76TH CONGRESS 3d Session } HOUSE OF REPRESENTATIVES { REPORT No. 3002

SECOND REVENUE BILL OF 1940

SEPTEMBER 30, 1940.—Ordered to be printed

Mr. DOUGHTON, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H. R. 10413]

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 10413) to provide revenue, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its amendments numbered 5, 34, and 37.

That the House recede from its disagreement to the amendments of the Senate numbered 2, 3, 4, 6, 10, 12, 13, 14, 15, 16, 17, 18, 19, 20, 23, 25, 28, 29, 30, 31, 32, and 33, and agree to the same.

Amendment numbered 1:

That the House recede from its disagreement to the amendment of the Senate numbered 1, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

TITLE I—CORPORATION INCOME TAX

SEC. 101. CORPORATION INCOME TAX

(a) TAX ON CORPORATIONS IN GENERAL.—Section 13 (b) of the Internal Revenue Code, as amended by section 3 of the Revenue Act of 1940, is amended to read as follows:

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231 (a), Supplement G, or Supplement Q) whichever of the following taxes is the lesser:

"(1) GENERAL RULE.—A tax of 22⅒ per centum of the normal-tax net income; or

"(2) ALTERNATIVE TAX (CORPORATIONS WITH NORMAL-TAX NET INCOME SLIGHTLY MORE THAN $25,000).—A tax of $3,775, plus 35 per centum of the amount of the normal-tax net income in excess of $25,000."

(b) TAX ON FOREIGN CORPORATIONS.—Section 14 (c) (1) of the Internal Revenue Code, as amended by section 3 of the Revenue Act of 1940, is amended to read as follows:

"(c) FOREIGN CORPORATIONS.—

"(1) In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the tax shall be an amount equal to 22 1/10 per centum of the normal-tax net income, regardless of the amount thereof."

(c) TAX ON MUTUAL INVESTMENT COMPANIES.—Section 362 (b) of the Internal Revenue Code, as amended by section 3 of the Revenue Act of 1940, is amended to read as follows:

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the Supplement Q net income of every mutual investment company a tax equal to 22 1/10 per centum of the amount thereof."

(d) DEFENSE TAX FOR FIVE YEARS.—The first sentence of section 15 of the Internal Revenue Code, added to such Code by section 201 of the Revenue Act of 1940, is amended to read as follows: "In the case of any taxpayer, the amount of tax under this chapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be the tax computed without regard to this section, increased by 10 per centum; except that in the case of a corporation the increase shall be limited to 10 per centum of the tax computed without regard to the amendments made by section 101 (a), (b), and (c) of the Second Revenue Act of 1940."

(e) TAXABLE YEARS TO WHICH APPLICABLE.—Amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1939.

TITLE II—EXCESS PROFITS TAX

SEC. 201. EXCESS PROFITS TAX OF 1940

The Internal Revenue Code is amended by inserting after section 706 the following new subchapter which may be cited as the "Excess Profits Tax Act of 1940":

"SUBCHAPTER E—EXCESS PROFITS TAX

"PART I

"SEC. 710. IMPOSITION OF TAX

"(a) IMPOSITION.—There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1939, on the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax as follows:

"(1) Upon adjusted excess profits net incomes of less than $20,000, 25 per centum of the adjusted excess profits net income.

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

"$14,000 upon adjusted excess profits net incomes of $50,000; and upon adjusted excess profits net incomes in excess of $50,000, and not in excess of $100,000, 35 per centum in addition of such excess.

"$31,500 upon adjusted excess profits net incomes of $100,000; and upon adjusted excess profits net incomes in excess of $100,000, and not in excess of $250,000, 40 per centum in addition of such excess.

"$91,500 upon adjusted excess profits net incomes of $250,000; and upon adjusted excess profits net incomes in excess of $250,000, and not in excess of $500,000, 45 per centum in addition of such excess.

"$204,000 upon adjusted excess profits net incomes of $500,000; and upon adjusted excess profits net incomes in excess of $500,000, 50 per centum in addition of such excess.

"(2) APPLICATION OF RATES IN CASE OF CERTAIN EXCHANGES.—If the taxpayer's highest bracket amount for the taxable year computed under section 752 (relating to certain exchanges) is less than $500,000, then in the application of paragraph (1) of this subsection to such taxpayer, in lieu of each amount, other than the percentages, specified in such paragraph, there shall be substituted an amount which bears the same ratio to the amount so specified as the highest bracket amount so computed bears to $500,000.

"(b) DEFINITION OF ADJUSTED EXCESS PROFITS NET INCOME.—As used in this section, the term 'adjusted excess profits net income' in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

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

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

"(3) UNUSED EXCESS PROFITS CREDIT.—In the case of a taxpayer the normal-tax net income of which for the taxable year is not more than $25,000, the amount by which the excess profits credit for the preceding taxable year (if beginning after December 31, 1939) exceeds the excess profits net income for such preceding taxable year.

"SEC. 711. EXCESS PROFITS NET INCOME.

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

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

"(A) Income Taxes.—The deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) under Chapter 1 for such taxable year;

"(B) Long-term Gains and Losses.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23 (l) over the losses from the sale or exchange of such property;

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

"(*D*) *Refunds and Interest on Agricultural Adjustment Act Taxes.—There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;*

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

"(*F*) *Dividends Received.—The credit for dividends received shall apply, without limitation, to dividends on stock of domestic corporations.*

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

"(*A*) *Dividends Received.—The credit for dividends received shall apply, without limitation, to all dividends on stock of all corporations, except dividends (actual or constructive) on stock of foreign personal-holding companies;*

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

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

"(*D*) *Long-term Gains and Losses.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23 (l) over the losses from the sale or exchange of such property;*

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

"(*F*) *Refunds and Interest on Agricultural Adjustment Act Taxes.—There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;*

"(*G*) *Interest on Certain Government Obligations.—The normal-tax net income shall be increased by an amount equal*

to the amount of the interest on obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income, if the taxpayer has so elected under section 720 (d); and

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

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

"(b) TAXABLE YEARS IN BASE PERIOD.—

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

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

"(B) Long-Term Gains and Losses.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23 (l) over the losses from the sale or exchange of such property;

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

"(D) Deductions on Account of Retirement or Discharge of Bonds, and So Forth.—If during the taxable year the taxpayer retires or discharges any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than eighteen months,

the following deductions for such taxable year shall not be allowed:

"(i) The deduction allowable under section 23 (a) for expenses paid or incurred in connection with such retirement or discharge;

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

"(iii) In case the issuance was at a discount, the amount deductible for such year solely because of such retirement or discharge;

"(E) Casualty, Demolition, and Similar Losses.—Deductions under section 23 (f) for losses arising from fires, storms, shipwreck, or other casualty, or from theft, or arising from the demolition, abandonment, or loss of useful value of property, not compensated for by insurance or otherwise, shall not be allowed;

"(F) Repayment of Processing Tax to Vendees.—The deduction under section 23 (a), for any taxable year, for expenses shall be decreased by an amount which bears the same ratio to the amount deductible on account of any repayment or credit by the corporation to its vendee of any amount attributable to any tax under the Agricultural Adjustment Act of 1933, as amended, as the excess of the aggregate of the amounts so deductible in the base period over the aggregate of the amounts attributable to taxes under such Act collected from its vendees which were includible in the corporation's gross income in the base period and which were not paid, bears to the aggregate of the amounts so deductible in the base period;

"(G) Payment of Judgments, and So Forth.—Deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest on any of the foregoing, shall not be allowed if in the light of the taxpayer's business it was abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurred such liability, the amount of such liability in the taxable year was grossly disproportionate to the amount of such liability in the four previous taxable years;

"(H) All expenditures for intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, or expenditures for development costs in the case of mines, which the taxpayer has deducted from gross income as an expense, shall not be allowed to the extent that in the light of the taxpayer's business it was abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurred such liability, to the extent that the amount of such liability in the taxable year was grossly disproportionate to the amount of such liability in the four previous taxable years; and

"(I) Dividends Received.—The credit for dividends received shall apply, without limitation, to dividends on stock of domestic corporations.

"(2) CAPITAL GAINS AND LOSSES.—For the purposes of this subsection the normal-tax net income and the special-class net income referred to in paragraph (1) shall be computed as if section 23 (g) (2), section 23 (k) (2), and section 117 were part of the revenue law applicable to the taxable year the excess profits net income of which

is being computed, with the exception that the net short-term capital loss carry-over provided in subsection (e) of section 117 shall be applicable to net short-term capital losses for taxable years beginning after December 31, 1934. Such exception shall not apply for the purposes of computing the tax under this subchapter for any taxable year beginning before January 1, 1941.

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

"*(a) DOMESTIC CORPORATIONS.—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall, at the election of the taxpayer made in its return for such taxable year, be an amount computed under section 713 or section 714. (For election in case of certain reorganizations of corporations not qualified under the preceding sentence, see section 741.) In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. In the case of a domestic corporation which for any taxable year does not file a return before the expiration of the time prescribed by law for filing such return, the excess profits credit for such taxable year shall be an amount computed under section 714.*

"*(b) FOREIGN CORPORATIONS.—In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the first taxable year of which under this subchapter begins on any date in 1940, which was in existence on the day forty-eight months prior to such date and which at any time during each of the taxable years in such forty-eight months was engaged in trade or business within the United States or had an office or place of business therein, the excess profits credit for any taxable year shall, at the election of the taxpayer in its return for such taxable year, be an amount computed under section 713 or section 714. In the case of all other such foreign corporations the excess profits credit for any taxable year shall be an amount computed under section 714. In the case of a foreign corporation which for any taxable year does not file a return before the expiration of the time prescribed by law for filing such return, the excess profits credit for such taxable year shall be an amount computed under section 714.*

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

"*(a) AMOUNT OF EXCESS PROFITS CREDIT.—The excess profits credit for any taxable year, computed under this section, shall be—*

"*(1) DOMESTIC CORPORATIONS.—In the case of a domestic corporation—*

"*(A) 95 per centum of the average base period net income, as defined in subsection (b),*

"*(B) Plus 8 per centum of the net capital addition as defined in subsection (c), or*

"*(C) Minus 6 per centum of the net capital reduction as defined in subsection (c).*

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

"*(b) AVERAGE BASE PERIOD NET INCOME.—For the purposes of this section the average base period net income of the taxpayer shall be determined as follows:*

"*(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer beginning after Decem-*

ber 31, 1935, and before January 1, 1940, reduced, in the case of each such taxable year in which the deductions plus the credit for dividends received exceeded the gross income, by the amount attributable to such excess under paragraph (4);

"(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

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

"(4) For the purposes of paragraph (1)—

"(A) In determining whether, for any taxable year, the deductions plus the credit for dividends received exceeded the gross income, and in determining the amount of such excess, the adjustments provided in section 711 (b) (1) shall be made; and

"(B) The amount attributable to any taxable year in which there is such an excess shall be the amount of such excess, except that such amount shall be zero if there is only one such year, or, if more than one, shall be zero for the year in which such excess is the greatest.

"(5) For the purposes of paragraph (1), if the taxpayer was in existence during only part of the 48 months preceding the beginning of its first taxable year under this subchapter (hereinafter in this paragraph called 'base period'), its excess profits net income—

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

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

"(ii) an amount equal to the same percentage of such daily invested capital as is applicable under section 720 in reduction of the average invested capital of the preceding taxable year;

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

"(6) In no case shall the average base period net income be less than zero.

"(7) For computation of average base period net income in case of certain reorganizations, see section 742.

"(c) ADJUSTMENTS IN EXCESS PROFITS CREDIT ON ACCOUNT OF CAPITAL CHANGES.—For the purposes of this section—

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

"(2) The net capital reduction for the taxable year shall be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital reduction for each day of the taxable

year over the aggregate of the daily capital addition for each day of the taxable year.

"(3) The daily capital addition for any day of the taxable year shall be the aggregate of the amounts of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, after the beginning of the taxpayer's first taxable year under this subchapter and prior to such day. In determining the amount of any property paid in, such property shall be included in an amount determined in the manner provided in section 718 (a) (2). A distribution by the taxpayer to its shareholders in its stock or rights to acquire its stock shall not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital. The amount ascertained under this paragraph shall be reduced by the excess, if any, of the excluded capital for such day over the excluded capital for the first day of the taxpayer's first taxable year under this subchapter. For the purposes of this paragraph the excluded capital for any day shall be an amount equal to the sum of the following:

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

"(B) The aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day, of stock of domestic corporations held by the taxpayer at the beginning of such day.

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

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

"SEC. 714. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL

"The excess profits credit, for any taxable year, computed under this section, shall be an amount equal to 8 per centum of the taxpayer's invested capital for the taxable year, determined under section 715.

"SEC. 715. DEFINITION OF INVESTED CAPITAL

"For the purposes of this subchapter the invested capital for any taxable year shall be the average invested capital for such year, determined under section 716, reduced by an amount computed under section 720 (relating to inadmissible assets. If the Commissioner finds that in any case the determination of invested capital, on a basis other than a daily basis, will produce an invested capital differing by not more than $1,000 from an invested capital determined on a daily basis, he may, under regulations prescribed by him with the approval of the Secretary, provide for such determination on such other basis. (For computation of invested capital in case of foreign corporations and corporations entitled to the benefits of section 251, see section 724)

"SEC. 716. AVERAGE INVESTED CAPITAL

"The average invested capital for any taxable year shall be the aggregate of the daily invested capital for each day of such taxable year, divided by the number of days in such taxable year.

"SEC. 717. DAILY INVESTED CAPITAL

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

"SEC. 718. EQUITY INVESTED CAPITAL

"(a) DEFINITION.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

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

"(2) PROPERTY PAID IN.—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113 (b) (2);

"(3) DISTRIBUTIONS IN STOCK.—Distributions in stock—

"(A) Made prior to such taxable year to the extent to which they are considered distributions of earnings and profits; and

"(B) Previously made during such taxable year to the extent to which they are considered distributions of earnings and profits oher than earnings and profits of such taxable year;

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

"(5) Increase on account of gain on tax-free liquidation.—In the case of the previous receipt of property (other than property described in the last sentence of section 113 (a) (15)) by the taxpayer in complete liquidation of another corporation under section 112 (b) (6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received, exceeds the sum of:

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

"(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of

such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the taxpayer for such property so received.

"(*b*) *Reduction in Equity Invested Capital.—The amount by which the equity invested capital for any day shall be reduced as provided in subsection (a) shall be the sum of the following amounts—*

"(*1*) *Distributions in previous years.—Distributions made prior to such taxable year which were not out of accumulated earnings and profits;*

"(*2*) *Distributions during the year.—Distributions previously made during such taxable year which are not out of the earnings and profits of such taxable year;*

"(*3*) *Earnings and profits of another corporation.—The earnings and profits of another corporation which previously at any time were included in accumulated earnings and profits by reason of a transaction described in section 112 (b) to (e), both inclusive, or in the corresponding provision of a prior revenue law, or by reason of the transfer by such other corporation to the taxpayer of property the basis of which in the hands of the taxpayer is or was determined with reference to its basis in the hands of such other corporation, or would have been so determined if the property had been other than money; and*

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

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

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

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

"(*c*) *Rules for Application of Subsections (a) and (b).—For the purposes of subsections (a) and (b)—*

"(*1*) *Distributions to shareholders.—The term 'distribution' means a distribution by a corporation to its shareholders, and the term 'distribution in stock' means a distribution by a corporation in its stock or rights to acquire its stock. To the extent that a distribution in stock is not considered a distribution of earnings and profits it shall not be considered a distribution. A distribution in stock shall*

not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital.

