to any corporation and its shareholders only if, within one year after the date of the enactment of this Act [Oct. 16, 1962]—

"(1) such corporation (in such manner as the Secretary of the Treasury or his delegate prescribes by regulations) elects to have the provisions of subsection (a) apply and consents to the application of subsection (c); and

"(2) each person who is a shareholder of such corporation on the date on which such corporation makes such election, and each person who was a shareholder of such corporation during any taxable year of such corporation beginning after December 31, 1957, and ending before the date of such election, consents (in such manner and at such time as the Secretary of the Treasury or his delegate prescribes by regulations) to such election and to the application of subsection (c).

"(c) *Tolling of statutes of limitations.*—In any case in which a corporation makes an election under subsection (b)—

"(1) if the assessment of any deficiency against the corporation making such election, or any shareholder of such corporation who consents to such election, for any taxable year is prevented, at any time on or before the expiration of one year after the date of such election, by the operation of any law or rule of law, assessment of such deficiency may, nevertheless, be made, to the extent such deficiency is attributable to the application of subsection (a), at any time on or before the expiration of such one-year period; and

"(2) if credit or refund of any overpayment of tax by the corporation making such election, or any shareholder of such corporation who consents to such election, for any taxable year is prevented, at any time on or before the expiration of one year after the date of such election, by the operation of any law or rule of law, credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to the application of subsection (a), if claim therefor is filed on or before the expiration of such one-year period."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 48, 57, 58, 163, 183, 1016, 1251, 1372, 6037 of this title.

§ 1372. Election by small business corporation.

(a) Eligibility.

Except as provided in subsection (f), any small business corporation may elect, in accordance with the provisions of this section, not to be subject to the taxes imposed by this chapter. Such election shall be valid only if all persons who are shareholders in such corporation—

(1) on the first day of the first taxable year for which such election is effective, if such election is made on or before such first day, or

(2) on the day on which the election is made, if the election is made after such first day,

consent to such election.

(b) Effect.

If a small business corporation makes an election under subsection (a), then—

(1) with respect to the taxable years of the corporation for which such election is in effect, such corporation shall not be subject to the taxes imposed by this chapter (other than the tax imposed by section 1378) and, with respect to such taxable years and all succeeding taxable years, the provisions of section 1377 shall apply to such corporation, and

(2) with respect to the taxable years of a shareholder of such corporation in which or with which the taxable years of the corporation for which such election is in effect end, the provisions of sections 1373, 1374, and 1375 shall apply to such shareholder, and with respect to such taxable years and all succeeding taxable years, the provisions of section 1376 shall apply to such shareholder.

(c) Where and how made.

(1) In general.

An election under subsection (a) may be made by a small business corporation for any taxable year at any time during the first month of such taxable year, or at any time during the month preceding such first month. Such election shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.

(2) Taxable years beginning before date of enactment.

An election may be made under subsection (a) by a small business corporation for its first taxable year which begins after December 31, 1957, and on or before the date of the enactment of this subchapter, and ends after such date at any time—

(A) within the 90-day period beginning on the day after the date of the enactment of this subchapter, or

(B) if its taxable year ends within such 90-day period, before the close of such taxable year.

An election may be made pursuant to this paragraph only if the small business corporation has been a small business corporation (as defined in section 1371 (a)) on each day after the date of the enactment of this subchapter and before the day of such election.

(d) Years for which effective.

An election under subsection (a) shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, unless it is terminated, with respect to any such taxable year, under subsection (e).

(e) Termination.

(1) New shareholders.

An election under subsection (a) made by a small business corporation shall terminate if any person who was not a shareholder in such corporation—

(A) on the first day of the first taxable year of the corporation for which the election is effective, if such election is made on or before such first day, or

(B) on the day on which the election is made, if such election is made after such first day,

becomes a shareholder in such corporation and does not consent to such election within such time as the Secretary or his delegate shall prescribe by regulations. Such termination shall be effective for the taxable year of the corporation in which such person becomes a shareholder in the corporation and for all succeeding taxable years of the corporation.

(2) Revocation.

An election under subsection (a) made by a small business corporation may be revoked by it for any taxable year of the corporation after the first taxable year for which the election is effective. An election may be revoked only if all persons who are shareholders in the corporation on the day on which the revocation is made consent to the revocation. A revocation under this paragraph shall be effective—

(A) for the taxable year in which made, if made before the close of the first month of such taxable year,

(B) for the taxable year following the taxable year in which made, if made after the close of such first month,

and for all succeeding taxable years of the corporation. Such revocation shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.

(3) Ceases to be small business corporation.

An election under subsection (a) made by a small business corporation shall terminate if at any time—

(A) after the first day of the first taxable year of the corporation for which the election is effective, if such election is made on or before such first day, or

(B) after the day on which the election is made, if such election is made after such first day,

the corporation ceases to be a small business corporation (as defined in section 1371 (a)). Such termination shall be effective for the taxable year of the corporation in which the corporation ceases to be a small business corporation and for all succeeding taxable years of the corporation.

(4) Foreign income.

An election under subsection (a) made by a small business corporation shall terminate if for any taxable year of the corporation for which the election is in effect, such corporation derives more than 80 percent of its gross receipts from sources outside the United States. Such termination shall be effective for the taxable year of the corporation in which it derives more than 80 percent of its gross receipts from sources outside the United States, and for all succeeding taxable years of the corporation.

(5) Passive investment income.

(A) Except as provided in subparagraph (B), an election under subsection (a) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 percent of which is passive investment income. Such termination shall be effective for the taxable year of the corporation in which it has gross receipts of such amount, and for all succeeding taxable years of the corporation.

(B) Subparagraph (A) shall not apply with respect to a taxable year in which a small business corporation has gross receipts more than 20 percent of which is passive investment income, if—

(i) such taxable year is the first taxable year in which the corporation commenced the active conduct of any trade or business or the next succeeding taxable year; and

(ii) the amount of passive investment income for such taxable year is less than $3,000.

(C) For purposes of this paragraph, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom). Gross receipts derived from sales or exchanges of stock or securities for purposes of this paragraph shall not include amounts received by an electing small business corporation which are treated under section 331 (relating to corporate liquidations) as payments in exchange for stock where the electing small business corporation owned more than 50 percent of each class of the stock of the liquidating corporation.

(f) Election after termination.

If a small business corporation has made an election under subsection (a) and if such election has been terminated or revoked under subsection (e), such corporation (and any successor corporation) shall not be eligible to make an election under subsection (a) for any taxable year prior to its fifth taxable year which begins after the first taxable year for which such termination or revocation is effective, unless the Secretary or his delegate consents to such election.

(g) Consent to election by certain shareholders of stock held as community property.

If a husband and wife owned stock which was community property (or the income from which was community income) under the applicable community property law of a State, and if either spouse filed a timely consent to an election under subsection (a) for a taxable year beginning before January 1, 1961, the time for filing the consent of the other spouse to such election shall not expire prior to May 15, 1961. (Added Pub. L. 85–866, title I, § 64 (a), Sept. 2, 1958, 72 Stat. 1650, and amended Pub. L. 87–29, § 2, May 4, 1961, 75 Stat. 64; Pub. L. 89–389, §§ 2(b)(2), 3(a), Apr. 14, 1966, 80 Stat. 114; Pub. L. 91–683, § 1(a), Jan. 12, 1971, 84 Stat. 2067.)

REFERENCES IN TEXT

Date of the enactment of this subchapter, referred to in subsec. (c), was Sept. 2, 1958.

AMENDMENTS

1971—Subsec. (e)(5)(C). Pub. L. 91–683 inserted sentence providing that gross receipts derived from sales or exchanges of stock or securities shall not include amounts received by an electing small business corporation which are treated under section 331 as payments in exchange for stock where the electing small business corporation owned more than 50 percent of each class of the stock of the liquidating corporation.

1966—Subsec. (b)(1). Pub. L. 89–389, § 2(b)(2), inserted "(other than the tax imposed by section 1378)" following "this chapter".

Subsec. (e)(5). Pub. L. 89–389, § 3(a), lumped royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities under the general term

"passive investment income" and provided that, during the first two taxable years in which the corporation carries on the active conduct of a trade or business, the provision requiring the termination of election when passive investment income exceeds 20 percent of the gross receipts be waived if the passive investment income is less than $3,000.

1961—Subsec. (g). Pub. L. 87-29 added subsec. (g).