"(2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF TAXABLE YEAR.—*In the application of such subsections to any taxable year beginning after December 31, 1940, so much of the distributions (taken in the order of time) made during the first sixty days thereof as does not exceed the accumulated earnings and profits as of the beginning thereof (computed without regard to this paragraph) shall be considered to have been made on the last day of the preceding taxable year.*

"(3) COMPUTATION OF EARNINGS AND PROFITS OF TAXABLE YEAR.—*For the purposes of subsections (a) (3) (B) and (b) (2) in determining whether a distribution is out of the earnings and profits of any taxable year, such earnings and profits shall be computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the tax under this subchapter for such year and the determination shall be made without regard to the amount of earnings and profits at the time the distribution was made.*

"(4) *Stock in case of merger or consolidation.—If a corporation owns stock in another corporation, and—*

"(A) *such corporations are merged or consolidated in a statutory merger or consolidation, or*

"(B) *such corporations are parties to a transaction which results in the elimination of such stock in a manner similar to that resulting from a statutory merger or consolidation,*

then such stock shall not be considered as property paid in for stock of or as paid-in surplus of, or as a contribution to capital of, the corporation resulting from the transaction referred to in subparagraph (A) or (B).

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

"(e) *For determination of equity invested capital in special cases, see section 723.*

"SEC. 719. BORROWED INVESTED CAPITAL

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

"(1) *The amount of the outstanding indebtedness (not including interest, and not including indebtedness described in section 751 (b) relating to certain exchanges) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus,*

"(2) *In the case of a taxpayer having a contract (made before the expiration of 30 days after the date of the enactment of the Second Revenue Act of 1940) with a foreign government to furnish articles, materials, or supplies to such foreign government, if such contract provides for advance payment and for repayment by the vendor of any part of such advance payment upon cancellation of the contract by such foreign government, the amount which would be required to be so repaid if cancellation occurred at the beginning of such day, but no amount shall be considered as borrowed capital under this paragraph which has been includible in gross income.*

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

"*SEC. 720. ADMISSIBLE AND INADMISSIBLE ASSETS*

"(a) *DEFINITIONS.—For the purposes of this subchapter—*

"(1) *The term 'inadmissible assets' means—*

"(A) *Stock in corporations except stock in a foreign personal-holding company; and*

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

"(2) *The term 'admissible assets' means all assets other than inadmissible assets.*

"(b) *RATIO OF INADMISSIBLES TO TOTAL ASSETS.—The amount by which the average invested capital for any taxable year shall be reduced as provided in section 715 shall be an amount which is the same percentage of such average invested capital as the percentage which the total of the inadmissible assets is of the total of admissible and inadmissible assets. For such purposes, the amount attributable to each asset held at any time during such taxable year shall be determined by ascertaining the adjusted basis thereof (or, in the case of money, the amount thereof) for each day of such taxable year so held and adding such daily amounts. The determination of such daily amounts shall be made under regulations prescribed by the Commissioner with the approval of the Secretary. The adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under section 113.*

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

"(d) *TREATMENT OF GOVERNMENT OBLIGATIONS AS ADMISSIBLE ASSETS.—If the excess profits credit for any taxable year is computed under section 714, the taxpayer may in its return for such year elect to increase its normal-tax net income for such taxable year by an amount equal to the amount of the interest on all obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income. In such case, for the purposes of this section, the term 'admissible assets' includes such obligations, and the term 'inadmissible assets' does not include such obligations.*

"*SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.*

"*If there is includible in the gross income of the taxpayer for any taxable year an item of income of any one or more of the following classes:*

"*(a) Arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or*

"*(b) Constituting an amount payable under a contract the performance of which required more than 12 months; or*

"*(c) Resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; or*

"*(d) Includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or*

"*(e) In the case of a lessor of real property, amounts included in gross income for the taxable year by reason of the termination of the lease; or*

"*(f) Dividends on stock of foreign corporations, except foreign personal holding companies;*

and, in the light of the taxpayer's business, it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class, the item includible in the gross income of the taxable year is grossly disproportionate to the gross income of the same class in the four previous taxable years, then: (1) the amount of such item attributable to any previous taxable year or years shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary; (2) the amount of such item attributable to any future taxable year or years shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary and shall, for the purposes of this subchapter, be included in the gross income for the future year or years to which attributable; and (3) the tax under this subchapter for the taxable year (in which the whole of such item would, without regard to this section, be includible) shall not exceed the sum of:

"*(A) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of such item which is attributable to any other taxable year, and*

"*(B) The aggregate of the increase in the tax under this subchapter which would have resulted for each previous taxable year to which any portion of such item is attributable, computed as if an amount equal to such portion had been included in gross income for such previous taxable year.*

"*SEC. 722. ADJUSTMENT OF ABNORMALITIES IN INCOME AND CAPITAL BY THE COMMISSIONER*

"*For the purposes of this subchapter, the Commissioner shall also have authority to make such adjustments as may be necessary to adjust abnormalities affecting income or capital, and his decision shall be subject to review by the United States Board of Tax Appeals.*

"*SEC. 723. EQUITY INVESTED CAPITAL IN SPECIAL CASES*

"*Where the Commissioner determines that the equity invested capital as of the beginning of the taxpayer's first taxable year under this sub-*

chapter cannot be determined in accordance with section 718, the equity invested capital as of the beginning of such year shall be an amount equal to the sum of (a) the money plus (b) the aggregate of the adjusted basis of the assets of the taxpayer held by the taxpayer at such time, such sum being reduced by the indebtedness outstanding at such time. The amount of the money, assets, and indebtedness at such time shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary. In such case, the equity invested capital for each day after the beginning of the taxpayer's first taxable year under this subchapter shall be determined, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, using as the basic figure the equity invested capital as so determined.

"SEC. 724. FOREIGN CORPORATIONS AND CORPORATIONS ENTITLED TO BENEFITS OF SECTION 251—INVESTED CAPITAL

"Nothwithstanding section 715, in the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, and in the case of a corporation entitled to the benefits of section 251, the invested capital for any taxable year shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, under which—

(a) GENERAL RULE.—The daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer on the beginning of such day. In the application of section 720 in reduction of the average invested capital (determined on the basis of such daily invested capital), the terms 'admissible assets' and 'inadmissible assets' shall include only United States assets; or

"(b) EXCEPTION.—If the Commissioner determines that the United States assets of the taxpayer cannot satisfactorily be segregated from its other assets, the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

"(c) DEFINITION OF UNITED STATES ASSET.—As used in this subsection, the term 'United States asset' means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

"725. PERSONAL SERVICE CORPORATIONS

"(a) DEFINITION.—As used in this subchapter, the term 'personal service corporation' means a corporation whose income is to be ascribed primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are the owners at all times during the taxable year of at least 70 per centum in value of each class of stock of the corporation, and in which capital is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists of gains, profits, or income derived from trading as a principal. For the purposes of this subsection, an individual shall be considered as

owning, at any time, the stock owned at such time by his spouse or minor child or by any guardian or trustee representing them.

"(b) Election as to Taxability.—If a personal service corporation signifies, in its return under Chapter 1 for any taxable year, its desire not to be subject to the tax imposed under this subchapter for such taxable year, it shall be exempt from such tax for such year, and the provisions of Supplement S of Chapter 1 shall apply to the shareholders in such corporation who were such shareholders on the last day of such taxable year of the corporation.

"SEC. 726. CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936

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

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

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

"(2) The amount of such payments.

"SEC. 727. EXEMPT CORPORATIONS

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

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

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

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

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

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

"(f) Foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein.

"(g) Domestic corporations satisfying the following conditions:

"(1) If 95 per centum or more of the gross income of such domestic corporation for the three-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 other than sources within the United States; and

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

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

"*SEC. 728. MEANING OF TERMS USED*

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

"*SEC. 729. LAWS APPLICABLE*

"(a) *GENERAL RULE.—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.*

"(b) *RETURNS.—Notwithstanding subsection* (a), *no return under section 52* (a) *shall be required to be filed by any taxpayer under this subchapter for any taxable year for which its excess profits net income, computed with the adjustments provided in section 711* (a) (2) *and placed on an annual basis as provided in section 711* (a) (3), *is not greater than $5,000.*

"(c) *FOREIGN TAXES PAID.—In the application of section 131 for the purposes of this subchapter the tax paid or accrued to any country shall be deemed to be the amount of such tax reduced by the amount of the credit allowed with respect to such tax against the tax imposed by Chapter 1.*

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

"(1) *The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources within such country bears to its entire excess profits net income for the same taxable year; and*

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

"*SEC. 730. CONSOLIDATED RETURNS*

"(a) *PRIVILEGE TO FILE CONSOLIDATED RETURNS.—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection* (b) *prescribed prior to the last day prescribed by law for the filing of such return; and the making of a consolidated return shall be considered as such consent.*

In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

"(b) REGULATIONS.—*The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the excess profits tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.*

"(c) COMPUTATION AND PAYMENT OF TAX.—*In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such return. Only one specific exemption of $5,000 provided in section 710 (b) (1) shall be allowed for the entire affiliated group of corporations.*

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

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

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

As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends.

"(e) DEFINITION OF 'INCLUDIBLE CORPORATION'.—*As used in this section, the term 'includible corporation' means any corporation except—*

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

"(2) *Foreign corporations.*

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

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

"(5) *Personal service corporations.*

"(6) *Insurance companies subject to taxation under section 201, 204, or 207.*

"(f) INCLUDIBLE INSURANCE COMPANIES.—*Despite the provisions of paragraph (6) of subsection (e), two or more domestic insurance companies each of which is subject to taxation under the same section of Chapter 1 shall be considered as includible corporations for the purpose of the application of subsection (d) to such insurance companies alone.*

"(g) SUBSIDIARY FORMED TO COMPLY WITH FOREIGN LAW.—*In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this subchapter as a domestic corporation.*

"(h) *Suspension of Running of Statute of Limitations.—If a notice under section 272 (a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such corporation made a consolidated return for such axable year.*

"*SEC. 731. CORPORATIONS ENGAGED IN MINING OF STRATEGIC METALS*

"*In the case of any domestic corporation engaged in the mining of tungsten, quicksilver, manganese, platinum, antimony, chromite, or tin, the portion of the adjusted excess profits net income attributable to such mining in the United States shall be exempt from the tax imposed by this subchapter. The tax on the remaining portion of such adjusted excess profits net income shall be an amount which bears the same ratio to the tax computed without regard to this section as such remaining portion bears to the entire adjusted excess profits net income.*

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

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

"*SEC. 740. DEFINITIONS*

"*For the purposes of this Supplement—*

"*(a) Acquiring Corporation.—The term 'acquiring corporation' means—*

"*(1) A corporation which has acquired—*

"*(A) substantially all the properties of another corporation and the whole or a part of the consideration for the transfer of such properties is the transfer to such other corporation of all the stock of all classes (except qualifying shares) of the corporation which has acquired such properties, or*

"*(B) substantially all the properties of another corporation and the sole consideration for the transfer of such properties is the transfer to such other corporation of voting stock of the corporation which has acquired such properties, or*

"*(C) before October 1, 1940, properties of another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock owned by such other corporation.*

For the purposes of subparagraphs (B) and (C) in determining whether such voting stock or such paid-in surplus or contribution to capital, is the sole consideration, 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. Subparagraph (B) or (C) shall apply only if the corporation transferring such properties is forthwith completely liquidated in pursuance of the plan under which the acquisition is made, and the transaction of which the acquisition is a part has the effect of a statutory merger or consolidation.

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

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

"(4) A corporation the result of a statutory consolidation of two or more corporations.

"(b) COMPONENT CORPORATION.—The term 'component corporation' means—

"(1) In the case of a transaction described in subsection (a) (1), the corporation which transferred the assets;

"(2) In the case of a transaction described in subsection (a) (2), the corporation the property of which was acquired;

"(3) In the case of a statutory merger, all corporations merged, except the corporation resulting from the merger; or

"(4) In the case of a statutory consolidation, all corporations consolidated, except the corporation resulting from the consolidation.

"(c) QUALIFIED COMPONENT CORPORATION.—The term 'qualified component corporation' means a component corporation which was in existence on the date of the beginning of the taxpayer's base period.

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

"(1) If the tax is being computed for any taxable year beginning in 1940, the forty-eight months preceding the beginning of such taxable year; or

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

"(e) BASE PERIOD YEARS.—In the case of a taxpayer which is an acquiring corporation its base period years shall be the four successive twelve-month periods beginning on the same date as the beginning of its base period.

"(f) EXISTENCE OF ACQUIRING CORPORATION.—For the purposes of subsection (c) and section 741, if any component corporation was in existence on the date of the beginning of the taxpayer's base period (either actually or by reason of this subsection), its acquiring corporation shall be considered to have been in existence on such date.

"(g) COMPONENT CORPORATIONS OF COMPONENT CORPORATIONS.—If a corporation is a component corporation of an acquiring corporation, under subsection (b) or under this subsection, it shall (except for the purposes of section 742 (d) (1) and (2) and section 743 (a)) also be a component corporation of the corporation of which such acquiring corporation is a component corporation.

"SEC. 741. ELECTION OF INCOME CREDIT

"In addition to the corporations which under section 712 (a) may elect the excess profits credit computed under section 713 or the excess profits credit computed under section 714, a taxpayer which is an acquiring corporation which was in existence on the date of the beginning of its base period shall have such election.

"SEC. 742. AVERAGE BASE PERIOD NET INCOME

"In the case of a taxpayer which is an acquiring corporation which was actually in existence on the date of the beginning of its base period, or

which is entitled under section 741 to elect the excess profits credit computed under section 713, its average base period net income (for the purpose of the credit computed under section 713) shall be computed as follows, in lieu of the method provided in section 713:

"*(a) By ascertaining with respect to each of its base period years—*

"*(1) The amount of its excess profits net income for each of its taxable years beginning after December 31, 1935, and ending with or within such base period year; or, in the case of each such taxable year in which the deductions plus the credit for dividends received exceeded the gross income, the amount of such excess;*

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

"*(3) (A) The aggregate of the amounts of excess profits net income ascertained under paragraphs (1) and (2); (B) the aggregate of the excesses ascertained under paragraphs (1) and (2); and (C) the difference between the aggregates found under clause (A) and clause (B). If the aggregate ascertained under clause (A) is greater than the aggregate found under clause (B), the difference shall for the purposes of subsection (b) be designated a 'plus amount', and if the aggregate ascertained under clause (B) is greater than the aggregate found under clause (A), the difference shall for the purposes of subsection (b) be designated a 'minus amount'.*

"*(b) By adding the plus amounts ascertained under subsection (a) (3) for each year of the base period; and by subtracting from such sum, if for two or more years of the base period there was a minus amount, the sum of such minus amounts, excluding the greatest.*

"*(c) By dividing the amount ascertained under subsection (b) by four.*

"*(d) In no case shall the average base period net income be less than zero. In the case of a taxpayer which becomes an acquiring corporation in any taxable year beginning after December 31, 1939, if, on September 11, 1940, and at all times until the taxpayer became an acquiring corporation—*

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

"*(2) one of the qualified component corporations involved in the transaction owned not less than 75 per centum of each class of stock of the taxpayer, and of each of the other qualified component corporations involved in the transaction.*

the average base period net income of the taxpayer shall not be less than (A) the average base period net income of that one of its qualified component corporations involved in the transaction the average base period net income of which is greatest, or (B) the average base period net income of the taxpayer computed without regard to the base period net income of any of its qualified component corporations involved in the transaction.

"*(e) For the purposes of subsection (a) (1) and (2) of this section—*

"*(1) There shall be excluded, in the various computations, any dividends paid by the taxpayer or any of its qualified component corporations during any of the taxable years of the payor which are*

included in the computation of the taxpayer's average base period net income. If the payor corporation is a corporation described in subsection (f) (1) or (2) of this section, the dividends to be excluded under this paragraph shall be only such as are paid after such payor corporation first became an acquiring corporation; and

"(2) In determining whether, for any taxable year, the deductions plus the credit for dividends received exceeded the gross income, and in determining the amount of such excess, the adjustments provided in section 711 (b) (1) shall be made.

"(f) (1) In the case of a taxpayer which is an acquiring corporation and which was not actually in existence on the date of the beginning of its base period, there shall be excluded from the various computations under subsection (a) (1) of this section the portion of its excess profits net income, or of the excess over gross income therein referred to, which is attributable to any period before it first became an acquiring corporation.

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

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

"(4) If during the taxable year for which tax is computed under this subchapter the taxpayer acquires assets in a transaction which constitutes ti an acquiring corporation, the amount includible under subsection (a) (2), attributable to such transaction, shall be limited to an amount which bears the same ratio to the amount computed without regard to this paragraph as the number of days in the taxable year after such transaction bears to the total number of days in such taxable year.

"SEC. 743. NET CAPITAL CHANGES

"(a) For the purposes of section 713 (c), upon the date of the transaction which constitutes a corporation an acquiring corporation, there shall be added to its daily capital addition or reduction for such day, the net capital addition or reduction, as the case may be, of each of the component corporations involved in such transaction, but no other capital addition or reduction shall be considered as having been made by reason of such transaction.

"(b) For the purposes of this section—

"(1) In computing the net capital addition of each such component corporation there shall be disregarded property paid in to such corporation by the taxpayer or by any of its component corporations.

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

"SEC. 744. FOREIGN CORPORATIONS

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

"Supplement B—Highest Bracket Amount and Invested Capital

"SEC. 750. DEFINITIONS

"As used in this Supplement—

"(a) EXCHANGE.—The term 'exchange' means an exchange, to which section 112 (b) (4) or (5) or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (4) or (5), or to which a corresponding provision of a prior revenue law, is or was applicable, by one corporation of its property wholly or in part for stock or securities of another corporation, or a transfer of property by one corporation to another corporation after December 31, 1917, the basis of which in the hands of such other corporation is or was determined under section 113 (a) (8) (B), or would have been so determined had such section been in effect.

"(b) TRANSFEROR UPON AN EXCHANGE.—The term 'transferor upon an exchange' means a corporation which upon an exchange transfers property to another corporation in exchange, wholly or in part, for stock or securities of such other corporation, or transfers property to another corporation after December 31, 1917, the basis of which in the hands of such other corporation is or was determined under section 113 (a) (8) (B), or would have been so determined had such section been in effect.

"(c) TRANSFEREE UPON AN EXCHANGE.—The term 'transferee upon an exchange' means a corporation which upon an exchange acquires property from another corporation in exchange, wholly or in part, for its stock or securities, or which acquires property from another corporation after December 31, 1917, the basis of which in its hands is or was determined under section 113 (a) (8) (B), or would have been so determined had such section been in effect.

"(d) CONTROL.—The term 'control' means the ownership of stock possessing at least 90 per centum of the total combined voting power of all classes of stock entitled to vote and at least 90 per centum of the total value of shares of all classes of stock of the corporation.

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

"SEC. 751. DETERMINATION OF PROPERTY PAID IN FOR STOCK AND OF BORROWED CAPITAL IN CONNECTION WITH CERTAIN EXCHANGES

"(a) PROPERTY PAID IN FOR STOCK.—In the application of section 718 (a) to a transferee upon an exchange in determining the amount paid in for stock of the transferee, or as paid in surplus or as a contribution to capital of the transferee, in connection with such exchange, only an amount shall be deemed to have been so paid in equal to the excess of the basis in the hands of the transferee of the property of the transferor received by the transferee upon the exchange over the sum of—

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

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

"(b) *Borrowed Capital.—In the application of section 719 (a) to a transferee upon an exchange, the term 'borrowed capital' shall not include indebtedness originally evidenced by securities issued by the transferee upon such exchange as consideration for the property of the transferor received by the transferee upon such exchange if (1) such securities were property permitted to be received by the person to whom such securities were issued without the recognition of gain and (2) the indebtedness originally evidenced by such securities did not arise out of indebtedness of the transferor (other than indebtedness which in the transferor's hands was subject to the limitations of this subsection) assumed by the transferee in connection with such exchange.*

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

"(a) *Special Application of Daily Invested Capital of Transferor Upon Exchange.—For the purposes of this section, the daily invested capital of a transferor upon an exchange for the day after the exchange shall be the daily invested capital determined under section 717 reduced by an amount equal to the amount by which the equity invested capital of the transferee upon such exchange was increased by reason of the receipt of property from such transferor upon such exchange.*

"(b) *Highest Bracket Amount of Transferor.—*

"(1) *Taxable year of exchange.—In the case of a transferor upon an exchange after the beginning of its first taxable year under this subchapter, its highest bracket amount for the taxable year in which the exchange takes place shall be the sum of—*

"(A) *Its highest bracket amount immediately preceding the exchange multiplied by the number of days in the taxable year up to and including the day of the exchange, plus*

"(B) *Its highest bracket amount for the taxable year after the exchange, multiplied by the number of days in the taxable year remaining after the day of the exchange,*

divided by the number of days in the taxable year.

"(2) *Taxable years after exchange involving control.—In the case of a transferor upon an exchange after the beginning of its first taxable year under this subchapter, if immediately after the exchange the transferor or its shareholders, or both, are in control of the transferee, the transferor's highest bracket amount for any taxable year after the taxable year in which the exchange takes place shall be an amount which is a percentage of its highest bracket amount immediately preceding the exchange equal to the percentage which its daily invested capital for the day after the exchange is of its daily invested capital for the day of the exchange.*

"(3) *Taxable years after exchange not involving control.—In the case of a transferor upon an exchange (other than a transferor described in paragraph (4) of this subsection) after the beginning of its first taxable year under this subchapter, if immediately after the exchange no transferor or its shareholders, or both, upon the exchange are in control of the transferee, and if the shareholders of the transferee immediately preceding the exchange are*

not in control of the transferee immediately after the exchange, the transferor's highest bracket amount for any taxable year after the exchange shall be the excess, if any, of the sum of the transferor's highest bracket amount immediately preceding the exchange and the transferee's highest bracket amount immediately preceding the exchange, over $500,000.

"*(4) TAXABLE YEARS AFTER CERTAIN EXCHANGES UNDER SECTION 112 (b) (5).—In the case of an exchange after the beginning of the first taxable year under this subchapter of any transferor or transferee upon such exchange, involving two or more transferors, or one or more transferors and one or more other persons, if immediately after the exchange no one of such transferors, or its shareholders, or both, and no one or more of such other persons are in control of the transferee and if such exchange is an exchange described in section 112 (b) (5) or so much of section 112 (c) or 112 (e) as refers to section 112 (b) (5), the highest bracket amount of any such transferor for any taxable year after the exchange shall be an amount equal to its highest bracket amount immediately preceding the exchange—*

"*(A) Minus an amount which bears the same ratio to its highest bracket amount immediately preceding the exchange as the excess of its daily invested capital for the day of the exchange over its daily invested capital for the day after the exchange bears to its daily invested capital for the day of the exchange, and*

"*(B) Plus an amount which bears the same ratio to the excess over $500,000 of the sum of the amounts computed under subparagraph (A) with respect to each transferor, as the amount computed under subparagraph (A) with respect to such transferor bears to the sum of the amounts computed under such subparagraph with respect to each transferor.*

"*(c) HIGHEST BRACKET AMOUNT OF TRANSFEREE.—*

"*(1) TAXABLE YEAR OF EXCHANGE INVOLVING CONTROL.—In the case of a transferee upon an exchange after the beginning of the first taxable year under this subchapter of a transferor upon such exchange the transferee's highest bracket amount for the taxable year in which the exchange takes place shall be the sum of—*

"*(A) Its highest bracket amount immediately preceding the exchange multiplied by the number of days in the taxable year up to and including the day of the exchange, plus*

"*(B) Its highest bracket amount for the taxable year after the exchange multiplied by the number of days in the taxable year remaining after the day of the exchange,*

divided by the number of days in the taxable year. For the purposes of this paragraph and subsection (d) of this section 'exchange' includes a liquidation described in paragraph (5) of this subsection, and such exchange shall be deemed to have taken place on the day such liquidation was completed.

"*(2) TAXABLE YEARS AFTER EXCHANGE INVOLVING CONTROL.—In the case of a transferee upon an exchange after the beginning of the first taxable year under this subchapter of a transferor upon such exchange, if immediately after the exchange any transferor upon such exchange or its shareholders, or both, are in control of the transferee, the transferee's highest bracket amount for any taxable year after the exchange shall be an amount which is a percentage of such trans-*

feror's highest bracket amount immediately preceding the exchange equal to the percentage which the excess of the transferee's daily invested capital for the day after the exchange over its daily invested capital for the day of the exchange is of such transferor's daily invested capital for the day of the exchange.

"(3) TAXABLE YEARS AFTER EXCHANGE NOT INVOLVING CONTROL.—*In the case of a transferee upon an exchange (other than a transferee described in paragraph (4) of this subsection) after the beginning of the first taxable year under this subchapter of a transferor upon such exchange, if immediately after the exchange no transferor or its shareholders, or both, are in control of the transferee, and if the shareholders of the transferee immediately preceding the exchange are not in control of the transferee immediately after the exchange, the transferee's highest bracket amount for any taxable year after the exchange shall be an amount equal to (A) the sum of the transferor's highest bracket amount immediately preceding the exchange and the transferee's highest bracket amount immediately preceding the exchange, or (B) $500,000, whichever is the smaller.*

"(4) TAXABLE YEARS AFTER CERTAIN EXCHANGES UNDER SECTION 112 (b) (5).—*In the case of an exchange described in subsection (b) (4) of this section, the highest bracket amount of the transferee upon such exchange for any taxable year after the exchange shall be an amount equal (A) to the sum of the amounts computed under subparagraph (A) of such subsection with respect to each transferor or (B) $500,000, whichever is the smaller.*

"(5) TAXABLE YEARS AFTER LIQUIDATION IN CASE OF CORPORATION RECEIVING PROPERTY UNDER SECTION 112 (b) (6).—*Upon the receipt by a corporation during any taxable year under this subchapter of property in complete liquidation of another corporation, gain or loss upon which is not recognized by reason of section 112 (b) (6), the highest bracket amount of the corporation receiving such property for any taxable year after the liquidation is completed shall be an amount equal to its highest bracket amount immediately preceding the completion of the liquidation increased, but in no case to an amount above $500,000, by an amount equal to the highest bracket amount of such other corporation immediately preceding the completion of such liquidation, if previously and after the beginning of the first taxable year under this subchapter of the corporation receiving such property such corporation was a transferor upon an exchange with respect to which such other corporation was a transferee.*

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

"*(1) If a transferor upon an exchange is in the same taxable year involved in more than one exchange (either as transferor or transferee), its highest bracket amount for such taxable year shall be the amount determined under subsection (b) (1) with respect to the last exchange in such taxable year. Its highest bracket amount immediately preceding any exchange in such taxable year subsequent to the first exchange therein shall be the amount computed under subsection (b) (1) with respect to the immediately preceding exchange as if the taxable year closed on the day of such subsequent exchange.*

"*(2) If a transferee upon an exchange is in the same taxable year involved in more than one exchange (either as transferee or transferor),*

its highest bracket amount for such taxable year shall be the amount determined under subsection (c) (1) with respect to the last exchange in such taxable year. Its highest bracket amount immediately preceding any exchange in such taxable year subsequent to the first exchange therein shall be the amount computed under subsection (c) (1) with respect to the immediately preceding exchange as if the taxable year closed on the day of such subsequent exchange.

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

And the Senate agree to the same.

Amendment numbered 7:

That the House recede from its disagreement to the amendment of the Senate numbered 7, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *June 10*; and the Senate agree to the same.

Amendment numbered 8:

That the House recede from its disagreement to the amendment of the Senate numbered 8, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *June 10*; and the Senate agree to the same.

Amendment numbered 9:

That the House recede from its disagreement to the amendment of the Senate numbered 9, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *June 10*; and the Senate agree to the same

Amendment numbered 11:

That the House recede from its disagreement to the amendment of the Senate numbered 11, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

"(i) Protection of the United States.—If the taxpayer has been or will be reimbursed by the United States for all or a part of the cost of any emergency facility pursuant to any contract with the United States, either—

"(1) directly, by a provision therein dealing expressly with such reimbursement, or

"(2) indirectly, because the price paid by the United States (insofar as return of cost of the facility is used as a factor in the fixing of such price) is recognized by the contract as including a return of cost greater than the normal exhaustion, wear and tear,

no amortization deduction with respect to such emergency facility shall be allowed for any month after the end of the month in which such con-

tract is made, unless, before the expiration of ninety days after the making of such contract or one hundred and twenty days after the date of the enactment of the Second Revenue Act of 1940, whichever of such periods expires the later, the Advisory Commission to the Council of National Defense, and either the Secretary of War or the Secretary of the Navy certify to the Commissioner that such contract adequately protects the United States with reference to the future use and disposition of such emergency facility. A certificate by the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy, made to the Commissioner before the expiration of ninety days after the making of a contract or one hundred and twenty days after the date of the enactment of the Second Revenue Act of 1940, whichever of such periods expires the later, to the effect that, under such contract, reimbursement for all or a part of the cost of any emergency facility is not provided for within the meaning of clause (1) or clause (2), shall be conclusive for the purposes of this subsection.

"The terms and conditions of contracts with reference to reimbursement of the cost of emergency facilities and the protecting of the United States with reference to the future use and disposition of such emergency facilities shall be made available to the public."

And the Senate agree to the same.

Amendment numbered 21:

That the House recede from its disagreement to the amendment of the Senate numbered 21, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

"(l) EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS AND OF RECEIPT OF TAX-FREE DISTRIBUTIONS.—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

> *"(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (2), 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*
>
> *"(2) for the purpose of the computation of 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 net 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 or profits, then the latter adjustment shall be used in determining the increase or decrease above provided.