EFFECTIVE DATE OF 1971 AMENDMENT; LIMITATION ON DEFICIENCY ASSESSMENTS

Section 1(b), (c) of Pub. L. 91-683 provided that:

"(b) The amendment made by subsection (a) [to subsec. (e)(5)(C) of this section] shall apply to taxable years of electing small business corporations ending after the date of the enactment of this Act [Jan. 12, 1971]. Such amendment shall also apply with respect to any taxable year ending before October 7, 1970, but only if—

"(1) on such date the making of a refund or the allowance of a credit to the electing small business corporation is not prevented by any law or rule of law, and

"(2) within one year after the date of enactment of this Act [Jan. 12, 1971] and in such manner as the Secretary of the Treasury or his delegate prescribes by regulations—

"(A) the corporation elects to have such amendment so apply, and

"(B) all persons (or their personal representatives) who were shareholders of such corporation at any time during any taxable year beginning with the first taxable year to which this amendment applies and ending on or before the date of the enactment of this Act [Jan. 12, 1971] consent to such election and to the application of the amendment made by subsection (a).

"(c) If the assessment of any deficiency in income tax resulting from the filing of such election for a taxable year ending before the date of such filing is prevented before the expiration of one year after the date of such filing by any law or rule of law, such deficiency (to the extent attributable to such election) may be assessed at any time prior to the expiration of such one-year period notwithstanding any law or rule of law which would otherwise prevent such assessment."

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsec. (b)(1) by Pub. L. 89-389 applicable with respect to taxable years of electing small business corporations beginning after April 14, 1966, but not applicable with respect to sales or exchanges occurring before February 24, 1966, see section 2(c) of Pub. L. 89-389, set out as a note under section 1378 of this title.

Section 3(b) of Pub. L. 89-389 provided that:

"The amendment made by subsection (a) [amending subsec. (e)(5) of this section] shall apply to taxable years of electing small business corporations ending after the date of the enactment of this Act. Such amendment shall also apply with respect to taxable years beginning after December 31, 1962, and ending on or before such date of enactment, if (at such time and in such manner as the Secretary of the Treasury or his delegate prescribes by regulations)—

"(1) the corporation elects to have such amendment so apply, and

"(2) all persons (or their personal representatives) who were shareholders of such corporation at any time during any taxable year beginning after December 31, 1962, and ending on or before the date of the enactment of this Act [Apr. 14, 1966], consent to such election and to the application of the amendment made by subsection (a)."

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85-866, set out as a note under section 172 of this title.

PREVENTION OF DENIAL OF SUBCHAPTER S STATUS

Section 1(d) of Pub. L. 91-683 provided that:

"If the election of a corporation under subsection (a) of section 1372 of the Internal Revenue Code of 1954 [subsec. (a) of this section] would have been terminated because of the application of subsection (e)(5) of such section (before the amendment made by subsection (a) of this section) but for the election by such corporation under paragraph (2) of subsection (b) [set out as a note under this section] (and the consent of shareholders under such paragraph), such election under section 1372(a) of such code shall not be treated as terminated for any year beginning before the date of the enactment of this Act [Jan. 12, 1971] as a result of—

"(1) such corporation filing its income tax return on a form 1120 (instead of a form 1120S), or

"(2) a new shareholder not consenting to such election of such corporation in accordance with the requirements of subsection (e)(1) of such section 1372."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1371, 1378 of this title.

§ 1373. Corporation undistributed taxable income taxed to shareholders.

(a) General rule.

The undistributed taxable income of an electing small business corporation for any taxable year shall be included in the gross income of the shareholders of such corporation in the manner and to the extent set forth in this section.

(b) Amount included in gross income.

Each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year. For purposes of this chapter, the amount so included shall be treated as an amount distributed as a dividend on the last day of the taxable year of the corporation.

(c) Undistributed taxable income defined.

For purposes of this section, the term "undistributed taxable income" means taxable income (computed as provided in subsection (d)) minus the sum of (1) the taxes imposed by sections 56 and 1378(a) and (2) the amount of money distributed as dividends during the taxable year, to the extent that any such amount is a distribution out of earnings and profits of the taxable year as specified in section 316(a)(2).

(d) Taxable income.

For purposes of this subchapter, the taxable income of an electing small business corporation shall be determined without regard to—

(1) the deduction allowed by section 172 (relating to net operating loss deduction), and

(2) the deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures).

(Added Pub. L. 85-866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1652, and amended Pub. L. 89-389, § 2(b)(3), Apr. 14, 1966, 80 Stat. 114; Pub. L. 91-172, title III, § 301(b)(10), Dec. 30, 1969, 83 Stat. 586.)

AMENDMENTS

1969—Subsec. (c). Pub. L. 91-172 inserted reference to tax imposed by section 56.

1966—Subsec. (c). Pub. L. 89-389 inserted "the sum of (1) the tax imposed by section 1378(a) and (2)" after "minus".

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsec. (c) by Pub. L. 89–389 applicable with respect to taxable years of electing small business corporations beginning after April 14, 1966, but not applicable with respect to sales or exchanges occurring before February 24, 1966, see section 2(c) of Pub. L. 89–389, set out as a note under section 1378 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85–866, set out as a note under section 172 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1372, 1375, 1376, 1377, 1378, 6042 of this title.

§ 1374. Corporation net operating loss allowed to shareholders.

(a) General rule.

A net operating loss of an electing small business corporation for any taxable year shall be allowed as a deduction from gross income of the shareholders of such corporation in the manner and to the extent set forth in this section.

(b) Allowance of deduction.

Each person who is a shareholder of an electing small business corporation at any time during a taxable year of the corporation in which it has a net operating loss shall be allowed as a deduction from gross income, for his taxable year in which or with which the taxable year of the corporation ends (or for the final taxable year of a shareholder who dies before the end of the corporation's taxable year), an amount equal to his portion of the corporation's net operating loss (as determined under subsection (c)).

(c) Determination of shareholder's portion.

(1) In general.

For purposes of this section, a shareholder's portion of the net operating loss of an electing small business corporation is his pro rata share of the corporation's net operating loss (computed as provided in section 172 (c), except that the deductions provided in part VIII (except section 248) of subchapter B shall not be allowed) for his taxable year in which or with which the taxable year of the corporation ends. For purposes of this paragraph, a shareholder's pro rata share of the corporation's net operating loss is the sum of the portions of the corporation's daily net operating loss attributable on a pro rata basis to the shares held by him on each day of the taxable year. For purposes of the preceding sentence, the corporation's daily net operating loss is the corporation's net operating loss divided by the number of days in the taxable year.

(2) Limitation.

A shareholder's portion of the net operating loss of an electing small business corporation for any taxable year shall not exceed the sum of—

(A) the adjusted basis (determined without regard to any adjustment under section 1376 for the taxable year) of the shareholder's stock in the electing small business corporation, determined as of the close of the taxable year of the corporation (or, in respect of stock sold or otherwise disposed of during such taxable year, as of the day before the day of such sale or other disposition), and

(B) the adjusted basis (determined without regard to any adjustment under section 1376 for the taxable year) of any indebtedness of the corporation to the shareholder, determined as of the close of the taxable year of the corporation (or, if the shareholder is not a shareholder as of the close of such taxable year, as of the close of the last day in such taxable year on which the shareholder was a shareholder in the corporation).

(d) Application with other provisions.

(1) In general.

The deduction allowed by subsection (b) shall, for purposes of this chapter, be considered as a deduction attributable to a trade or business carried on by the shareholder.

(2) Adjustment of net operating loss carrybacks and carryovers of shareholders.

For purposes of determining, under section 172, the net operating loss carrybacks to taxable years beginning before January 1, 1958, from a taxable year of the shareholder for which he is allowed a deduction under subsection (b), such deduction shall be disregarded in determining the net operating loss for such taxable year. In the case of a net operating loss for a taxable year in which a shareholder is allowed a deduction under subsection (b), the determination of the portion of such loss which may be carried to subsequent years shall be made without regard to the preceding sentence and in accordance with section 172 (b) (2), but the sum of the taxable incomes for taxable years beginning before January 1, 1958, shall be deemed not to exceed the amount of the net operating loss determined with the application of the preceding sentence.

(Added Pub. L. 85–866, title I, § 64 (a), Sept. 2, 1958, 72 Stat. 1653, and amended Pub. L. 86–376, § 2(b), Sept. 23, 1959, 73 Stat. 699.)

AMENDMENTS

1959—Subsec. (b). Pub. L. 86–376 inserted "(or for the final taxable year of a shareholder who dies before the end of the corporation's taxable year)" following "the taxable year of the corporation ends".

EFFECTIVE DATE OF 1959 AMENDMENT

Section 2(d) of Pub. L. 86–376 provided in part that the amendment of subsec. (b) of this section by section 2(b) of Pub. L. 86–376 shall take effect on Sept. 24, 1959.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85–866, set out as a note under section 172 of this title.

DEDUCTION OF DECEASED SHAREHOLDER'S PRO RATA SHARE OF NET OPERATING LOSS

Section 30 of Pub. L. 87–834, Oct. 16, 1962, 76 Stat. 1069, provided that: "The amendment made by section 2(b) of Public Law 86-376 (73 Stat. 699) [which inserted "(or for the final taxable year of a shareholder who dies before the end of the corporations taxable year)" in subsec. (b) of this section] shall take effect on September 2, 1958."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 58, 163, 1372, 1375, 1376, 1377 of this title.