And on page 95, lines 8 and 9, of the House bill, strike out "(for any period beginning after February 28, 1913)".

And the Senate agree to the same.

Amendment numbered 22:

That the House recede from its disagreement to the amendment of the Senate numbered 22, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

"(m) *Earnings and Profits—Increase in Value Accrued before March 1, 1913.*—

"(1) *If any increase or decrease in the earnings or 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 (l) 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 (l) 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.*"

And the Senate agree to the same.

Amendment numbered 24:

That the House recede from its disagreement to the amendment of the Senate numbered 24, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

(c) *Under Prior Acts.—For the purposes of the Revenue Act of 1938 or any prior Revenue Act the amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such Revenue Act on the date of its enactment. Nothing in this subsection shall affect the tax liability of any taxpayer for any year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States.*

And the Senate agree to the same.

Amendment numbered 26:

That the House recede from its disagreement to the amendment of the Senate numbered 26, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *725*; and the Senate agree to the same.

Amendment numbered 27:

That the House recede from its disagreement to the amendment of the Senate numbered 27, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *725*; and the Senate agree to the same.

Amendment numbered 35:

That the House recede from its disagreement to the amendment of the Senate numbered 35, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

TITLE VI—NATIONAL SERVICE LIFE INSURANCE AND PROVISIONS AFFECTING THE RAILROAD RETIREMENT BOARD.

PART I—NATIONAL SERVICE LIFE INSURANCE

SEC. 601. When used in this part—

(a) The term "person" means (1) a commissioned officer; (2) a warrant officer; (3) enlisted personnel (including persons selected for training and service under the Selective Training and Service Act of 1940); (4) a member of the Army Nurse Corps (female); and (5) a member of the Navy Nurse Corps (female);

(b) The term "Administrator" means the Administrator of Veterans' Affairs;

(c) The term "active service" means active service in the land or naval forces (including the Coast Guard) of the United States and service in the land or naval forces of the United States under the Selective Training and Service Act of 1940, but the service of any person ordered to active duty in any such force for a period of thirty days or less, shall not be deemed to be active service in such force during such period;

(d) The term "insurance" means National Service Life Insurance;

(e) The term "child" includes an adopted child.

SEC. 602. (a) Every person who is commissioned and hereafter ordered into, or who is hereafter examined, accepted, and enrolled in, the active service and while in such active service shall, upon application in writing (made within one hundred and twenty days after entrance into such active service) and payment of premiums as hereinafter provided and without further medical examination, be granted insurance on the five-year level premium term plan by the United States against the death of such person occurring while such insurance is in force.

(b) Any person who is released from active service within one hundred and twenty days after such enrollment shall be granted such insurance upon application therefor in writing (made within one hundred and twenty days after a subsequent enrollment or entrance into active service and before discharge or resignation therefrom), and upon payment of premiums and evidence satisfactory to the Administrator showing such person to be in good health at the time of such application.

(c) Any person upon reenlistment or reentrance into or reemployment in active service and before discharge or resignation therefrom and any person in the active service upon discharge to accept a commission and

before resignation therefrom, shall be granted such insurance upon application therefor in writing (made within one hundred and twenty days following such reenlistment, reentrance, reemployment, or discharge to accept a commission), and upon payment of premiums and evidence satisfactory to the Administrator showing such person to be in good health at the time of such application.

(d) Any person who has been commissioned, or examined, accepted, and enrolled, in the active service and is in such active service on the date of enactment of this Act shall be granted such insurance upon application therefor in writing (made within one hundred and twenty days after the date of enactment of this Act and before discharge or resignation from such active service), and upon payment of premiums and evidence satisfactory to the Administrator showing such person to be in good health at the time of such application.

(e) The premium rates for such insurance shall be the net rates based upon the American Experience Table of Mortality and interest at the rate of 3 per centum per annum. All cash, loan, paid up, and extended values, and all other calculations in connection with such insurance, shall be based upon said American Experience Table of Mortality and interest at the rate of 3 per centum per annum.

(f) Such insurance shall be issued upon the five year level premium term plan, with the privilege of conversion as of the date when any premium becomes or has become due, or exchange as of the date of the original policy, upon payment of the difference in reserve, at any time after such policy has been in effect for one year and within the five year term period, to policies of insurance upon the following plans: Ordinary life, twenty payment life, thirty payment life. All five year level premium term policies shall cease and terminate at the expiration of the five year term period. Provisions for cash, loan, paid up, and extended values, dividends from gains and savings, refund of unearned premiums, and such other provisions as may be found to be reasonable and practicable, may be provided for in the policy of insurance or from time to time by regulations promulgated by the Administrator.

(g) The insurance shall be payable only to a widow, widower, child (including a stepchild or an illegitimate child if designated as beneficiary by the insured), parent (including person in loco parentis if designated as beneficiary by the insured), brother or sister of the insured. The insured shall have the right to designate the beneficiary or beneficiaries of the insurance, but only within the classes herein provided, and shall, subject to regulations, at all times have the right to change the beneficiary or beneficiaries of such insurance without the consent of such beneficiary or beneficiaries but only within the classes herein provided.

(h) Such insurance shall be payable in the following manner:

(1) If the beneficiary to whom payment is first made is under thirty years of age at the time of maturity, in two hundred and forty equal monthly installments.

(2) If the beneficiary to whom payment is first made is thirty or more years of age at the time of maturity, in equal monthly installments for one hundred and twenty months certain, with such payments continuing during the remaining lifetime of such beneficiary.

(3) Any installments certain of insurance remaining unpaid at the death of any beneficiary shall be paid in equal monthly installments in an amount equal to the monthly installments paid to the first beneficiary, to the person or persons then in being within the

classes hereinafter specified and in the order named, unless designated by the insured in a different order—

(A) to the widow or widower of the insured, if living;

(B) if no widow or widower, to the child or children of the insured, if living, in equal shares;

(C) if no widow, widower, or child, to the parent or parents of the insured, if living, in equal shares;

(D) if no widow, widower, child, or parent, to the brothers and sisters of the insured, if living, in equal shares.

(i) If no beneficiary is designated by the insured or if the designated beneficiary does not survive the insured, the beneficiary shall be determined in accordance with the order specified in subsection (h) (3) of this section and the insurance shall be payable in equal monthly installments in accordance with subsection (h) (1) or (2), as the case may be. The right of any beneficiary to payment of any installments shall be conditioned upon his or her being alive to receive such payments. No person shall have a vested right to any installment or installments of any such insurance and any installments not paid to a beneficiary during such beneficiary's lifetime shall be paid to the beneficiary or beneficiaries within the permitted class next entitled to priority, as provided in subsection(h).

(j) No installments of such insurance shall be paid to the heirs or legal representatives as such of the insured or of any beneficiary, and in the event that no person within the permitted class survives to receive the insurance or any part thereof no payment of the unpaid installments shall be made.

(k) When the amount of an individual monthly payment is less than $5, such amount may, in the discretion of the Administrator, be allowed to accumulate without interest and be disbursed annually.

(l) Any payments of insurance made to a person represented by the insured to be within the permitted class of beneficiaries shall be deemed to have been properly made and to satisfy fully the obligation of the United States under such insurance policy to the extent of such payments.

(m) The Administrator shall, by regulations, prescribe the time and method of payment of the premiums on such insurance, but payments of premiums in advance shall not be required for periods of more than one month each, and may at the election of the insured be deducted from his active service pay or be otherwise made.

(n) Upon application by the insured and under such regulations as the Administrator may promulgate, payment of premiums on such insurance may be waived during continuous total disability of the insured which commenced subsequent to the effective date of such insurance and which has existed for six consecutive months or more prior to the attainment by the insured of the age of sixty years, effective as of the due date of the monthly premium becoming payable on or after the first day of the seventh consecutive month of such disability: Provided, That application for waiver is made while the insurance is currently kept in force by the payment of premiums, and the insured furnishes proof satisfactory to the Administrator showing that he is and has been continuously totally disabled for six or more months prior to attaining sixty years of age. Any waiver granted by the Administrator under this subsection shall not become effective prior to the date of application therefor; except that, in the discretion of the Administrator, it may be made effective at any time within a period of not more than six months prior to such date but in no event prior to the first day of the seventh month of such continuous disability. Any

premiums tendered to cover a period during which such waiver is effective shall be refunded. The Administrator shall provide by regulations for reexaminations of beneficiaries under this subsection and, in the event that it is found that an insured is no longer totally disabled, the waiver of premiums shall cease as of the date of such finding and the policy of insurance may be continued by payment of premiums as provided in said policy. Premium rates shall be calculated without charge for the cost of the waiver of premiums herein provided and no deduction from benefits otherwise payable shall be made on account thereof.

(o) The Administrator shall promptly determine and publish the terms and conditions of such insurance. Pending the promulgation of the terms and conditions of the five year level premium term policy and the printing of such policy, the Administrator may issue a certificate in lieu thereof as evidence that insurance has been granted and the rights and liabilities of the applicant and of the United States shall be those specified by the terms and conditions of the policy when published.

(p) Such insurance may be made effective, as specified in the application, not later than the first day of the calendar month following the date of application therefor, but the United States shall not be liable thereunder for death occurring prior to such effective date.

(q) Such insurance shall be issued in any multiple of $500 and the amount of such insurance with respect to any one person shall be not less than $1,000 or more than $10,000.

SEC. 603. No person may carry a combined amount of National Service Life Insurance and United States Government life insurance in excess of $10,000 at any one time.

SEC. 604. There is hereby authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, such sums as may be necessary to carry out the provisions of this part, to be known as the National Service Life Insurance appropriation, for the payment of liabilities under National Service Life Insurance. Payments from this appropriation shall be made upon and in accordance with awards by the Administrator.

SEC. 605. (a) There is hereby created in the Treasury a permanent trust fund to be known as the National Service Life Insurance Fund. All premiums paid on account of National Service Life Insurance shall be deposited and covered into the Treasury to the credit of such fund, which, together with interest earned thereon, shall be available for the payment of liabilities under such insurance, including payment of dividends and refunds of unearned premiums. Payments from this fund shall be made upon and in accordance with awards by the Administrator.

(b) The Administrator is authorized to set aside out of such fund such reserve amounts as may be required under accepted actuarial principles, to meet all liabilities under such insurance; and the Secretary of the Treasury is hereby authorized to invest and reinvest such fund, or any part thereof, in interest-bearing obligations of the United States or in obligations guaranteed as to principal and interest by the United States, and to sell such obligations for the purposes of such fund.

SEC. 606. The United States shall bear the cost of administration in connection with this part, including expenses for medical examinations, printing and binding, and for such other expenditures as are necessary in the discretion of the Administrator. The appropriations made for the Veterans' Administration for the fiscal year 1941 for administrative

expenses shall be available for the payment of such costs of administration under this part.

Sec. 607. (a) The United States shall bear the excess mortality cost and the cost of waiver of premiums on account of total disability traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator.

(b) Whenever benefits under such insurance become payable because of the death of the insured as the result of disease or injury traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator, the liability for payment of such benefits shall be borne by the United States in an amount which, when added to the reserve of the policy at the time of death of the insured, will equal the then value of such benefits under such policy. The Administrator is authorized and directed to transfer from time to time from the National Service Life Insurance appropriation to the National Service Life Insurance Fund such sums as may be necessary to carry out the provisions of this section.

(c) Whenever the premiums under such insurance are waived as provided in section 602 (n) because of the total disability of the insured as the result of disease or injury traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator, the premiums so waived shall be paid by the United States and the Administrator is authorized and directed to transfer from time to time an amount equal to the amount of such premiums from the National Service Life Insurance appropriation to the National Service Life Insurance Fund.

Sec. 608. The Administrator, subject to the general direction of the President, shall administer, execute and enforce the provisions of this part, shall have power to make such rules and regulations, not inconsistent with the provisions of this part, as are necessary or appropriate to carry out its purposes, and shall decide all questions arising hereunder. All officers and employees of the Veterans' Administration shall perform such duties in connection with the administration of this part as may be assigned to them by the Administrator. All official acts performed by such officers or employees designated therefor by the Administrator shall have the same force and effect as though performed by the Administrator in person. Except in the event of suit as provided in section 617 hereof, all decisions rendered by the Administrator under the provisions of this part, or regulations issued pursuant thereto, shall be final and conclusive on all questions of law and fact, and no other official or court of the United States shall have jurisdiction to review by motion or otherwise any such decision.

Sec. 609. (a) There shall be no recovery of payments made under this part from any person who, in the judgment of the Administrator, is without fault on his part and where, in the judgment of the said Administrator, such recovery would defeat the purpose of benefits otherwise authorized herein or would be against equity and good conscience. No disbursing officer or certifying officer shall be held liable for any amount paid to any person where the recovery of such amount is waived under this section.

(b) Where, under the provisions of this section, the recovery of a payment made from the National Service Life Insurance Fund is waived, the National Service Life Insurance Fund shall be reimbursed for the amount of such payment from the current appropriation for National Service Life Insurance.

Sec. 610. No State law providing for presumption of death shall be applicable to claims for National Service Life Insurance. If evidence satisfactory to the Administrator is produced establishing the fact of the continued and unexplained absence of any individual from his home and family for a period of seven years, during which period no evidence of his existence has been received, the death of such individual as of the date of the expiration of such period may, for the purposes of this part, be considered as sufficiently proved.

Sec. 611. No United States Government life insurance shall be granted hereafter to any person under the provisions of section 300 of the World War Veterans' Act, 1924, as amended: Provided, That this section shall not be construed to prohibit the issue of United States Government life insurance policies in cases in which acceptable applications accompanied by proper and valid remittances or authorizations for the payment of premiums have, prior to the date of enactment of this Act, been received by the Veterans' Administration or which have, prior to said date, been placed in the mails properly directed to said Veterans' Administration, or been delivered to an authorized representative of the War Department, the Navy Department, or the Coast Guard, and which are forwarded to the Veterans' Administration not later than one hundred and twenty days subsequent to said date.

Sec. 612. Any person guilty of mutiny, treason, spying, or desertion, or who, because of conscientious objections, refuses to perform service in the land or naval forces of the United States or refuses to wear the uniform of such force, shall forfeit all rights to insurance under this part. No insurance shall be payable for death inflicted as a lawful punishment for crime or for military or naval offense, except when inflicted by an enemy of the United States; but the cash surrender value, if any, of such insurance on the date of such death shall be paid to the designated beneficiary, if living, or otherwise to the beneficiary or beneficiaries within the permitted class in accordance with the order specified in section 602 (h) (3).

Sec. 613. Whoever in any claim for insurance issued under the provisions of this part makes any sworn statement of a material fact knowing it to be false, shall be guilty of perjury and shall, upon conviction thereof, be punished by a fine of not more than $5,000, or by imprisonment for not more than two years, or by both such fine and imprisonment.

Sec. 614. Whoever, with intent to defraud the United States or any beneficiary of such insurance, shall obtain or receive any money or check for National Service Life Insurance without being entitled to the same, shall, upon conviction thereof, be punished by a fine of not more than $2,000, or by imprisonment for not more than one year, or by both such fine and imprisonment.

Sec. 615. Any person who shall knowingly make or cause to be made, or conspire, combine, aid, or assist in, agree to, arrange for, or in any wise procure the making or presentation of a false or fraudulent affidavit, declaration, certificate, statement, voucher, or paper, or writing purporting to be such, concerning any application for insurance or reinstatement thereof, waiver of premiums or claim for benefits under National Service Life Insurance for himself or any other person, shall, upon conviction thereof, be punished by a fine of not more than $1,000, or imprisonment for not more than one year, or by both such fine and imprisonment.

Sec. 616. The provisions of Public Law Numbered 262, Seventy-fourth Congress, approved August 12, 1935 (49 Stat. 607), and titles II and III of Public Law Numbered 844, Seventy-fourth Congress, approved June

29, 1936 (49 Stat. 2031), insofar as they are applicable, shall apply to the provisions of this part.

Sec. 617. In the event of a disagreement as to claim arising under this part, suit may be brought in the same manner and subject to the same conditions and limitations as are applicable to United States Government (converted) life insurance under the provisions of sections 19 and 500 of the World War Veterans' Act, 1924, as amended: Provided, That in any such suit the decision of the Administrator as to waiver or non-waiver of premiums under section 602 (n) shall be conclusive and binding on the court.

Sec. 618. This part may be cited as the "National Service Life Insurance Act of 1940".

PART II—CREDITING MILITARY SERVICE FOR ANNUITY PURPOSES UNDER THE RAILROAD RETIREMENT ACTS

Sec. 625. The Act entitled "An Act to amend an Act entitled 'An Act to establish a retirement system for employees of carriers subject to the Interstate Commerce Act, and for other purposes', approved August 29, 1935," approved June 24, 1937 (50 Stat. 307), is hereby amended by inserting after section 3 the following new section:

"MILITARY SERVICE

"Sec. 3A. (a) For the purposes of determining eligibility for an annuity and computing an annuity, including a minimum annuity, there shall also be included in an individual's years of service, within the limitations hereinafter provided in this section, voluntary or involuntary military service of an individual prior to January 1, 1937, within or without the United States during any war service period: Provided, however, That such military service shall be included only subject to and in accordance with the provisions of subsection (b) of section 3, in the same manner as though military service were service rendered as an employee: Provided further, That an individual who entered military service prior to a war service period shall not be regarded as having been in military service in a war service period with respect to any part of the period for which he entered such military service.

"(b) For the purpose of this section and section 202, as amended, an individual shall be deemed to have been in 'military service' when commissioned or enrolled in the active service of the land or naval forces of the United States and until resignation o. discharge therefrom; and the service of any individual in any reserve component of the land or naval forces of the United States who was ordered to active duty in any such force for a period of thirty days or less shall be deemed to have been active service in such force during such period.

"(c) For the purpose of this section and section 202, as amended, a 'war service period' shall mean (1) any war period, or (2) with respect to any particular individual, any period during which such individual (i) having been in military service at the end of a war period, was required to continue in military service, or (ii) was required by any Act of Congress, any regulation promulgated, order issued, or proclamation made, in pursuance of such Act, to enter and continue in military service.

"(d) For the purpose of this section and section 202, as amended, a 'war period' shall be deemed to have begun on whichever of the following

dates is the earliest: (1) the date on which the Congress of the United States declared war; or (2) the date as of which the Congress of the United States declared that a state of war has existed; or (3) the date on which war was declared by one or more foreign states against the United States; or (4) the date on which any part of the United States or any territory under its jurisdiction was invaded or attacked by any armed force of one or more foreign states; or (5) the date on which the United States engaged in armed hostilities for the purpose of preserving the Union or of maintaining in any State of the Union a republican form of government.

"*(e) For the purpose of this section and section 202, as amended, a 'war period' shall be deemed to have ended on the date on which hostilities ceased.*

"*(f) Military service shall not be included in the years of service of an individual unless, in the calendar year in which his military service in a war service period began, or in the calendar year next preceding such calendar year, he rendered service for compensation to an employer, or to a person service to which is otherwise creditable under this Act, or lost time as an employee for which he received remuneration, or was serving as an employee representative.*

"*(g) A calendar month in which an individual was in military service which may be included in the individual's years of service or service period, as the case may be, shall be counted as a month of service: Provided, however, That no calendar month shall be counted as more than one month of service.*

"*(h) In determining the monthly compensation for computing an annuity, military service and any remuneration therefor shall be disregarded.*

"*(i) In the event military service is or has been used as the basis or as a partial basis for a pension, disability compensation, or any other gratuitous benefits payable on a periodic basis under any other Act of Congress, any annuity under this Act or the Railroad Retirement Act of 1935, which is based in part on such military service and is with respect to a calendar month for all or part of which such pension or other benefit is also payable, shall be reduced with respect to that month by the proportion which the number of years of service by which such military service increases the years of service or the service period, as the case may be, bears to the total years of service, or by the aggregate amount of such pension or other benefit with respect to that month, whichever would result in the smaller reduction.*

"*(j) Any department or agency of the United States maintaining records of military service, at the request of the Board, shall certify to the Board, with respect to any individual, the number of months of military service which such department or agency finds the individual to have had during any period or periods with respect to which the Board's request is made, the date and manner of entry into such military service, and the conditions under which such service was continued. Any department or agency of the United States which is authorized to make awards of pensions, disability compensation, or any other gratuitous benefits or allowances payable, on a periodic basis or otherwise, under any other Act of Congress on the basis of military service, at the request of the Board, shall certify to the Board, with respect to any individual, the calendar months for all or part of which any such pension, compensation, benefit, or allowance is payable to, or with respect to, the individual, the amounts of any such pension, compensation, benefit, or allowance, and the mili-*

tary service on which such pension, compensation, benefit, or allowance is based. Any certification made pursuant to the provisions of this subsection shall be conclusive on the Board: Provided, That if evidence inconsistent with any such certification is submitted, and the claim is in the course of adjudication or is otherwise open for such evidence, the Board shall refer such evidence to the department or agency which made the original certification and such department or agency shall make such recertification as in its judgment the evidence warrants. Such recertification, and any subsequent recertification, shall be conclusive, made in the same manner, and subject to the same conditions as an original certification.

"(k) In the event that an individual was, on or before the date of enactment of the Second Revenue Act of 1940, denied an annuity but could have been granted an annuity under the provisions of this Act or the Railroad Retirement Act of 1935 had military service been included in his years of service or service period, as the case may be, no annuity shall be payable with respect to such individual, or with respect to his death, by reason of the provisions of this section, unless such individual files a new application with the Board. In determining the earliest date upon which an annuity can begin to accrue for such an individual in accordance with the provisions of section 2, the filing date of the application shall be the date on which such new application is filed.

"(l) An individual who, on or before the date of enactment of the Second Revenue Act of 1940, was awarded an annuity under the provisions of this Act or the Railroad Retirement Act of 1935, but whose annuity would have been increased if his military service had been included in his years of service or service period, as the case may be, may, notwithstanding the previous award of an annuity, make application (in such manner and form as may be prescribed by the Board) for an increase in such annuity based on his military service. Upon the filing of such application, if the Board finds that the military service thus claimed is creditable and would result in an increase in the annuity, the Board, notwithstanding the previous award, shall recertify the annuity on an increased basis in the same manner as though this section had been in effect at the time of the original certification: Provided, however, That if the annuity previously awarded is a joint and survivor annuity, the increased annuity shall be a joint and survivor annuity of the same type except that if on the date the increase begins to accrue the individual has no spouse for whom the election of the joint and survivor annuity was made, the increase on a single life basis shall be added to the individual's annuity: And provided further, That such increase in the annuity shall not begin to accrue more than sixty days before the filing date of the application for an increase in the annuity based on military service, and in the event the annuity is a joint and survivor annuity, the actuarial value of the increase in annuity shall be computed as of the effective date of the increase.

"(m) In addition to the amount authorized to be appropriated in subsection (a) of section 15 of this Act, there is hereby authorized to be appropriated to the Railroad Retirement Account for each fiscal year, beginning with the fiscal year ending June 30, 1941, an amount sufficient to meet the additional expenditures necessary to be made during each such fiscal year by reason of crediting under the Railroad Retirement Acts military service prior to January 1, 1937. The Railroad Retirement Board, as promptly as practicable after the date of enactment of the Second Revenue Act of 1940, and thereafter annually, shall submit to the

Bureau of the Budget estimates of such military service appropriations to be made to the account in addition to the annual estimates by the Board, in accordance with subsection (a) of section 15 of this Act, of the appropriations to be made to the account to provide for the payment of annuities, pensions and death benefits not based on military service. Each such estimate shall take into account the excess or the deficiency, if any, in such military service appropriation for the preceding fiscal year."

SEC. 626. Section 202 of such Act of June 24, 1937, is hereby amended by inserting immediately after the second proviso of such section the following new proviso: "And provided further, That for the purposes of determining eligibility for an annuity and computing an annuity there shall also be included in an individual's service period, subject to and in accordance with subsections (a) to (l), inclusive, of section 3A of this Act, voluntary or involuntary military service of an individual prior to January 1, 1937, within or without the United States during any war service period, if, in the calendar year in which his military service in a war service period began, or in the calendar year next preceding such calendar year, he was in the compensated service of a carrier, or of a person service to which is otherwise creditable, or was serving as a representative; but such military service shall be included only subject to and in accordance with the provisions of the Railroad Retirement Act of 1935, in the same manner as though military service were service rendered as an employee:".

And the Senate agree to the same.

Amendment numbered 36:

That the House recede from its disagreement to the amendment of the Senate numbered 36, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

TITLE VII—CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES

SEC. 701. CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES

(a) ALLOWANCE OF CREDIT.—Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, or against the tax imposed by the Federal Unemployment Tax Act for the calendar year 1939, any taxpayer shall be allowed credit for the amount of contributions paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

(2) On or after such sixtieth day (except in the case of the tax for the calendar year 1939) with respect to wages paid after the fortieth day after such date of enactment;

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

The amount of such credit, in the case of contributions with respect to the calendar year 1939 paid after the last day upon which the taxpayer was

required under section 1604 of the Federal Unemployment Tax Act to file a return for such year, shall not exceed 90 per centum of the amount which would have been allowable as credit on account of such contributions had they been paid on or before such last day. The provisions of the Social Security Act in force prior to February 11, 1939 (except the provision limiting the credit to amounts paid before the date of filing returns) shall, with respect to the tax for the calendar year 1936, 1937, or 1938, apply to allowance of credit under this section, and the provisions of the Federal Unemployment Tax Act (except section 1601 (a) (3)) shall, with respect to the tax for the calendar year 1939, apply to allowance of credit under this section. The terms used in this subsection shall, with respect to the tax for the calendar year 1936, 1937, or 1938, have the same meaning as when used in title IX of the Social Security Act prior to February 11, 1939, and shall, with respec to the tax for the calendar year 1939, have the same meaning as when used in the Federal Unemployment Tax Act. The total credit allowable against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, or against the tax imposed by section 1600 of the Federal Unemployment Tax Act for the calendar year 1939, shall not exceed 90 per centum of such tax.

(b) REFUND.—Refund of the tax (including penalty and interest collected with respect thereto, if any), based on any credit allowable under this section, may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. No interest shall be allowed or paid on the amount of any such refund.

And the Senate agree to the same.

R. L. DOUGHTON,
THOMAS H. CULLEN,
JOHN W. MCCORMACK,
JERE COOPER,
ALLEN T. TREADWAY,
FRANK CROWTHER,
HAROLD KNUTSON,
Managers on the part of the House.

PAT HARRISON,
WILLIAM H. KING,
WALTER F. GEORGE,
ARTHUR CAPPER,
JOHN G. TOWNSEND, Jr.,
Managers on the part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 10413) to provide revenue, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendment No. 1: This amendment strikes out title I (excess-profits tax) of the House bill and substitutes title I (corporation income tax) and title II (excess-profits tax); and the House recedes with an amendment.

Title I of this amendment being new and title II being in effect title I of the House bill with amendments, the action on this amendment will be discussed section by section.

TITLE I—CORPORATION INCOME TAX

House bill.—There is no comparable provision in the House bill. Section 710 of the excess-profits tax as passed by the House did, however, provide, as part of the excess-profits tax in the case of corporations which elected to compute their excess-profits credit on the average earnings plan, for the payment of an additional amount equal to $4\frac{1}{10}$ percent of the normal tax net income.

Senate amendment.—The Senate amendment increased by $3\frac{1}{10}$ percent the corporate income tax of all corporations (except nonresident foreign corporations taxable under section 231 (a)). Such increase applied to the entire rate schedule contained in sections 13 and 14, that is, whether or not the corporation's normal tax net income was in excess of $25,000. The permanent corporate tax rate applicable to corporations not entitled to the special treatment provided for small corporations was therefore $22\frac{1}{10}$ percent. It was provided, however, that in computing the 10-percent increase in tax imposed by section 15 of the Internal Revenue Code, added to such code by section 201 of the first Revenue Act of 1940, the corporate tax prior to the $3\frac{1}{10}$ percent increase contained in the Senate amendment was to be used as the basis for such computation. Thus, the general effective rate applicable to corporations with normal-tax net incomes in excess of $31,964.30, so long as the defense-tax provisions of section 15 were in force, would be 24 percent.

Conference agreement.—Under the conference agreement, there is no increase of the chapter 1 tax of corporations whose normal-tax net income is not in excess of $25,000, if such corporations are entitled to the treatment provided by section 14 of the Internal Revenue Code. In the case of corporations whose normal-tax net income is slightly in excess of $25,000 and which are taxable as provided in section 13, the full $3\frac{1}{10}$ percent increase is not applicable in fact until the normal-tax net income reaches $38,565.89. Like the Senate amendment the bill as agreed to in conference provides that the additional 10 percent imposed by the First Revenue Act of 1940 is to be figured on the basis of the permanent rates prior to their increase by the bill. Therefore, in the case of corporations whose normal-tax net income is slightly in excess of $25,000, the 10 percent increase may be computed on the basis of the tax (at the unincreased rates) under the general rule, even though the corporation may still be subject to the alternative tax under

the bill. The applicable rates under the conference agreement are illustrated by the following table:

	Permanent rate			Temporary additional rate (defense tax)	Total normal tax rate
	Existing law	Additional rate under the conference bill	Total		
Corporations with normal-tax net incomes not in excess of $31,964.30:	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
First $5,000	13.50	0	13.50	1.35	14.85
Next $15,000	15.00	0	15.00	1.50	16.50
Next $5,000	17.00	0	17.00	1.70	18.70
Next $6,964.30	33.00	2	35.00	3.30	[1] 38.30
Corporations with normal-tax net incomes in excess of $31,964.30, but not in excess of $38,565.89:					
First $5,000	13.50	0	13.50	1.9	15.4
Next $15,000	15.00	0	15.00	1.9	16.9
Next $5,000	17.00	0	17.00	1.9	18.9
Next $13,565.89	33.00	2	35.00	1.9	[1] 36.9
Corporations with normal-tax net incomes in excess of $38,565.89 [2]	19.00	3.1	22.10	1.9	24.00

[1] This is the "notch provision." The specified rate, coupled with the low rates applicable to the first $25,000, does not produce an effective rate as high as that applicable to large corporations until the normal-tax net income reaches $31,964.30, in the case of existing law, and $38,565.89, under the bill.