§ 1375. Special rules applicable to distributions of electing small business corporations.

(a) Capital gains.

(1) Treatment in hands of shareholders.

The amount includible in the gross income of a shareholder as dividends (including amounts treated as dividends under section 1373 (b)) from an electing small business corporation during any taxable year of the corporation, to the extent that such amount is a distribution of property out of earnings and profits of the taxable year as specified in section 316 (a) (2), shall be treated as a long-term capital gain to the extent of the shareholder's pro rata share of the excess of the corporation's net long-term capital gain over its net short-term capital loss for such taxable year. For purposes of this paragraph, such excess shall be deemed not to exceed the corporation's taxable income (computed as provided in section 1373 (d)) for the taxable year.

(2) Determination of shareholder's pro rata share.

A shareholder's pro rata share of such excess for any taxable year shall be an amount which bears the same ratio to such excess as the amount of dividends described in paragraph (1) includible in the shareholder's gross income bears to the entire amount of dividends described in paragraph (1) includible in the gross income of all shareholders.

(3) Reduction for taxes imposed.

For purposes of paragraphs (1) and (2), the excess of an electing small business corporation's net long-term capital gain over its net short-term capital loss for a taxable year shall be reduced by an amount equal to the amount of the taxes imposed by sections 56 and 1378(a) on such corporation for such year.

(b) Dividends received credit not allowed.

The amount includible in the gross income of a shareholder as dividends from an electing small business corporation during any taxable year of the corporation (including any amount treated as a dividend under section 1373 (b)) shall not be considered a dividend for purposes of section 37 or section 116 to the extent that such amount is a distribution of property out of earnings and profits of the taxable year as specified in section 316(a)(2). For purposes of this subsection, the earnings and profits of the taxable year shall be deemed not to exceed the corporation's taxable income (computed as provided in section 1373(d) for the taxable year.

(c) Treatment of family groups.

Any dividend received by a shareholder from an electing small business corporation (including any amount treated as a dividend under section 1373 (b)) may be apportioned or allocated by the Secretary or his delegate between or among shareholders of such corporation who are members of such shareholder's family (as defined in section 704 (e) (3)), if he determines that such apportionment or allocation is necessary in order to reflect the value of services rendered to the corporation by such shareholders.

(d) Distributions of undistributed taxable income previously taxed to shareholders.

(1) Distributions not considered as dividends.

An electing small business corporation may distribute, in accordance with regulations prescribed by the Secretary or his delegate, to any shareholder all or any portion of the shareholder's net share of the corporation's undistributed taxable income for taxable years prior to the taxable year in which such distribution is made. Any such distribution shall, for purposes of this chapter, be considered a distribution which is not a dividend, but the earnings and profits of the corporation shall not be reduced by reason of any such distribution.

(2) Shareholder's net share of undistributed taxable income.

For purposes of this subsection, a shareholder's net share of the undistributed taxable income of an electing small business corporation is an amount equal to—

(A) the sum of the amounts included in the gross income of the shareholder under section 1373 (b) for all prior taxable years (excluding any taxable year to which the provisions of this section do not apply and all taxable years preceding such year), reduced by

(B) the sum of—

(i) the amounts allowable under section 1374 (b) as a deduction from gross income of the shareholder for all prior taxable years (excluding any taxable year to which the provisions of this section do not apply and all taxable years preceding such year), and

(ii) all amounts previously distributed during the taxable year and all prior taxable years (excluding any taxable year to which the provisions of this section do not apply and all taxable years preceding such year) to the shareholder which under subsection (f) or paragraph (1) of this subsection were considered distributions which were not dividends.

(e) Repealed. Pub. L. 89-389, § 1(a)(2), Apr. 14, 1966, 80 Stat. 111.

(f) Distributions within 2½-month period after close of taxable year.

(1) Distributions considered as distributions of undistributed taxable income.

Any distribution of money made by a corporation after the close of a taxable year with respect to which it was an electing small business corporation and on or before the 15th day of the third month following the close of such taxable year to a person who was a shareholder of such corporation at the close of such taxable year shall be treated as a distribution of the corporation's undistributed taxable income for such year, to the extent such distribution (when added to the sum of all prior distributions of money made to such person by such corporation following the close of such year) does not exceed such person's share of the corporation's undistributed taxable income for such year. Any distribution so treated shall, for purposes of this chapter, be considered a distribu-

tion which is not a dividend, and the earnings and profits of the corporation shall not be reduced by reason of such distribution.

(2) Share of undistributed taxable income.

For purposes of paragraph (1), a person's share of a corporation's undistributed taxable income for a taxable year is the amount required to be included in his gross income under section 1373(b) as a shareholder of such corporation for his taxable year in which or with which the taxable year of the corporation ends.

(3) Election under subsection (e).

Paragraph (1) shall not apply to any distribution with respect to which an election under subsection (e) applies.

(Added Pub. L. 85–866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1654, and amended Pub. L. 88–272, title II, §§ 201(d)(13), 233(b), Feb. 26, 1964, 78 Stat. 32, 112; Pub. L. 89–389, §§ 1(a), (b), 2(b)(4), Apr. 14, 1966, 80 Stat. 111, 114; Pub. L. 91–172, title III, § 301(b)(11), Dec. 30, 1969, 83 Stat. 586.)

AMENDMENTS

1969—Subsec. (a)(3). Pub. L. 91–172 substituted "taxes imposed" for "tax imposed by section 1378" in the heading and "taxes imposed by sections 56 and 1378(a) on" for "tax imposed by section 1378(a) on the income of" in the text, respectively.

1966—Subsec. (a). Pub. L. 89–389, § 2(b)(4), added par. (3).

Subsec. (d)(2)(B)(ii). Pub. L. 89–389, § 1(b), substituted "under subsection (f) or paragraph (1) of this subsection" for "under paragraph (1)".

Subsec. (e). Pub. L. 89–389, § 1(a)(2), repealed subsec. (e) which permitted distributions of the proceeds of a sale of capital assets to be treated as having been made on the last day of the taxable year within which the sale occurred, if the distributions were made within two and one-half months after the end of that taxable year and were made pursuant to a resolution of the board of directors adopted before the end of the year in question and if each shareholder owned the same proportion of the corporation's stock on the distribution date as he did on the last days of the corporation's last taxable year.

Subsec. (f). Pub. L. 89–389, § 1(a)(1), added subsec. (f).

1964—Subsec. (b). Pub. L. 88–272, § 201(d)(13), deleted "section 34," preceding "section 37."

Subsec. (e). Pub. L. 88–272, § 233(b), added subsec. (e).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to taxable years ending after Dec. 31, 1969, see section 301(c) of Pub. L. 91–172, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of subsec. (a) by Pub. L. 89–389 applicable with respect to taxable years of electing small business corporations beginning after April 14, 1966, but not applicable with respect to sales or exchanges occurring before February 24, 1966, see section 2(c) of Pub. L. 89–389, set out as a note under section 1378 of this title.

Section 1(a)(2) of Pub. L. 89–389 provided in part that the repeal of subsec. (e) was effective "with respect to distributions made after the close of any taxable year of the corporation beginning after the date of the enactment of this Act [Apr. 14, 1966]."

Section 1(c) of Pub. L. 89–389 provided that: "Except as provided by subsection (d) [set out as a note under this section], the amendments made by subsections (a)(1) and (b) [adding subsec. (f) and amending subsec. (d)(2)(B)(ii) of this section] shall apply only with respect to distributions made after the date of the enactment of this Act [Apr. 14, 1966]."

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment of subsec. (b) by Pub. L. 88–272 applicable with respect to dividends received after Dec. 31, 1964, in taxable years ending after such date, see section 201(e) of Pub. L. 88–272, set out as a note under section 35 of this title.

Amendment of subsec. (e) by Pub. L. 88–272 applicable to taxable years of corporations beginning after Dec. 31, 1957, see section 233(c) of Pub. L. 88–272, set out as a note under section 1371 of this title.

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85–866, set out as a note under section 172 of this title.

DISTRIBUTIONS OF MONEY BY CORPORATIONS ON OR BEFORE APRIL 14, 1966; ELECTION BY CORPORATIONS AND CONSENT OF SHAREHOLDERS; EXTENSION OF FILING PERIOD; DEFICIENCY ASSESSMENT

Section 1(d) of Pub. L. 89–389 provided that:

"(1) The amendments made by subsections (a)(1) and (b) [adding subsec. (f) and amending subsec. (d)(2)(B)(ii) of this section] shall also apply with respect to distributions of money (other than distributions with respect to which an election under section 1375(e) of the Internal Revenue Code of 1954 [subsec. (e) of this section] applies) made by a corporation on or before the date of the enactment of this Act [Apr. 14, 1966] and on or after the date of the first distribution of money during the taxable year designated by the corporation if—

"(A) such corporation elects to have such amendments apply to all such distributions made by it, and

"(B) except as otherwise provided by this subsection, all persons (or their personal representatives) who were shareholders of such corporation at any time on or after the date of such first distribution and before the date on which the corporation files the election with the Secretary of the Treasury or his delegate consent to such election and to the application of this subsection.