[2] In this group would also fall mutual investment companies and foreign corporations not taxable under section 231 (a), regardless of the amount of their income.

Title II (Title I of House Bill)—Excess-Profits Tax

SECTION 710. IMPOSITION OF TAX

House bill.—Under the House bill, the excess-profits tax imposed upon corporations which elected to compute their excess-profits credit on the income plan consisted of 4⅒ percent of the corporation's normal-tax net income plus a graduated tax of from 25 to 50 percent of the corporation's adjusted excess-profits net income. The excess-profits tax imposed upon corporations which elected to compute their excess-profits credit on the invested capital method consisted solely of a graduated tax of from 20 to 45 percent of the corporation's adjusted excess-profits net income. The term "adjusted excess-profits net income," which constituted the measure of the graduated tax, was defined as the excess-profits net income less a specific exemption of $5,000 and the amount of the taxpayer's excess-profits credit for the taxable year.

In the case of any corporations which had been through certain types of tax-free exchanges, adjustments were to be made in the dollar amounts constituting the dividing lines between the various brackets. If, for example, a corporation, in a tax-free transaction, split up into two corporations, the rate schedule was adjusted so that the sum of the amounts of income of both corporations subject to each bracket would not exceed the amount of income which would have been taxed in such bracket had the original corporation remained intact. The amount in each bracket was divided between the two corporations on the basis of the relationship of its invested capital immediately after the exchange to the invested capital of the original corporation immediately preceding the exchange. To accomplish this result, since section 759 required a similar adjustment to be made in the case of the preferential rate amount, which in the case of corporations which had not been through a prior tax-free exchange was always

$500,000, the ratio of the taxpayer's preferential rate amount to $500,000 was, as a matter of convenience, applied in the adjustment of the dollar amounts in the rate schedule provided by section 710.

Senate amendment.—The additional 4⁄10 percent of the normal-tax net income of corporations electing the excess-profits tax based on average earnings was eliminated. The 5-percent differential in rate between corporations computing their excess-profits credit on the invested-capital plan and corporations computing their excess-profits credit on the income plan was also eliminated and the 25 to 50 percent graduated rate schedule applicable under the House bill to corporations electing the income credit was made applicable to all corporations. However, such rate schedule was further modified so as to make the dividing line between the brackets depend upon specified dollar amounts of adjusted excess-profits net income only if such specified dollar amounts are greater than alternative amounts representing specified percentages of the excess-profits credit. The rate schedule contained in the Senate amendment is as follows:

Twenty-five percent of so much of the adjusted excess-profits net income as does not exceed the greater of $20,000 or 20 percent of the excess-profits credit;

Thirty percent of so much of the adjusted excess-profits net income as exceeds the greater of $20,000 or 20 percent of the excess-profits credit and does not exceed the greater of $50,000 or 40 percent of such credit;

Thirty-five percent of so much of the adjusted excess-profits net income as exceeds the greater of $50,000 or 40 percent of the excess-profits credit and does not exceed the greater of $100,000 or 60 percent of such credit;

Forty percent of so much of the adjusted excess-profits net income as exceeds the greater of $100,000 or 60 percent of the excess-profits credit and does not exceed the greater of $250,000 or 80 percent of such credit;

Forty percent of so much of the adjusted excess-profits net income as exceeds the greater of $250,000 or 80 percent of the excess-profits credit and does not exceed the greater of $500,000 or 100 percent of such credit; and

Fifty percent of so much of the adjusted excess-profits net income as exceeds the greater of $500,000 or 100 percent of the excess-profits credit.

The adjustment in the rate schedule required in the case of taxpayers which had been through certain types of tax-free transactions was eliminated.

The definition of "adjusted excess-profits net income" contained in the House bill was retained except that the specific exemption allowable in computing such adjusted excess-profits net income was increased from $5,000 to $10,000.

Conference agreement.—Under the conference agreement, the excess-profits tax of all corporations, whether computing their excess-profits credit on the income or invested-capital plan, is based solely on the following rate schedule:

Amount of adjusted excess-profits net income:	*Rate of tax percent—*
First $20,000	25
Next $30,000	30
Next $50,000	35
Next $150,000	40
Next $250,000	45
Over $500,000	50

This was the graduated schedule applicable to corporations computing their excess profit on the income plan under the House bill and was the schedule applicable to all corporations under the amendment as reported by the Senate Finance Committee.

The adjustment in the above rate schedule which was required, under the House bill, in the case of taxpayers which had been through certain types of tax-free transactions has been restored, with clerical changes.

The specific exemption allowable in computing the adjusted excess-profits net income has been restored to $5,000. An additional credit is also allowed, in computing such adjusted excess-profits net income, to corporations whose normal-tax net income for the taxable year is not in excess of $25,000, such additional credit to consist of the amount if any, by which the excess profits credit for the preceding taxable year exceeded the excess-profits net income for such year. It is understood that the Treasury and members of the staff of the Joint Committee on Internal Revenue Taxation will study the operation of this limited carry-over, with a view to its possible extension or modification, and will report to the appropriate committees on the subject as soon as possible.

SECTION 711. EXCESS-PROFITS NET INCOME

House bill.—Under the House bill the excess-profits net income was defined to be the normal-tax net income with certain adjustments.

Senate amendment.—In addition to certain technical amendments, the Senate amendment made the following changes in and additions to the adjustments contained in the House bill:

(1) The additional deduction on account of corporate income taxes was modified so as to exclude the section 102 tax imposed on corporations improperly accumulating surplus. Under both the House and Senate bills, however, the normal corporate income tax (after the allowance of the foreign tax credit) for the taxable year for which the excess-profits net income is being computed is allowable as an additional deduction.

(2) The treatment of gains and losses on depreciable assets held for more than 18 months as long-term capital gains and losses and their consequent exclusion from the computation was eliminated. In lieu thereof a provision was inserted providing that only the excess of gains arising from the sale or exchange of such assets over any losses arising therefrom should be excluded from the computation. The effect of this provision is to allow losses from the sale or exchange of depreciable assets held for more than 18 months to be deducted from ordinary income to the extent such losses exceed the gains from similar transactions.

(3) The adjustment on account of income derived from the retirement or discharge of bonds, etc., was rewritten to make certain that amounts which would be otherwise includible upon such retirement or discharge on account of any premium received upon issuance should be left out of the computation, and that the adjustment should apply although the indebtedness retired or discharged is indebtedness which has been assumed by the taxpayer and although it is evidenced, so far as the taxpayer is concerned, only by a contract with the person whose liabilities have been assumed.

(4) A corresponding adjustment was added requiring that certain deductions otherwise allowable on account of the retirement or discharge of bonds, etc., should be excluded from the computation.

(5) A new adjustment was added, applicable only to taxable years after the base period, requiring the exclusion of income attributable to refunds of Agricultural Adjustment Act taxes and interest upon such refunds.

(6) It was also provided that, if the excess-profits credit is computed under the invested-capital plan, the normal-tax net income should be increased by an amount equal to the interest on United States obliga-

tions and the obligations of Federal instrumentalities not specifically exempted from excess-profits taxes and, in addition thereto, the interest on all other Federal, State, or local obligations, if the taxpayer elects, under section 720 (d) (added by the Senate amendment), to treat all such other obligations as admissible assets for the taxable year.

(7) Losses arising from the demolition, abandonment, and loss of useful value of property are excluded from the computation of excess-profits net income for taxable years in the base period.

(8) An additional adjustment was provided, applicable only to taxable years in the base period, to the effect that deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest thereon, would not be required to be taken into account if, in the light of the taxpayer's business, it is abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurs liabilities of such character, the amount of the particular liabilities of such character in the taxable year is grossly disproportionate to the average amount of liabilities of such character in each of the four previous taxable years.

(9) Income attributable to the recovery of a bad debt, if a deduction from gross income was allowed with reference to such debt was allowed from gross income for a taxable year beginning prior to January 1, 1940, is excluded in the case of taxable years after the base period.

(10) A new adjustment, applicable to both the taxable years in the base period and taxable years after the base period in the case of corporations computing their excess-profits credit under the income plan, was added requiring the exclusion of any deductions in connection with exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing.

(11) Corporations computing their excess-profits credit under the income plan are given the same dividends received credit, both for taxable years in the base period and for taxable years after the base period, as is given to corporations computing their excess-profits credit on the invested capital plan, i. e., the full amount of all dividends received, except dividends on stock of a foreign personal holding company.

(12) Amounts received pursuant to an award of the Mixed Claims Commission, United States and Germany, are excluded from income for taxable years after the base period in the case of corporations computing their excess-profits credit under the income plan.

(13) In case of taxable years in the base period, the deduction under section 23 (k) for bad debts is decreased by an amount representing unrecovered loans made by a parent corporation to its subsidiary, in so far as such deduction includes an amount representing such unrecovered loans.

In addition to applying section 117 of the Internal Revenue Code (relative to capital gains and losses) to taxable years in the base period, which was done in the House bill, the Senate amendment applies section 23 (g) and (k) to such taxable years in order that long-term losses due to securities (stocks and bonds) having become worthless would be disallowed in computing excess-profits net income for taxable years in which such losses were not treated as capital losses under the income-tax law applicable to such years.

Conference agreement.—With the exceptions and modifications described below, the Senate provision is adopted:

(1) The adjustment relative to income realized upon the retirement or discharge of bonds, etc., has been further redrafted so as to make

certain that the excluded income on account of the issuance of the bonds at a premium relates only to premium unamortized on the date of retirement or discharge. There is not to be excluded from income the accrued amortization of bond premium for that portion of the taxable year preceding such retirement or discharge.

(2) The adjustment requiring that certain deductions otherwise allowable on account of the retirement or discharge of bonds, etc., should be excluded from the computation has been eliminated for taxable years after the base period. As retained relative to taxable years in the base period, it has been redrafted so as to make certain that the excluded deduction on account of the issuance of bonds, etc., at a discount relates only to discount unamortized on the date of the retirement or discharge. The ordinary deduction for amortization of bond discount accrued for that portion of the taxable year preceding the retirement or discharge is not to be excluded from the computation.

(3) The adjustment relative to interest on Federal, State, and local obligations has been revised as follows: The distinction between certain United States obligations and obligations of Federal instrumentalities, on the one hand, and all other Federal, State, or local obligations, on the other, has been eliminated, and the treatment of all such obligations has been made optional with the taxpayer. Instead of requiring the taxpayer to elect to treat such obligations as admissible assets and having the taxation of the interest derived therefrom follow as a consequence, however, the conference agreement provides that the taxpayer's election shall be with respect to the inclusion of the interest in income and that, if such an election is made, the obligations from which such interest was derived shall be treated as admissible assets for the taxable year. See discussion under section 720. A taxpayer must elect as to all such interest and may not elect as to only a portion thereof.

(4) The adjustment requiring the exclusion of any deduction in connection with exploration, etc., has been eliminated as to taxable years after the base period. As retained relative to taxable years in the base period, the adjustment has been limited to deductions allowed in respect of expenditures for intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, or for development costs in the case of mines. Such deductions are excluded only if and to the extent that in the light of the taxpayer's business it is abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurs such liability, only to the extent that the amount of such liability in the taxable year in question was grossly disproportionate to the amount of such liability in the 4 previous taxable years.

(5) Corporations computing their excess-profits credit on the income plan are allowed a dividends-received credit of 100 percent of the dividends received from a domestic corporation, but, unlike corporations on the invested-capital plan, are given no credit for dividends received from a foreign corporation. Such dividends, however, if their receipt constitutes an abnormality, are entitled to the treatment provided by section 721.

(6) The specific adjustment excluding from income awards of the Mixed Claims Commission has been eliminated, since it is already covered by the general provisions of section 721. Such income would be abnormal in kind, and, to the extent it constituted compensation for past losses, would be attributable to the years such losses occurred. Most of these awards of the Mixed Claims Commission

were paid many years ago. However, a number of awards to American nationals were rendered by the Commission only recently and have not yet been paid. The conferees were unanimous that such awards when paid, to the extent they do not include current interest, should not and would not be subject to the excess-profits tax. Section 711 (a) (1) (I) of Senate amendment has been omitted from the bill as agreed to in conference by reason of the fact that the conferees are convinced (and have the assurances of the Treasury) that section 721 of the bill accomplishes the same result, since the very nature of the award makes any resulting income abnormal, and none of the amounts paid pursuant to such awards will be attributable to any taxable year beginning after December 31, 1939, within the meaning of such section. Insofar as such amounts are properly includible in the normal tax net income of the recipients, they will, of course, be subject to the normal tax in the year in which they are accrued or (in the case of recipients upon the cash receipts basis) are actually received.

(7) The adjustment in the base period on account of bad debts representing unrecovered loans made by a parent corporation to a subsidiary has been eliminated.

SECTION 712. ALLOWANCE OF EXCESS-PROFITS CREDIT

House bill.—Under the House bill a domestic corporation was permitted to choose between the income credit and the invested capital credit only if it had been in existence during the entire 48 months prior to the beginning of its first taxable year which began in 1940. Foreign corporations subject to excess-profits tax were required to compute their excess-profits credit on the income plan if they were in existence during the entire 48 months prior to the beginning of their first excess-profits tax taxable year beginning in 1940 and were engaged in trade or business within the United States or had an office or place of business therein at any time during each of the taxable years in the 48 months prior to such date. All other domestic and foreign corporations subject to excess-profits tax were required to compute their excess-profits credit on the invested-capital plan.

Senate amendment.—Under the Senate amendment all domestic corporations which have been in existence prior to January 1, 1940, and all foreign corporations which, under the House bill, were required to compute their excess-profits credit on the income plan, are permitted to choose between the income and the invested capital plan. All other corporations including corporations which for any taxable year do not file returns, must compute their excess-profits credit on the invested capital plan.

Conference agreement.—The Senate provision is adopted.

SECTION 713. EXCESS-PROFITS CREDIT BASED ON INCOME

House bill.—Under the House bill all taxable years in the base period, including taxable years for which there were deficits, were taken into account in computing the average base period net income, except that the loss for one deficit year (the largest, if the taxpayer had more than one) was not to be applied in reduction of the aggregate income for other years. In ascertaining the average, however, the period covered by such taxable year was taken into account, i. e., the aggregate for the other years was divided by the total number of years in the base period, not by such total number less one.

Senate amendment.—In lieu of the treatment relative to deficits contained in the House bill, the Senate amendment provides that a taxpayer may entirely exclude one base period taxable year in computing its average earnings. Not only may the excess-profits net income or the deficit for such year be excluded from the computation, but the period embraced by such taxable year is excluded in ascertaining the average base period net income for the base period. Thus, if the base period includes 4 calendar years and the taxpayer chooses to drop one of such years out of the computation, the aggregate income for the remaining 3 years is divided by three, and not by four, in ascertaining the base-period average.

Since under the Senate amendment all domestic corporations which have been in existence prior to January 1, 1940, are permitted to choose between the income and the invested capital plan, even though they may not have been in existence during the entire base period, the Senate amendment also provides for a constructive excess-profits net income in the case of corporations electing the income plan for such portion of the base period as the corporation was not in existence. Such excess-profits net income is to be computed in the same manner as the House bill provided in the case of corporations electing the invested-capital plan, i. e., 8 percent of the invested capital for the day following the close of the base period, reduced by the same ratio of inadmissibles as is applicable to the last year of the base period.

The adjustment on account of capital additions and reductions was amended so as to treat 100 percent of the stock of another corporation owned by the taxpayer as excluded capital. This conforms with the change made in the dividends received credit of corporations computing their excess-profits credit on the income plan.

Conference agreement.—The Senate provision permitting the complete exclusion of 1 year in the computation of average base-period net income has been eliminated, and the House provision relative to the treatment of deficit years has been restored. In addition, it is provided that, in computing the income credit, the amount thereof, prior to adjustment on account of capital additions or capital reductions, shall be 95 percent of the average base period net income instead of 100 percent of such average base-period net income. This 5-percent reduction of the average base period net income is in lieu of the House provision which included an additional 4$\frac{1}{10}$ percent of the normal-tax net income in the excess profits tax of corporations electing the income plan and provided a 5-percent differential in the graduated rate schedule applicable to such corporations.

In view of the conference agreement on sections 711 and 712, the Senate provision relative to a constructive excess profits net income in the case of corporations in existence during part, but not all, of the base period has been retained, and the treatment of corporate stock as excluded capital has been limited to the stock of domestic corporations.

SECTION 714. EXCESS-PROFITS CREDIT BASED ON INVESTED CAPITAL

House bill.—Under the House bill the invested capital credit for any taxable year reflected, in part, the base period experience of the taxpayer. In general, the excess-profits credit consisted of an amount representing the base period rate of return (but not less than 7 percent or more than 10 percent on the first $500,000 and not less than 5 percent or more than 10 percent on the remainder) on so much of the corporation's invested capital for the taxable year as did not exceed its invested capital at the close of the base period, plus 10 percent of so

much of the remaining invested capital as did not bring the total invested capital beyond $500,000, and 8 percent of the remainder.

Senate amendment.—Under the Senate amendment the base period experience of a corporation electing the invested capital credit is eliminated from consideration. The excess-profits credit of any such corporation is 8 percent of the taxpayer's invested capital for the taxable year, without regard to its earnings record in the base period.

Conference agreement.—The conference agreement adopts the Senate provision.

SECTIONS 715–718. INVESTED CAPITAL

The only change, other than clerical and technical changes, made by the Senate amendment in these sections of the House bill was the insertion of a new sentence in section 715 authorizing the Commissioner of Internal Revenue, pursuant to regulations, to permit, in the computation of invested capital, the use of averages or ratios on a monthly, annual, or other appropriate basis, where in his opinion the circumstances do not require daily computation.

Under the conference agreement, the authorization to compute invested capital on some basis other than a daily basis is limited to cases where such other method will not cause the invested capital to vary by more than $1,000 from the invested capital computed on a daily basis. The conference agreement also makes further technical changes in order to eliminate duplications in the computation of equity invested capital. Provisions have been inserted governing the extent to which the equity invested capital of a parent corporation is to be increased or decreased following a liquidation under section 112 (b) (6). This provision enables the provisions of section 718 (b) (3) to be expanded so as to cover all situations in which, under the doctrine of *Commissioner* v. *Sansome* (60 F. (2d) 931), the earnings and profits of one corporation become the earnings and profits of another. A proper application of the provisions of section 718 prevents, it is believed, improper duplications in the case of the merger or consolidation of two or more corporations, one of which owns stock in the other; for the sake of clarity, however, subsection (c) (4) has been inserted dealing with the merger or consolidation of two or more corporations, one of which owns stock in the other. In case the corporation whose stock is owned by the other, is merged into the other, no corresponding provision is necessary, since the property transferred in the merger represented by such stock is not within any provision of section 718 (a).

SECTION 719. BORROWED INVESTED CAPITAL

House bill.—Under the House bill borrowed capital (i. e., indebtedness evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust) was included in invested capital under a graduated limitation at varying percentages (100, 66⅔, 33⅓), these percentages depending upon the size of the corporation.

Senate amendment.—Under the Senate amendment all borrowed capital is included in invested capital at 50 percent, regardless of the size of the corporation. Borrowed capital is defined to mean, in addition to the types of indebtedness described in the House bill, certain amounts received as advance payment in connection with a contract

with a foreign government to furnish articles, materials, or supplies, to the extent such amounts would be repayable, pursuant to the terms of the contract, if cancelation by such foreign government occurred at the beginning of the day for which the borrowed capital is being ascertained. Such contract must have been made before the expiration of 30 days after the date of enactment of the bill.

Conference agreement.—The Senate provision has been adopted except that the clause relative to amounts repayable to a foreign government has been redrafted so as to make certain that the amounts included as borrowed capital thereunder do not include amounts treated as income and therefore reflected in equity invested capital through the accumulated earnings and profits account.

SECTION 720. ADMISSIBLE AND INADMISSIBLE ASSETS

House bill.—Under the House bill, in addition to corporate stock, all Federal, State, and local obligations were treated as inadmissible assets for the taxable year, and the interest derived therefrom was not included in normal-tax net income, upon the basis of which the excess-profits net income was computed.

Senate amendment.—Under the Senate amendment all United States obligations and obligations of Federal instrumentalities, the interest from which is not exempt from excess-profits taxation, are treated as admissible assets and the interest derived therefrom is subject to tax. In addition, the taxpayer may elect to treat all other Federal, State, and local obligations as admissible assets for the taxable year. If such an election is made, the normal tax net income is increased by the amount of interest derived from such obligations. The taxpayer is required to make a single election relative to all such obligations and may not elect as to only a portion thereof.

Conference agreement.—Under the conference agreement the distinction between certain United States obligations and obligations of Federal instrumentalities, on the one hand, and of other Federal, State, and local obligations, on the other, is eliminated. The taxpayer's election, instead of being an election to treat the obligations in question as admissible assets, is an election to include the interest derived therefrom in normal tax net income. It is provided that, if such an election is made, the obligations from which such included interest is derived are treated as admissible assets for the taxable year.

SECTION 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD

House bill.—There were no comparable provisions in the House bill.

Senate amendment.—Section 721 (a) of the Senate amendment was designed to provide relief in the case of—

(1) Income arising out of a claim, award, judgment, or decree, or out of interest on any of the foregoing;

(2) Income received with respect to a contract whose performance required more than 1 year;

(3) Income resulting from the exploration, discovery, prospecting, research, or development of tangible property, patents, formulas, or processes, or any combination thereof, by the taxpayer or any of its predecessors, providing that such exploration, etc., extended over a period of more than 1 year;

(4) Income which is required to be included for the taxable year as a result of a change in the taxpayer's accounting period or method of accounting;

(5) Income received by the lessor of real property on the termination of the lease as a result of improvements on the property during the lease.

Any of the above types of income which is abnormal in kind, or which, in the light of the taxpayer's experience in the 4 previous taxable years, is abnormal in amount, is entitled to the following treatment:

The amount thereof attributable to any previous taxable year or years is to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary. In the case of income from exploration, etc., the Commissioner is required to allocate in equal amounts so much of such income as is not attributed to the taxable year to each of the preceding years (not exceeding 5) during which the exploration, etc., was conducted. The excess-profits tax for the taxable year shall not exceed the excess-profits tax for such taxable year computed without including such income in gross income, plus the aggregate of the additional excess-profits taxes which would have been payable in each of the preceding taxable years (including the current taxable year) to which a portion of such income is attributed if such portion had been included in income in such year.

Section 721 (b) provides a 2-year carry-over of the unused excess-profits credit for any taxable year beginning after December 31, 1939, in the case of corporations 80 percent or more of whose gross income is derived from mining or processing minerals or from processing or otherwise preparing for market any seasonal fruit or vegetable, or any fish or other marine life. The unused excess-profits credit for any taxable year is the amount by which the excess-profits credit for such taxable year exceeds the excess-profits net income for such taxable year.

Conference agreement.—The conference agreement retains section 721 with the following modifications:

(1) The item relative to income resulting from explorations, etc., has been rewritten. The exploration, etc., from which the income is derived must be the taxpayer's own exploration. Income resulting from activities of such a character carried on by a predecessor corporation is not entitled to the treatment provided in section 721.

(2) The item relative to income arising from the termination of a lease has been broadened so as to include all income arising from such source and not merely income occasioned by improvements on the property during the term of the lease.

(3) A new category of potentially abnormal income has been added, consisting of dividends on stock of foreign corporations, except foreign personal holding companies. This is part of the conference agreement relative to the dividends received credit of corporations computing their excess-profits credit on the income plan. See section 710.

(4) The fixed rule of allocation applicable to income resulting from exploration, etc., has been eliminated.

(5) A new provision is inserted making certain that income attributed to any future year or years will be included in excess-profits net income for such future year or years and subjected to excess-profits tax.

(6) Subsections (b) and (c), providing for a special 2-year carry-over of the unused excess-profits credit in the case of certain businesses, are eliminated.

SECTION 722 (SEC. 721½ OF THE SENATE AMENDMENT). ADJUSTMENT OF ABNORMALITIES IN INCOME AND CAPITAL

Section 721½ of the Senate amendment provides that the Commissioner shall have authority to make any adjustments which abnormally affect income or capital, and that his decision shall be subject to review by the Board of Tax Appeals.

Conference agreement.—Under the conference agreement section 721½ is renumbered section 722 and given the heading "Adjustment of Abnormalities of Income and Capital." It grants the Commissioner authority to adjust any items which abnormally affect income or capital, and provides that the Commissioner's decision shall be subject to review by the Board of Tax Appeals. It is understood that the Treasury and members of the staff of the Joint Committee on Internal Revenue Taxation will give further study to the entire problem covered by this section and will report to the appropriate committees on the subject as soon as possible.

SECTIONS 723 AND 724 (SECS. 722 AND 723 OF THE SENATE AMENDMENT AND SECS. 721 AND 722 OF THE HOUSE BILL). EQUITY INVESTED CAPITAL IN SPECIAL CASES—FOREIGN CORPORATIONS, INVESTED CAPITAL

In addition to changes in section numbers, a clerical change was made by the Senate amendment because of the changes made in section 714. The Senate provision is adopted with a further change in section number.

SECTION 724 (SEC. 723 OF THE HOUSE BILL). PERSONAL SERVICE CORPORATIONS

House bill.—The House bill allowed a personal service corporation an election to have its income taxed in the hands of its shareholders in lieu of paying an excess-profits tax. A personal service corporation was defined to mean a corporation whose income is attributable primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are owners at all times during the taxable year of at least 80 percent in value of the stock of the corporation, and in which capital (whether invested or borrowed) is not a material income-producing factor. Foreign corporations and any corporation 50 percent or more of whose gross income consisted of gains, profits, or income derived from trading as a principal were excluded. For the purposes of the stock-ownership test, an individual was considered as owning stock owned by his spouse or minor child.

Senate amendment.—The Senate amendment contains, in effect, three alternative definitions of a personal service corporation. The first is that contained in the House bill. The second defines a personal service corporation as a corporation (in which capital is not an income-producing factor) at least 80 percent in value of whose stock is owned at all times during the taxable year by shareholders who are regularly engaged in the active conduct of the corporation's affairs. This definition differs from the House definition in that it does not require the corporation's income to be ascribed primarily to the activities of such shareholders. The third alternative contained in the Senate amendment defines a personal service corporation as a corporation (in which capital is not an income-producing factor) the income of which is to be ascribed primarily to the activities of shareholders who are actively engaged in the conduct of the corporation's

affairs and all of the stock of which is owned at all times during the taxable year by or for not more than 20 individuals. The effect of this alternative is to include corporations which have so-called silent partners who own more than 20 percent of its stock. As to both alternatives added by the Senate amendment, it is provided that an individual shall be considered as owning stock owned not only by his spouse or minor child, but by any guardian or trustee representing them.

Conference agreement.—Under the conference agreement a personal service corporation is defined to mean a corporation whose income is attributable primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are owners at all times during the taxable year of at least 70 percent in value of each class of stock of the corporation, and in which capital (whether invested or borrowed) is not a material income-producing factor. Foreign corporations and any corporation 50 percent or more of whose gross income consisted of gains, profits, or income derived from trading as a principal are excluded. For the purposes of the stock-ownership test, an individual is considered as owning stock owned by his spouse or minor child or by any guardian or trustee representing them.

SECTION 726 (SEC. 725 OF THE SENATE AMENDMENT AND SEC. 724 OF THE HOUSE BILL). CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936

In addition to changing the section number, only a clarifying change was made in this section by the Senate amendment. The Senate provision is adopted, with a further change in section number.

SECTION 727 (SEC. 726 OF THE SENATE AMENDMENT AND SEC. 725 OF THE HOUSE BILL). EXEMPT CORPORATIONS

The Senate amendment made no change in this section as contained in the House bill except to change the section number and to advance from December 1, 1940, to July 1, 1941, the date before which an investment company must register as a diversified company under the Investment Company Act of 1940 in order to qualify for exemption for the taxable years 1940 and 1941. The Senate provision is adopted with a further change in section number.

SECTION 728 (SEC. 727 OF THE SENATE AMENDMENT AND SEC. 726 OF THE HOUSE BILL). MEANING OF TERMS USED

The Senate amendment and the conference agreement merely change the section number.

SECTION 729 (SEC. 728 OF THE SENATE AMENDMENT AND SEC. 727 OF THE HOUSE BILL). LAWS APPLICABLE

House bill.—Section 727 (b) of the House bill provided that no return need be filed by a corporation whose excess-profits net income (placed on an annual basis in the case of a taxable period of less than 1 year) was not greater than $5,000, the amount of the specific exemption contained in the House bill.

Senate amendment.—The Senate amendment provides that no return need be filed unless the corporation's excess-profits net income (placed on an annual basis in the case of a taxable period of less than 1 year) is in excess of $10,000, the amount of the specific exemption provided by the Senate amendment.

Conference agreement.—In view of the conference action restoring the specific exemption to $5,000, the House provision is adopted with a further change in section number.

SECTION 730 (SEC. 729 OF THE SENATE AMENDMENT). CONSOLIDATED RETURNS

This section was not in the House bill. As added by the Senate amendment it permits consolidated returns to be filed by affiliated groups of corporations under certain circumstances, among which is the requirement that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made must consent to regulations prescribed by the Commissioner, with the approval of the Secretary, prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent.

The term "affiliated group" is defined to mean one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 percent of each class of the stock 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 95 percent of each class of the stock of at least one of the other corporations.

Foreign corporations (except certain 100-percent owned foreign subsidiaries of domestic corporations), China Trade Act corporations, and certain corporations deriving income from United States possessions are not to be deemed to be affiliated with any other corporation within the meaning of this provision.