"(2) An election by a corporation under this subsection, and the consent thereto of the persons who are or were shareholders of such corporation, shall be made in such manner and within such time as the Secretary of the Treasury or his delegate prescribes by regulations, but the period for making such election shall not expire before one year after the date on which the regulations prescribed under this subsection are published in the Federal Register.

"(3) In applying paragraphs (1) and (2), the consent of a person (or his personal representative) shall not be required if, under regulations prescribed under this subsection, it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the liability of such person for Federal income tax for any taxable year cannot be affected by the election of the corporation of which he is or was a shareholder.

"(4) In applying this subsection, the reference in section 1375(f) of the Internal Revenue Code of 1954 [subsec. (f) of this section] (as added by subsection (a)(1)) to the 15th day of the third month following the close of the taxable year shall be treated as referring to the 15th day of the fourth month following the close of the taxable year.

"(5) The statutory period for the assessment of any deficiency for any taxable year against the corporation filing the election or any person consenting thereto, to the extent such deficiency is attributable to an election under this subsection, shall not expire before the last day of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register; and such deficiency may be assessed at any time before the expiration of such 2-year period, notwithstanding any law or rule of law which would otherwise prevent such assessment.

"(6) If—

"(A) credit or refund of the amount of any overpayment for any taxable year attributable to an election under this subsection is not prevented, on the date of the enactment of this Act [Apr. 14, 1966], by the operation of any law or rule of law, and

"(B) credit or refund of the amount of such overpayment is prevented, by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises) [Chapter 74 of this title], at any time on or before the expiration of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register,

credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to such election, if claim therefor is filed before the expiration of such 2-year period.

"(7) If—

"(A) (i) one or more consecutive distributions of money made by the corporation after the close of a taxable year and on or before the 15th day of the fourth month following the close of the taxable year were substantially the same in amount as the undistributed taxable income of such corporation for such year, or

"(ii) it is established to the satisfaction of the Secretary of the Teasury or his delegate that one or more distributions of money made by the corporation during the period described in clause (i) were intended to be distributions of the undistributed taxable income of such corporation for the taxable year preceding such period, and

"(B) credit or refund of the amount of any overpayment for the taxable year in which such distribution or distributions were received is prevented on the date of the enactment of this Act [Apr. 14, 1966], by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises),

credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to an election under this subsection, if claim therefor is filed before the expiration of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register.

"(8) No interest on any deficiency attributable to an election under this subsection shall be assessed or collected for any period before the expiration of the 2-year period beginning on the date on which the regulations prescribed under this subsection are published in the Federal Register. No interest on any overpayment attributable to an election under this subsection shall be allowed or paid for any period before the expiration of such 2-year period."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1372 of this title.

§ 1376. Adjustment to basis of stock of, and indebtedness owing, shareholders.

(a) Increase in basis of stock for amounts treated as dividends.

The basis of a shareholder's stock in an electing small business corporation shall be increased by the amount required to be included in the gross income of such shareholder under section 1373 (b), but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in any redetermination of the shareholder's tax liability.

(b) Reduction in basis of stock and indebtedness for shareholder's portion of corporation net operating loss.

(1) Reduction in basis of stock.

The basis of a shareholder's stock in an electing small business corporation shall be reduced (but not below zero) by an amount equal to the amount of his portion of the corporation's net operating loss for any taxable year attributable to such stock (as determined under section 1374 (c)).

(2) Reduction in basis of indebtedness.

The basis of any indebtedness of an electing small business corporation to a shareholder of such corporation shall be reduced (but not below zero) by an amount equal to the amount of the shareholder's portion of the corporation's net operating loss for any taxable year (as determined under section 1374(c)), but only to the extent that such amount exceeds the adjusted basis of the stock of such corporation held by the shareholder.

(Added Pub. L. 85–866, title I, § 64 (a), Sept. 2, 1958, 72 Stat. 1655.)

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64 (e) of Pub. L. 85–866, set out as a note under section 172 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1016, 1372, 1374 of this title.

§ 1377. Special rules applicable to earnings and profits of electing small business corporations.

(a) Reduction for undistributed taxable income.

The accumulated earnings and profits of an electing small business corporation as of the close of its taxable year shall be reduced to the extent that its undistributed taxable income for such year is required to be included in the gross income of the shareholders of such corporation under section 1373 (b).

(b) Current earnings and profits not reduced by any amount not allowable as deduction.

The earnings and profits of an electing small business corporation for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income (as provided in section 1373 (d)) for such taxable year.

(c) Earnings and profits not affected by net operating loss.

The earnings and profits and the accumulated earnings and profits of an electing small business corporation shall not be affected by any item of gross income or any deduction taken into account in determining the amount of any net operating loss (computed as provided in section 1374 (c)) of such corporation. (Added Pub. L. 85–866, title I, § 64 (a), Sept. 2, 1958, 72 Stat. 1656.)

EFFECTIVE DATE

Section applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 64(e) of Pub. L. 85–866, set out as a note under section 172 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1372 of this title.

§ 1378. Tax imposed on certain capital gains.

(a) General rule.

If for a taxable year of an electing small business corporation—

(1) the excess of the net long-term capital gain over the net short-term capital loss of such corporation exceeds $25,000, and exceeds 50 percent of its taxable income for such year, and

(2) the taxable income of such corporation for such year exceeds $25,000,

there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation.

(b) Amount of tax.

The tax imposed by subsection (a) shall be the lower of—

(1) an amount equal to the tax, determined as provided in section 1201(a), on the amount by which the excess of the net long-term capital gain over the net short-term capital loss of the corporation for the taxable year exceeds $25,000, or

(2) an amount equal to the tax which would be imposed by section 11 on the taxable income (computed as provided in section 1373(d)) of the corporation for the taxable year if the corporation was not an electing small business corporation.

No credit shall be allowable under part IV of subchapter A of this chapter (other than under section 39) against the tax imposed by subsection (a). In applying section 1201(a)(1) (A) and (B) for purposes of paragraph (1), the $25,000 limitation shall first be deducted from the amount (determined without regard to this subsection) subject to tax in accordance with section 1201(a)(1)(B), to the extent thereof, and then from the amount (determined without regard to this subsection) subject to tax in accordance with section 1201(a)(1)(A).

(c) Exceptions.

(1) In general.

Subsection (a) shall not apply to an electing small business corporation for any taxable year if the election under section 1372(a) which is in effect with respect to such corporation for such taxable year has been in effect for the 3 immediately preceding taxable years.

(2) New corporations.

Subsection (a) shall not apply to an electing small business corporation if—

(A) it has been in existence for less than 4 taxable years, and

(B) an election under section 1372(a) has been in effect with respect to such corporation for each of its taxable years.

(3) Property with substituted basis.

If—

(A) but for paragraph (1) or (2), subsection (a) would apply for the taxable year,

(B) any long-term capital gain is attributable to property acquired by the electing small business corporation during the period beginning 3 years before the first day of the taxable year and ending on the last day of the taxable year, and

(C) the basis of such property is determined in whole or in part by reference to the basis of any property in the hands of another corporation which was not an electing small business corporation throughout all of the period described in subparagraph (B) before the transfer by such other corporation and during which such other corporation was in existence,

then subsection (a) shall apply for the taxable year, but the amount of the tax determined under subsection (b) shall not exceed a tax, determined as provided in section 1201(a), on the excess of the net long-term capital gain over the net short-term capital loss attributable to property acquired as provided in subparagraph (B) and having a basis described in subparagraph (C).

(Added Pub. L. 89-389, § 2(a), Apr. 14, 1966, 80 Stat. 113, and amended Pub. L. 91-172, title V, § 511(c)(4), Dec. 30, 1969, 83 Stat. 638.)

AMENDMENTS

1969—Subsec. (b). Pub. L. 91-172, § 511(c)(4)(B), added provision requiring in the application of section 1201(a)(1) (A) and (B) of this title for purposes of par. (1) of subsec. (b) of this section, the $25,000 limitation shall first be deducted from the amount (determined without regard to this subsec.) subject to tax in accordance with section 1201(a)(1)(B), to the extent thereof, and then from the amount (determined without regard to this subsec.) subject to tax in accordance with section 1201(a)(1)(A).

Subsec. (b)(1). Pub. L. 91-172, § 511(c)(4)(A), substituted "the tax, determined as provided in section 1201(a), on" for "25 percent of."

Subsec. (c)(3). Pub. L. 91-172, § 511(c)(4)(C), substituted "a tax, determined as provided in section 1201(a), on" for "25 percent of."

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable with respect to taxable years beginning after Dec. 31, 1969, see section 511(d) of Pub. L. 91-172, set out as a note under section 1201 of this title.

EFFECTIVE DATE

Section 2(c) of Pub. L. 89-389 provided that: "The amendments made by this section [adding this section and amending sections 46(a)(3), 1372(b), (1), 1373(c), and 1375(a)(3) of this title] shall apply with respect to taxable years of electing small business corporations beginning after the date of enactment of this Act [Apr. 14, 1966], but such amendments shall not apply with respect to sales or exchanges occurring before February 24, 1966."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 58, 1372, 1373, 1375 of this title.

§ 1379. Certain qualified pension, etc., plans.

(a) Additional requirement for qualification of stock bonus or profit-sharing plans.

A trust forming part of a stock bonus or profit-sharing plan which provides contributions or benefits for employees some or all of whom are shareholder-employees shall not constitute a qualified trust under section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) unless the plan of which such trust is a part provides that forfeitures attributable to contributions deductible under section 404(a)(3) for any taxable year (beginning after December 31, 1970) of the employer with respect to which it is an electing small business corporation may not inure to the benefit of any individual who is a shareholder-employee for such taxable year. A plan shall be considered as satisfying the requirement of this subsection for the period beginning with the first day of a taxable year and ending with the 15th day of the third month following the close of such taxable year, if all the provisions of the plan which are necessary to satisfy this requirement are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period.

(b) Taxability of shareholder-employee beneficiaries.

(1) Inclusion of excess contributions in gross income.

Notwithstanding the provisions of section 402 (relating to taxability of beneficiary of employees' trust), section 403 (relating to taxation of employee annuities), or section 405(d) (relating to

taxability of beneficiaries under qualified bond purchase plans), an individual who is a shareholder-employee of an electing small business corporation shall include in gross income, for his taxable year in which or with which the taxable year of the corporation ends, the excess of the amount of contributions paid on his behalf which is deductible under section 404(a) (1), (2), or (3) by the corporation for its taxable year over the lesser of—

(A) 10 percent of the compensation received or accrued by him from such corporation during its taxable year, or

(B) $2,500.

(2) Treatment of amounts included in gross income.

Any amount included in the gross income of a shareholder-employee under paragraph (1) shall be treated as consideration for the contract contributed by the shareholder-employee for purposes of section 72 (relating to annuities).

(3) Deduction for amounts not received as benefits.

If—

(A) amounts are included in the gross income of an individual under paragraph (1), and

(B) the rights of such individual (or his beneficiaries) under the plan terminate before payments under the plan which are excluded from gross income equal the amounts included in gross income under paragraph (1),

then there shall be allowed as a deduction, for the taxable year in which such rights terminate, an amount equal to the excess of the amounts included in gross income under paragraph (1) over such payments.

(c) Carryover of amounts deductible.

No amount deductible shall be carried forward under the second sentence of section 404(a)(3)(A) (relating to limits on deductible contributions under stock bonus and profit-sharing trusts) to a taxable year of a corporation with respect to which it is not an electing small business corporation from a taxable year (beginning after December 31, 1970) with respect to which it is an electing small business corporation.

(d) Shareholder-employee.

For purposes of this section, the term "shareholder-employee" means an employee or officer of an electing small business corporation who owns (or is considered as owning within the meaning of section 318(a)(1), on any day during the taxable year of such corporation, more than 5 percent of the outstanding stock of the corporation. (Added Pub. L. 91-172, title V, § 531(a), Dec. 30, 1969, 83 Stat 654.)

EFFECTIVE DATE

Section 531(d) of Pub. L. 91-172 provided that: "The amendments made by this section [enacting this section and amending section 62 of this title] shall apply with respect to taxable years of electing small business corporations beginning after December 31, 1970."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 62 of this title.

Subchapter T.—Cooperatives and Their Patrons

Part

I. Tax treatment of cooperatives.
II. Tax treatment by patrons of patronage dividends and per-unit retain allocations.
III. Definitions; special rules.

AMENDMENTS

1966—Pub. L. 89-809, title II, § 211(b)(5), Nov. 13, 1966, 80 Stat. 1582, inserted "and per-unit retain allocations" in heading of Part II.

1962—Pub. L. 87-834, § 17(a), Oct. 16, 1962, 76 Stat. 1045, added the headings of subchapter T and of parts I—III.

PART I.—TAX TREATMENT OF COOPERATIVES

Sec.

1381. Organizations to which part applies.
1382. Taxable income of cooperatives.
1383. Computation of tax where cooperative redeems nonqualified written notices of allocation or nonqualified per-unit retain certificates.

AMENDMENTS

1966—Pub. L. 89-809, title II, § 211(a)(8), Nov. 13, 1966, 80 Stat. 1582, inserted "or nonqualified per-unit retain certificates" in item 1383.

1962—Pub. L. 87-834, §17(a), Oct. 16, 1962, 76 Stat. 1045, added the heading of Part I and items 1381—1383.

PART REFERRED TO IN OTHER SECTIONS

This part is referred to in section 521 of this title.

§ 1381. Organizations to which part applies.

(a) In general.

This part shall apply to—

(1) any organization exempt from tax under section 521 (relating to exemption of farmers' cooperatives from tax), and

(2) any corporation operating on a cooperative basis other than an organization—

(A) which is exempt from tax under this chapter,

(B) which is subject to the provisions of—

(i) part II of subchapter H (relating to mutual savings banks, etc.), or

(ii) subchapter L (relating to insurance companies), or

(C) which is engaged in furnishing electric energy, or providing telephone service, to persons in rural areas.

(b) Tax on certain farmers' cooperatives.

An organization described in subsection (a)(1) shall be subject to the taxes imposed by section 11 or 1201. (Added Pub. L. 87-834, § 17(a), Oct. 16, 1962, 76 Stat. 1045.)

EFFECTIVE DATE

Section 17(c) of Pub. L. 87-834 provided that:

"(1) *For the cooperatives.*—Except as provided in paragraph (3), the amendments made by subsections (a) and (b) [adding this subchapter, amending sections 521 and 6072 of this title, and repealing section 522 of this title] shall apply to taxable years of organizations described in section 1381(a) of the Internal Revenue Code of 1954 (as added by subsection (a)) [this section] beginning after December 31, 1962.

"(2) *For the patrons.*—Except as provided in paragraph (3), section 1385 of the Internal Revenue Code of 1954 (as added by subsection (a)) [section 1385 (3) of this title] shall apply with respect to any amount received from any organization described in section 1381(a) of such Code [subsec. (a) of this section], to the extent that such amount is paid by such organization in a taxable year of such organization beginning after December 31, 1962.

"(3) *Application of existing law.*—In the case of any money, written notice of allocation, or other property paid by any organization described in section 1381(a) [subsec. (a) of this section]—

"(A) before the first day of the first taxable year of such organization beginning after December 31, 1962, or

"(B) on or after such first day with respect to patronage occurring before such first day,

the tax treatment of such money, written notice of allocation, or other property (including the tax treatment of gain or loss on the redemption, sale, or other disposition of such written notice of allocation) by any person shall be made under the Internal Revenue Code of 1954 without regard to subchapter T of chapter 1 of such Code [this subchapter]."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 1381, 1385, 6044, 6072 of this title.

§ 1382. Taxable income of cooperatives.

(a) Gross income.

Except as provided in subsection (b), the gross income of any organization to which this part applies shall be determined without any adjustment (as a reduction in gross receipts, an increase in cost of goods sold, or otherwise) by reason of any allocation or distribution to a patron out of the net earnings of such organization or by reason of any amount paid to a patron as a per-unit retain allocation (as defined in section 1388(f)).

(b) Patronage dividends and per-unit retain allocations.

In determining the taxable income of an organization to which this part applies, there shall not be taken into account amounts paid during the payment period for the taxable year—

(1) as patronage dividends (as defined in section 1388(a)), to the extent paid in money, qualified written notices of allocation (as defined in section 1388(c)), or other property (except nonqualified written notices of allocation (as defined in section 1388(d))) with respect to patronage occurring during such taxable year;

(2) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred;

(3) as per-unit retain allocations (as defined in section 1388(f)), to the extent paid in money, qualified per-unit retain certificates (as defined in section 1388(h)), or other property (except nonqualified per-unit retain certificates, as defined in section 1388(i)) with respect to marketing occurring during such taxable year; or

(4) in money or other property (except per-unit retain certificates) in redemption of a nonqualified per-unit retain certificate which was paid as a per-unit retain allocation during the payment period for the taxable year during which the marketing occurred.

For purposes of this title, any amount not taken into account under the preceding sentence shall, in the case of an amount described in paragraph (1) or (2), be treated in the same manner as an item of gross income and as a deduction therefrom, and in the case of an amount described in paragraph (3) or (4), be treated as a deduction in arriving at gross income.

(c) Deduction for nonpatronage distributions, etc.

In determining the taxable income of an organization described in section 1381(a)(1), there shall be allowed as a deduction (in addition to other deductions allowable under this chapter)—

(1) amounts paid during the taxable year as dividends on its capital stock; and

(2) amounts paid during the payment period for the taxable year—

(A) in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) on a patronage basis to patrons with respect to its earnings during such taxable year which are derived from business done for the United States or any of its agencies or from sources other than patronage, or

(B) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid, during the payment period for the taxable year during which the earnings were derived, on a patronage basis to a patron with respect to earnings derived from business or sources described in subparagraph (A).

(d) Payment period for each taxable year.

For purposes of subsections (b) and (c)(2), the payment period for any taxable year is the period beginning with the first day of such taxable year and ending with the fifteenth day of the ninth month following the close of such year. For purposes of subsections (b)(1) and (c)(2)(A), a qualified check issued during the payment period shall be treated as an amount paid in money during such period if endorsed and cashed on or before the 90th day after the close of such period.

(e) Products marketed under pooling arrangements.

For purposes of subsection (b), in the case of a pooling arrangement for the marketing of products—

(1) the patronage shall (to the extent provided in regulations prescribed by the Secretary or his delegate) be treated as patronage occurring during the taxable year in which the pool closes, and

(2) the marketing of products shall be treated as occurring during any of the taxable years in which the pool is open.

(f) Treatment of earnings received after patronage occurred.

If any portion of the earnings from business done with or for patrons is includible in the organization's gross income for a taxable year after the taxable year during which the patronage occurred, then for purposes of applying paragraphs (1) and (2) of subsection (b) to such portion the patronage shall, to the extent provided in regulations prescribed by the Secretary or his delegate, be considered to have occurred during the taxable year of the organization during which such earnings are includible in gross income. (Added Pub. L. 87–834, § 17(a), Oct. 16, 1962, 76 Stat. 1046, and amended Pub. L. 89–809,

title II, § 211(a)(1)—(4), Nov. 13, 1966, 80 Stat. 1580, 1581; Pub. L. 91–172, title IX, § 911(a), Dec. 30, 1969, 83 Stat. 722.)

AMENDMENTS

1969—Subsec. (b)(3). Pub. L. 91–172 expanded the category of per-unit retain allocations that may not be taken into account in determining the taxable income of an organization, by including per-unit retain allocations paid for in money or other property (except nonqualified per-unit retain certificates as defined in section 1388(i) of this section).

1966—Subsec. (a). Pub. L. 89–809, § 211(a)(1), inserted reference to amounts paid to patrons as a per-unit retain allocation as defined in section 1388(f).

Subsec. (b). Pub. L. 89–809, § 211(a)(2), inserted "and per-unit retain allocations" in the subsec. catchline, added pars. (3) and (4), and, in the material following the pars., added provisions making the existing material applicable only to amounts described in pars. (1) and (2) and adding material covering the treatment of amounts described in pars. (3) and (4).

Subsec. (e). Pub. L. 89–809, § 211(a)(3), added provision that the marketing of products shall be treated as occurring during any of the taxable years in which the pool is open.

Subsec. (f). Pub. L. 89–809, § 211(a)(4), substituted "paragraphs (1) and (2) of subsection (b)" for "subsection (b)".

EFFECTIVE DATE OF 1969 AMENDMENT

Section 911(c) of Pub. L. 91–172 provided that: "The amendments made by this section [amending this section and section 1388 of this title] shall apply to per-unit retain allocations made after October 9, 1969."

EFFECTIVE DATE OF 1966 AMENDMENT

Section 211(e) of Pub. L. 89–809 provided that:

"(1) The amendments made by subsections (a), (b), and (c) [amending this section and sections 1383, 1385, and 1388 of this title] shall apply to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after April 30, 1966, with respect to products delivered during such years.

"(2) The amendments made by subsection (d) [amending section 6044 of this title] shall apply with respect to calendar years after 1966."

EFFECTIVE DATE

Except as otherwise provided, section applicable to taxable years of organizations described in section 1381(a) of this title beginning after Dec. 31, 1962, see section 17(c) of Pub. L. 87–834, set out as a note under section 1381 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 46, 1383, 1385, 1388, 6044, 6072 of this title.

§ 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation or nonqualified per-unit retain certificates.

(a) General rule.

If, under section 1382 (b)(2) or (4), or (c)(2)(B), deduction is allowable to an organization for the taxable year for amounts paid in redemption of nonqualified written notices of allocation or non-qualified per-unit retain certificates, then the tax imposed by this chapter on such organization for the taxable year shall be the lesser of the following:

(1) the tax for the taxable year computed with such deduction; or

(2) an amount equal to—

(A) the tax for the taxable year computed without such deduction, minus

(B) the decrease in tax under this chapter for any prior taxable year (or years) which would result solely from treating such nonqualified written notices of allocation or nonqualified per-unit retain certificates as qualified written notices of allocation or qualified per-unit retain certificates (as the case may be).

(b) Special rules.

(1) If the decrease in tax ascertained under subsection (a)(2)(B) exceeds the tax for the taxable year (computed without the deduction described in subsection (a)) such excess shall be considered to be a payment of tax on the last day prescribed by law for the payment of tax for the taxable year, and shall be refunded or credited in the same manner as if it were an overpayment for such taxable year.

(2) For purposes of determining the decrease in tax under subsection (a)(2)(B), the stated dollar amount of any nonqualified written notice of allocation or nonqualified per-unit retain certificate which is to be treated under such subsection as a qualified written notice of allocation or qualified per-unit retain certificate (as the case may be) which is allowable as a deduction under section 1382 (b)(2) or (4), or (c)(2)(B) for the taxable year.

(3) If the tax imposed by this chapter for the taxable year is the amount determined under subsection (a)(2), then the deduction described in subsection (a) shall not be taken into account for any purpose of this subtitle other than for purposes of this section.

(Added Pub. L. 87–834, § 17(a), Oct. 16, 1962, 76 Stat. 1047, and amended Pub. L. 89–809, title II, § 211(a)(5)–(7), Nov. 13, 1966, 80 Stat. 1581.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809, § 211(a)(5), (6), added "or nonqualified per-unit retain certificates" to the section catchline, substituted "section 1382(b)(2) or (4)" for "1382(b)(2)", and inserted references to per-unit retain certificates.

Subsec. (b)(2). Pub. L. 89–809, § 211(a)(7), substituted "section 1382(b)(2) or (4)" for "section 1382(b)(2)" and inserted references to per-unit retain certificates.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by section 211 of Pub. L. 89–809 applicable to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after Apr. 30, 1966, with respect to products delivered during such years, see section 211(e)(1) of Pub. L. 89–809, set out as a note under section 1382 of this title.

EFFECTIVE DATE

Except as otherwise provided, section applicable to taxable years of organizations described in section 1381(a) of this title beginning after Dec. 31, 1962, see section 17(c) of Pub. L. 87–834, set out as a note under section 1381 of this title.

PART II.—TAX TREATMENT BY PATRONS OF PATRONAGE DIVIDENDS AND PER-UNIT RETAIN ALLOCATIONS

Sec.
1385. Amounts includible in patron's gross income.

AMENDMENTS

1962—Pub. L. 87–834, § 17(a), Oct. 16, 1962, 76 Stat. 1048, added the heading of Part II and item 1385.

§ 1385. Amounts includible in patron's gross income.

(a) General rule.

Except as otherwise provided in subsection (b), each person shall include in gross income—

(1) the amount of any patronage dividend which is paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation), and which is received by him during the taxable year from an organization described in section 1381(a),

(2) any amount, described in section 1382(c)(2)(A) (relating to certain nonpatronage distributions by tax-exempt farmers' cooperatives), which is paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation), and which is received by him during the taxable year from an organization described in section 1381(a)(1), and

(3) the amount of any per-unit retain allocation which is paid in qualified per-unit retain certificates and which is received by him during the taxable year from an organization described in section 1381(a).

(b) Exclusion from gross income.

Under regulations prescribed by the Secretary or his delegate, the amount of any patronage dividend, and any amount received on the redemption, sale, or other disposition of a nonqualified written notice of allocation which was paid as a patronage dividend, shall not be included in gross income to the extent that such amount—

(1) is properly taken into account as an adjustment to basis of property, or

(2) is attributable to personal, living, or family items.

(c) Treatment of certain nonqualified written notices of allocation and certain nonqualified per-unit retain certificates.

(1) Application of subsection.

This subsection shall apply to—

(A) any nonqualified written notice of allocation which—

(i) was paid as a patronage dividend, or

(ii) was paid by an organization described in section 1381(a)(1) on a patronage basis with respect to earnings derived from business or sources described in section 1382(c)(2)(A), and

(B) any nonqualified per-unit retain certificate which was paid as a per-unit retain allocation.

(2) Basis; amount of gain.

In the case of any nonqualified written notice of allocation or nonqualified per-unit retain certificate to which this subsection applies, for purposes of this chapter—

(A) the basis of such written notice of allocation or per-unit retain certificate in the hands of the patron to whom such written notice of allocation or per-unit retain certificate was paid shall be zero,

(B) the basis of such written notice of allocation or per-unit retain certificate which was acquired from a decedent shall be its basis in the hands of the decedent, and

(C) gain on the redemption, sale, or other disposition of such written notice of allocation or per-unit retain certificate by any person shall, to the extent that the stated dollar amount of such written notice of allocation or per-unit retain certificate exceeds its basis, be considered as gain from the sale or exchange of property which is not a capital asset.

(Added Pub. L. 87–834, § 17(a), Oct. 16, 1962, 76 Stat. 1048, and amended Pub. L. 89–809, title II, § 211(b)(1)—(4), Nov. 13, 1966, 80 Stat. 1582.)

AMENDMENTS

1966—Subsec. (a). Pub. L. 89–809, § 211(b)(1), added par. (3).

Subsec. (c). Pub. L. 89–809, § 211(b)(2)–(4), inserted "and certain nonqualified per-unit retain certificates" into the subsection catchline, added provisions to par. (1) for the application of the subsection to any nonqualified per-unit retain certificates which were paid as per-unit retain allocations, and inserted references to per-unit retain certificates in par. (2).

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by section 211 of Pub. L. 89–809 applicable to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after Apr. 30, 1966, with respect to products delivered during such years, see section 211(e)(1) of Pub. L. 89–809, set out as a note under section 1382 of this title.

EFFECTIVE DATE

Except as otherwise provided, section applicable to taxable years of organizations described in section 1381(a) of this title beginning after Dec. 31, 1962, see section 17(c) of Pub. L. 87–834, set out as a note under section 1381 of this title.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 1388 of this title.

PART III.—DEFINITIONS; SPECIAL RULES

Sec.
1388. Definitions; special rules.

AMENDMENTS

1962—Pub. L. 87–834, § 17(a), Oct. 16, 1962, 76 Stat. 1049, added the heading of Part III and item 1388.

§ 1388. Definitions; special rules.

(a) Patronage dividend.

For purposes of this subchapter, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of this subchapter applies—

(1) on the basis of quantity or value of business done with or for such patron,

(2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and

(3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

Such term does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions.

(b) Written notice of allocation.

For purposes of this subchapter, the term "written notice of allocation" means any capital stock, revolving fund certificate, retain certificate, certificate of indebtedness, letter of advice, or other written notice, which discloses to the recipient the stated dollar amount allocated to him by the organization and the portion thereof, if any, which constitutes a patronage dividend.

(c) Qualified written notice of allocation.

(1) Defined.

For purposes of this subchapter, the term "qualified written notice of allocation" means—

(A) a written notice of allocation which may be redeemed in cash at its stated dollar amount at any time within a period beginning on the date such written notice of allocation is paid and ending not earlier than 90 days from such date, but only if the distributee receives written notice of the right of redemption at the time he receives such written notice of allocation; and

(B) a written notice of allocation which the distributee has consented, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385(a).

Such term does not include any written notice of allocation which is paid as part of a patronage dividend or as part of a payment described in section 1382(c)(2)(A), unless 20 percent or more of the amount of such patronage dividend, or such payment, is paid in money or by qualified check.

(2) Manner of obtaining consent.

A distributee shall consent to take a written notice of allocation into account as provided in paragraph (1)(B) only by—

(A) making such consent in writing,

(B) obtaining or retaining membership in the organization after—

(i) such organization has adopted (after the date of the enactment of the Revenue Act of 1962) a bylaw providing that membership in the organization constitutes such consent, and

(ii) he has received a written notification and copy of such bylaw, or

(C) if neither subparagraph (A) nor (B) applies, endorsing and cashing a qualified check, paid as a part of the patronage dividend or payment of which such written notice of allocation is also a part, on or before the 90th day after the close of the payment period for the taxable year of the organization for which such patronage dividend or payment is paid.

(3) Period for which consent is effective.

(A) General rule.

Except as provided in subparagraph (B)—

(i) a consent described in paragraph (2)(A) shall be a consent with respect to all patronage of the distributee with the organization occurring (determined with the application of section 1382(e)) during the taxable year of the organization during which such consent is made and all subsequent taxable years of the organization; and

(ii) a consent described in paragraph (2)(B) shall be a consent with respect to all patronage of the distributee with the organization occurring (determined without the application of section 1382(e)) after he received the notification and copy described in paragraph (2)(B)(ii).

(B) Revocation, etc.

(i) Any consent described in paragraph (2)(A) may be revoked (in writing) by the distributee at any time. Any such revocation shall be effective with respect to patronage occurring on or after the first day of the first taxable year of the organization beginning after the revocation is filed with such organization; except that in the case of a pooling arrangement described in section 1382(e), a revocation made by a distributee shall not be effective as to any pool with respect to which the distributee has been a patron before such revocation.

(ii) Any consent described in paragraph (2)(B) shall not be effective with respect to any patronage occurring (determined without the application of section 1382(e)) after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2)(B)(i).

(4) Qualified check.

For purposes of this subchapter, the term "qualified check" means only a check (or other instrument which is redeemable in money) which is paid as a part of a patronage dividend, or as a part of a payment described in section 1382(c)(2)(A), to a distributee who has not given consent as provided in paragraph (2)(A) or (B) with respect to such patronage dividend or payment, and on which there is clearly imprinted a statement that the endorsement and cashing of the check (or other instrument) constitutes the consent of the payee to include in his gross income, as provided in the Federal income tax laws, the stated dollar amount of the written notice of allocation which is a part of the patronage dividend or payment of which such qualified check is also a part. Such term does not include any check (or other instrument) which is paid as part of a patronage dividend or payment which does not include a written notice of allocation (other than a written notice of allocation described in paragraph (1)(A)).

(d) Nonqualified written notice of allocation.

For purposes of this subchapter, the term "nonqualified written notice of allocation" means a written notice of allocation which is not described in subsection (c) or a qualified check which is not cashed on or before the 90th day after the close of the payment period for the taxable year for which the distribution of which it is a part is paid.

(e) Determination of amount paid or received.

For purposes of this subchapter, in determining amounts paid or received—

(1) property (other than a written notice of allocation or a per-unit retain certificate) shall be taken into account at its fair market value, and

(2) a qualified written notice of allocation or qualified per-unit retain certificate shall be taken into account at its stated dollar amount.

(f) Per-unit retain allocation.

For purposes of this subchapter, the term "per-unit retain allocation" means any allocation, by an organization to which part I of this subchapter applies, to a patron with respect to products marketed for him, the amount of which is fixed without reference to the net earnings of the organization pursuant to an agreement between the organization and the patron.

(g) Per-unit retain certificate.

For purposes of this subchapter, the term "per-unit retain certificate" means any written notice which discloses to the recipient the stated dollar amount of a per-unit retain allocation to him by the organization.

(h) Qualified per-unit retain certificate.

(1) Defined.

For purposes of this subchapter, the term "qualified per-unit retain certificate" means any per-unit retain certificate which the distributee has agreed, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385(a).

(2) Manner of obtaining agreement.

A distributee shall agree to take a per-unit retain certificate into account as provided in paragraph (1) only by—

(A) making such agreement in writing, or

(B) obtaining or retaining membership in the organization after—

(i) such organization has adopted (after the date of the enactment of this subsection) a bylaw providing that membership in the organization constitutes such agreement, and

(ii) he has received a written notification and copy of such bylaw.

(3) Period for which agreement is effective.

(A) General rule.

Except as provided in subparagraph (B)—

(i) an agreement described in paragraph (2)(A) shall be an agreement with respect to all products delivered by the distributee to the organization during the taxable year of the organization during which such agreement is made and all subsequent taxable years of the organization; and

(ii) an agreement described in paragraph (2)(B) shall be an agreement with respect to all products delivered by the distributee to the organization after he received the notification and copy described in paragraph (2)(B)(ii).

(B) Revocation, etc.

(i) Any agreement described in paragraph (2)(A) may be revoked (in writmg) by the distributee at any time. Any such revocation shall be effeetive with respect to products delivered by the distributee on or after the first day of the first taxable year of the organization beginning after the revocation is filed with the organization; except that in the case of a pooling arrangement described in section 1382(e) a revocation made by a distributee shall not be effective as to any products which were delivered to the organization by the distributee before such revocation.

(ii) Any agreement described in paragraph (2)(B) shall not be effective with respect to any products delivered after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2)(B)(i).

(i) Nonqualified per-unit retain certificate.

For purposes of this subchapter, the term "nonqualified per-unit retain certificate" means a per-unit retain certificate which is not described in subsection (h). (Added Pub. L. 87–834, § 17(a), Oct. 16, 1962, 76 Stat. 1049, and amended Pub. L. 89–809, title II, § 211(c), Nov. 13, 1966, 80 Stat. 1582; Pub. L. 91–172, title IX, § 911(b), Dec. 30, 1969, 83 Stat. 722.)

REFERENCES IN TEXT

The date of the enactment of the Revenue Act of 1962, referred to in subsec. (c), means the date of the enactment of Pub. L. 87–834, which was approved on Oct. 16, 1962.

AMENDMENTS

1969—Subsec. (f). Pub. L. 91–172 struck out reference to allocations made by organizations other than by payment of money or other property except per-unit retain certificates.

1966—Subsec. (e). Pub. L. 89–809, § 211(c)(1), inserted references to per-unit retain certificates.

Subsecs. (f)—(i). Pub. L. 89–809, § 211(c)(2), added subsecs. (f)—(i).

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91–172 applicable to per-unit retain allocations made after Oct. 9, 1969, see section 911(c) of Pub. L. 91–172, set out as a note under section 1382 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment of section by section 211 of Pub. L. 89–809 applicable to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after Apr. 30, 1966, with respect to products delivered during such years, see section 211(e)(1) of Pub. L. 89–809, set out as a note under section 1382 of this title.

EFFECTIVE DATE

Except as otherwise provided, section applicable to taxable years of organizations described in section 1331(a) of this title beginning after Dec. 31, 1962, see section 17(c) of Pub. L. 87–834, set out as a note under section 1381 of this title.

PER-UNIT RETAIN CERTIFICATES COVERED BY WRITTEN AGREEMENTS BETWEEN OCT. 14, 1965, AND NOV. 13, 1966: TRANSITION TREATMENT OF BY-LAW PROVISIONS

Section 211(f) of Pub. L. 89–809 provided that:

"(1) Except as provided in paragraph (2), a written agreement between a patron and a cooperative association—

"(A) which clearly provides that the patron agrees to treat the stated dollar amounts of all per-unit retain certificates issued to him by the association as representing cash distributions which he has, of his own choice, reinvested in the cooperative association,

"(B) which is revocable by the patron at any time after the close of the taxable year in which it was made,

"(C) which was entered into after October 14, 1965, and before the date of the enactment of this Act [Nov. 13, 1966], and

"(D) which is in effect on the date of the enactment of this Act [Nov. 13, 1966], and with respect to which a written notice of revocation has not been furnished to the cooperative association,

shall be effective (for the period prescribed in the agreement) for purposes of section 1388(h) of the Internal Revenue Code of 1954 [subsec. (h) of this section] as if entered into, pursuant to such section, after the date of the enactment of this Act [Nov. 13, 1966].

"(2) An agreement described in paragraphs (1)(A) and (C) which was included in a by-law of the cooperative association and which is in effect on the date of the enactment of this Act [Nov. 13, 1966] shall be effective for purposes of section 1388(h) of such Code only for taxable years of the association beginning before May 1, 1967."

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1382, 6044 of this title.

Chapter 2.—TAX ON SELF-EMPLOYMENT INCOME

Sec.
1401. Rate of tax.
1402. Definitions.
1403. Miscellaneous provisions.

CHAPTER REFERRED TO IN OTHER SECTIONS

This chapter is referred to in sections 6015, 6017, 6103, 6654 of this title; title 42 sections 401, 405, 408; title 48 sections 1421h, 1421i.

§ 1401. Rate of tax.

(a) Old-age, survivors, and disability insurance.

In addition to other taxes, there shall be imposed for each taxable year, on the self-employment income of every individual, a tax as follows:

(1) in the case of any taxable year beginning after December 31, 1967, and before January 1, 1969, the tax shall be equal to 5.8 percent of the amount of the self-employment income for such taxable year;

(2) in the case of any taxable year beginning after December 31, 1968, and before January 1, 1971, the tax shall be equal to 6.3 percent of the amount of the self-employment income for such taxable year;

(3) in the case of any taxable year beginning after December 31, 1970, and before January 1, 1973, the tax shall be equal to 6.9 percent of the amount of the self-employment income for such taxable year; and

(4) in the case of any taxable year beginning after December 31, 1972, the tax shall be equal to 7.0 percent of the amount of the self-employment income for such taxable year.

(b) Hospital insurance.

In addition to the tax imposed by the preceding subsection, there shall be imposed for each taxable year, on the self-employment income of every individual, a tax as follows:

(1) in the case of any taxable year beginning after December 31, 1967, and before January 1, 1973, the tax shall be equal to 0.60 percent of the amount of the self-employment income for such taxable year;

(2) in the case of any taxable year beginning after December 31, 1972, and before January 1, 1976, the tax shall be equal to 0.65 percent of the amount of the self-employment income for such taxable year;

(3) in the case of any taxable year beginning after December 31, 1975, and before January 1, 1980, the tax shall be equal to 0.70 percent of the amount of the self-employment income for such taxable year;

(4) in the case of any taxable year beginning after December 31, 1979, and before January 1, 1987, the tax shall be equal to 0.80 percent of the amount of the self-employment income for such taxable year; and

(5) in the case of any taxable year beginning after December 31, 1986, the tax shall be equal to 0.90 percent of the amount of the self-employment income for such taxable year.

(Aug. 16, 1954, ch. 736, 68A Stat. 353; Sept. 1, 1954, ch. 1206, title II, § 208(a), 68 Stat. 1093; Aug. 1, 1956, ch. 836, title II, § 202(a), 70 Stat. 845; Aug. 28, 1958, Pub. L. 85–840, title IV, § 401(a), 72 Stat. 1041; June 30, 1961, Pub. L. 87–64, title II, § 201(a), 75 Stat. 140; July 30, 1965, Pub. L. 89–97, title I, § 111(c)(4), title III, § 321(a), 79 Stat. 342, 394; Jan. 2, 1968, Pub. L. 90–248, title I, § 109(a)(1), (b)(1), 81 Stat. 835, 836.)

AMENDMENTS

1968—Subsec. (a)(1)—(4). Pub. L. 90–248, § 109(a)(1), substituted "December 31, 1967" and "January 1, 1969" for "December 31, 1965" and "January 1, 1967" in par. (1), "December 31, 1968", "January 1, 1971" and "6.3" for "December 31, 1966", "January 1, 1969", and "5.9" in par. (2), and "December 31, 1970" and "6.9" for "December 31, 1968" and "6.6" in par. (3), and reenacted par. (4) without change.

Subsec. (b)(1)—(5). Pub. L. 90–248, § 109(b)(1), struck out par. (1) provision for rate of 0.35 percent of amount of self-employment income for any taxable year beginning after Dec. 31, 1965, and before Jan. 1, 1967, redesignated former pars. (2)—(6) as (1)—(5), substituted "December 31, 1967" for "December 31, 1966" in such par. (1) and increased the rate by 0.10 percent to 0.60, 0.65, 0.70, 0.80, and 0.90 in pars. (1)—(5), respectively.

1965—Pub. L. 89–97, § 321(a), divided the total tax imposed under the entire section for each taxable year upon the self-employment income for such taxable year into two separate taxes by dividing the section into subsecs. (a) and (b), with subsec. (a) reflecting the tax for old-age, survivors, and disability insurance and subsec. (b) reflecting a separate tax for hospital insurance; reduced from 6.2 percent to 6.15 percent the rate of total tax imposed under the entire section for taxable years beginning after Dec. 31, 1965, and before Jan. 1, 1967 (resulting from a tax of 5.8 percent under subsec. (a) and 0.35 percent under subsec. (b)), increased from 6.2 percent to 6.4 percent the rate for taxable years beginning after Dec. 31, 1966, and before Jan. 1, 1968 (resulting from a tax of 5.9 percent under subsec. (a) and 0.50 percent under subsec. (b)), reduced from 6.9 percent to 6.4 percent the rate for taxable years beginning after Dec. 31, 1967, and before Jan. 1, 1969 (resulting from a tax of 5.9 percent under subsec. (a) and 0.50 percent under subsec. (b)), increased from 6.9 percent to 7.1 percent the rate for taxable years beginning after Dec. 31, 1968, and before Jan. 1, 1973 (resulting from a tax of 6.6 percent under subsec. (a) and 0.50 percent under subsec. (b)), from 6.9 percent to 7.55 percent the rate for taxable years beginning after Dec. 31, 1972, and before Jan. 1, 1976 (resulting from a tax of 7.0 percent under subsec. (a) and 0.55 percent under subsec. (b)), from 6.9 percent to 7.60 percent the rate for taxable years beginning after Dec. 31, 1975, and before Jan. 1, 1980 (resulting from a tax of 7.0 percent under subsec. (a) and 0.60 percent under subsec. (b)), from 6.9 percent to 7.70 percent the rate for taxable years beginning after Dec. 31, 1979, and before Jan. 1, 1987 (resulting from a tax of 7.0 percent under subsec. (a) and 0.70 percent under subsec. (b)), and from 6.9 percent to 7.80 percent the rate for taxable years beginning after Dec. 31, 1986 (resulting from a tax of 7.0 percent under subsec. (a) and 0.80 percent under