Under the conference agreement—

(1) The class of corporations excluded from membership in an affiliated group is expanded to include certain other corporations in addition to those specified in the Senate amendment. As thus expanded, the class of corporations excluded from the affiliated group includes all those corporations which, by reason of the fact that they are themselves exempt from the excess-profits tax, or are taxable on a basis different from that used in the case of corporations generally (as in the case of foreign corporations), or are otherwise allowed special treatment (as in the case of China Trade Act corporations, personal service corporations, and corporations doing business in possessions of the United States), cannot appropriately be associated for tax purposes with corporations not accorded such special treatment. While insurance companies in general are not includible in an affiliated group, an insurance company may be affiliated with other insurance companies of the same taxable character. For example, an insurance company taxable under section 201 may file a consolidated return with another insurance company taxable under the same section, assuming both companies meet the stock ownership test. An insurance company taxable under section 201 may not, however, file a consolidated return with another insurance company taxable under section 204 or section 207. The conference agreement preserves the exception relative to certain 100-percent owned foreign subsidiaries of domestic corporations contained in the Senate amendment.

(2) The definition of the term "affiliated group" has been revised so as to speak in terms of includible corporations (all corporations not excluded from membership in an affiliated group being termed includ-

ible corporations) and to provide that the type of stock to which the 95-percent ownership test applies shall not include nonvoting stock which is limited and preferred as to dividends.

The term "affiliated group" is defined to mean one or more chains of includible corporations connected through stock ownership with a common parent corporation which is itself an includible corporation if—

(a) At least 95 per centum of the stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(b) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other includible corporations.

In view of the above definition consolidated returns may not be filed by subsidiary corporations as an affiliated group unless the parent corporation through which such subsidiaries are connected is a member of the group. For instance, there will not be recognized as an affiliated group two industrial corporations the common parent of which is an insurance company or a personal holding company. In addition, no corporation which is connected by stock ownership with an affiliated group of includible corporations only through a nonincludible corporation may be included in a consolidated return. If a common parent which is an includible corporation owns 95 percent of the stock of a nonincludible corporation and 95 percent of the stock of an includible corporation, it, and the other includible corporations may, of course, file a consolidated return.

Under section 141 of the Internal Revenue Code and corresponding sections of prior revenue acts, the Commissioner has prescribed by regulations the requirement that all corporations falling within the affiliated group at any time during the taxable year shall join in the consolidated return. The section provides that all the members of the group shall consent to such regulations as a condition to the privilege of filing such return. It is contemplated that the Commissioner will prescribe like requirements for the purposes of the consolidated returns authorized by this section and the section provides that such regulations shall be consented to by all of the includible corporations.

SECTION 731. INCOME FROM MINING STRATEGIC METALS (SEC. 730 OF SENATE AMENDMENT)

This section is new in the Senate amendment, no comparable provision having been contained in the House bill. It exempts from excess-profits tax income derived from mining, reduction or beneficiation of tungsten, quicksilver, manganese, platinum, antimony, chromite, and tin, or the ores and material containing such metals. These materials have been declared to be strategic materials by the War Department. The exemption provided in section 730 is intended to encourage their domestic production.

Under the conference agreement, this section is changed to section 731 and it is given a new caption. It exempts from excess-profits tax that portion of the adjusted excess-profits net income of a domestic corporation which is attributable to mining within the United States of tungsten, quicksilver, manganese, platinum, antimony, chromite, or tin. The tax on the remaining portion of the adjusted excess-profits net income is an amount which bears the same ratio to the

tax computed on all the adjusted excess-profits net income as such remaining portion bears to the entire adjusted excess-profits net income.

Supplement A. Exchanges: Excess-Profits Credit Based on Income

Except for technical changes and the changes indicated below, supplement A of the Senate amendment is the same as supplement A of the House bill.

House bill.—Supplement A of the House bill contained provisions whereby, in computing the excess-profits credit of a taxpayer on the average earnings plan, the base-period experience of corporations, the assets of which had previously been acquired by the taxpayer in certain types of transactions, could be taken into account. This provision was intended not only to enable the base-period experience of the enterprise to be more truly reflected but to enable the income credit to be available in certain cases even though the taxpayer had not been in existence during the entire base period. The types of transactions in which the assets of another corporation must have been acquired to entitle the acquiring corporation to these benefits were as follows:

(1) Whereby all the assets of another corporation were acquired in whole or in part for all the stock of the acquiring corporation.

(2) Complete liquidations of subsidiaries under section 112 (b) (6).

(3) Statutory mergers or consolidations.

Senate amendment.—Aside from certain technical changes the Senate amendment changed this provision of the House bill only in the following respects:

In addition to the types of transactions covered by the House bill, the Senate amendment added the type of exchange described in section 112 (g) (1) (C) of the Internal Revenue Code, that is, the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, the assumption by the acquiring corporation of a liability of the other or the fact that property acquired is subject to a liability being disregarded in the determination of whether the exchange is solely for voting stock. There were also added transfers before October 1, 1940, by one corporation of property to another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock of the transferee corporation owned by the transferor corporation, assumptions of liabilities being disregarded as in the case of section 112 (g) (1) (C) reorganizations. Neither of these types of transactions are includible unless the transferor corporation is forthwith completely liquidated in pursuance of the plan under which the acquisition is made, and the transaction of which the acquisition is a part has in all respects the effect of a statutory merger or consolidation.

The Senate amendment also provides that in the case of a taxpayer which became an acquiring corporation in a taxable year after December 31, 1939, if, on September 11, 1940, and at all times thereafter until the taxpayer became an acquiring corporation, either the taxpayer or one of the transferor corporations involved in the transaction in which the taxpayer became an acquiring corporation owned not less than 75 percent of each class of stock of each of the other corporations involved in the transaction, then the average base period net income of the taxpayer should not be less than either (1) its average

base period net income would have been if the transaction had not taken place or (2) the average base period net income of that transferor corporation whose average base period net income is the greatest.

A change, corresponding to that made in section 713, was made in section 742, authorizing the omission of one taxable year in the computation of average base period net income.

Conference agreement.—The Senate provisions are adopted, except to the extent they authorize the complete exclusion of one taxable year in computing average base-period net income. (See sec. 713.) The conference agreement also makes a clarifying change, whereby section 743 (c) is striken out and section 740 (g) inserted in lieu thereof. Section 740 (g) provides that the term "component corporation" includes a component corporation of a component corporation, except as used in section 742 (d) (1) and (2) and section 743 (a).

SUPPLEMENT B. EXCHANGES: HIGHEST BRACKET AMOUNT AND INVESTED CAPITAL

House bill.—In the computation of the invested capital credit under the House bill, a number of variable factors were employed depending upon the size of the corporation. The preferential treatment accorded small corporations made it necessary to include provisions to prevent a large corporation from receiving small corporation treatment through breaking itself up into a number of small corporations by means of tax-free transactions. Supplement B of the House bill provided the necessary rules for adjusting the various factors employed in the computation of the invested capital credit following certain tax-free transactions.

Senate amendment.—The Senate amendment eliminates most of Supplement B as no longer necessary in view of the change made in section 714, relative to the computation of the invested capital credit. Section 751, relative to the determination of property paid in for stock and of borrowed capital in connection with certain exchanges, was retained, however, with a clerical amendment. Section 759, relative to the determination of the preferential rate amount (renumbered sec. 752 and entitled "Highest Bracket Amount"), was also retained, with technical amendments.

The definitions of "exchange", "transfer or upon exchange", "transferee upon exchange", and "preferential rate amount" (renamed "highest bracket amount"), contained in section 750 of the House bill, were also retained but the term "exchange" was clarified so as to make it clear that only transactions occurring after December 31, 1917, are embraced in the definition. Broadly speaking, the tax-free exchange provisions did not appear in the income-tax law until after such date.

Conference agreement.—The conference agreement adopts the Senate provisions.

Amendments Nos. 2, 3, and 4: These are changes in title and section numbers. The House recedes.

Amendment No. 5: Section 124 (d) as added to the Internal Revenue Code by the House bill provided for making certain adjustments on account of changes in prior amortization or depreciation deductions occasioned by the provisions of subsection (d) (1), (2), (3), and (4), which adjustments were to be made without regard to the statute of limitations, closing agreements, or any other final determination of tax liability. This amendment expands such provision so as

to cover the recomputation required by subsection (i), added by amendment No. 11. Because of the changes made in subsection (i) in conference, this amendment is no longer necessary, and the Senate recedes.

Amendment No. 6: This is a clarifying amendment expanding the definition of the term "emergency facility" to include any facility which meets the required conditions, as well as land, buildings, machinery, or equipment, in terms of which the definition in the House bill was phrased. This is to make certain that the cost of dry docks, channels, airports, and similar facilities may be amortized. The House recedes.

Amendments Nos. 7, 8, and 9: These amendments substitute January 1, 1940, for July 10, 1940, the date contained in the House bill, as the date (1) after which the construction, reconstruction, erection, or installation of any facility must have been completed or its acquisition have taken place in order that the cost thereof may be subject to amortization, (2) with which the period of national emergency begins during which the facility must have been necessary in the interest of national defense, and (3) in terms of which the portion of the adjusted basis subject to amortization is defined. The House recedes with an amendment fixing June 10, 1940, as such date.

Amendment No. 10: Under the House bill, the certificate entitling the taxpayer to amortization must have been issued before whichever of the following dates was the later: (1) The beginning of the construction, etc., of the facility, or the date of its acquisition, or (2) the sixtieth day after the enactment of the bill. The Senate amendment changed the day specified in (2) to the one hundred and twentieth day after the enactment of the bill. The House recedes.

Amendment No. 11: This amendment substitutes for section 124 (i), (j) and (k) of the House bill a new subsection (i). In general, subsections (i), (j) and (k) of the House bill prohibited the destruction, demolition, etc., of any emergency facility without the consent of the Secretary of War or the Secretary of the Navy, and provided penalties for violations thereof. The substitute provision inserted by the Senate amendment provides that, if the taxpayer has been or will be paid or substantially reimbursed by the Government for all or a part of the cost of any emergency facility pursuant to any Government contract for the construction or acquisition of such facilities, or the purchase of supplies, or otherwise, amortization of the cost of such facility (including any amortization previously taken) will be disallowed unless within 30 days after making of such contract, or 60 days after the date of the enactment of the bill, whichever of such periods expires the later, the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy have certified to the Commissioner of Internal Revenue that the contract contains provisions adequately protecting the public interest with respect to the future use and disposition of the facilities. The terms and conditions of such contracts with reference to payment or reimbursement of the cost of such facilities and the protecting of the Government's interest therein shall be made available to the public.

The House recedes with an amendment. Under the conference agreement, reimbursement by the United States must have been either (1) directly, by provision of any contract with the United States dealing expressly with such reimbursement, or (2) indirectly, because the price paid by the United States (insofar as return of cost of the facility is used as a factor in the fixing of such price) is recognized

by the contract as including a return of cost greater than the normal exhaustion, wear and tear. In the event of such reimbursement and in the absence of the required certificate, amortization with respect to the facility in question is disallowed, but only for the period following the end of the month in which the contract is made. The time within which the certification that the Government's interest is adequately protected is required to be made has been increased to 90 days after the making of the contract or 120 days after the date of enactment of the bill. It is further provided that a certificate made by the Advisory Commission and either the Secretary of War or the Secretary of the Navy to the Commissioner of Internal Revenue, within 90 days after any contract is made or 120 days after the enactment of the bill, to the effect that, under such contract, reimbursement is not provided for within the meaning of the above provisions, shall be conclusive of such fact for the purposes of this provision.

Under the conference agreement the provision with respect to publicity has been retained.

Amendments Nos. 12, 13, 14, and 15: These are clerical amendments. The House recedes.

Amendments Nos. 16 and 17: The effect of these amendments is to add to the class of contracts or subcontracts relative to which the profit-limiting provisions of the Vinson-Trammell Act are suspended, any contracts or subcontracts which were entered into before the beginning of the contractor's or subcontractor's first taxable year which began in the year 1940 and which are not completed until after the last taxable year to which the excess-profits tax is applicable. The House recedes.

Amendment No. 18: This amendment adds a new section suspending the profit-limiting provisions of the Merchant Marine Act of 1936 as to any subcontract which would otherwise be subject to such act, if such subcontract was entered into by a corporate contractor with a corporate subcontractor in any taxable year of the subcontractor subject to the excess-profits tax, and if the principal contractor and the subcontractor were not affiliated at the time such subcontract was entered into or at any time thereafter up to and including the date of its completion. The definition of "affiliated" is substantially the same as that contained in section 2704 (b) (1) of the Internal Revenue Code, i. e., two or more corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 percent of the stock of the other or others, or (2) if at least 95 percent of the stock of two or more corporations is owned by the same interests. For the purposes of such rule the term "stock" is not to include nonvoting stock which is limited and preferred as to dividends. The House recedes.

Amendments Nos. 19 and 20: These are changes in title and certain numbers. The House recedes.

Amendments Nos. 21, 22, 23, and 24:

The House bill provided rules applicable to taxable years beginning after December 31, 1938, for determining the effect on earnings and profits of the sale or other disposition (after February 28, 1913) of property by a corporation or the receipt by it of tax-free distributions. It also provided that such rules should not affect the extent to which accumulated earnings and profits are increased by reason of increase in value of property accrued before March 1, 1913, but realized on or after such date. In order to effect a uniform rule for all prior taxable years, it provided that the stated rules shall be applied for the purpose of the Revenue Act of 1938 or any prior revenue act as if such rules

were a part of each such act when it was enacted. The rules apply not only for the purpose of determining when a distribution is a taxable dividend but also for the purpose of determining accumulated earnings and profits in computing equity invested capital for excess-profits-tax purposes.

The Senate amendments rearrange the provisions of the House bill, define earnings and profits, provide a method for determining that part of the earnings and profits consisting of the increase in value of property accrued before March 1, 1913, and, as to prior acts, provide that the rules for determining earnings and profits shall not affect the tax liability of any taxpayer for a particular year now pending before, or heretofore determined by, the Board of Tax Appeals, or any court of the United States.

The House recedes on amendment No. 23 and with amendments Nos. 21, 22, and 24, which substitute for the Senate provisions two subsections providing as follows:

Subsection (l) provides that the gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation is to be determined for two purposes: (1) The computation of earnings and profits of the corporation as a whole, primarily for invested-capital purposes and (2) the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, for the purpose of determining the character of dividend distributions. In (1) there is used the adjusted basis (under the law applicable to the year in which the sale or other disposition is made) for determining gain, but disregarding value as of March 1, 1913. In (2) there is used such adjusted basis for determining gain, giving effect to the value as of March 1, 1913, whenever applicable. The term "adjusted basis" means adjusted basis specified by the law, for example, see section 113 (b) of the Internal Revenue Code, but is subject to the limitations of the third sentence of subsection (l) relative to adjustments proper in determining earnings and profits. The proper adjustments may differ under subsection (l) (1) and (2). Where the operation of subsection (l) results in a loss to be applied in decrease of earnings and profits, such loss may be subject to an adjustment required by subsection (m) (2).

The provisions in the House and Senate bills, that gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent *recognized* in computing net income under the law applicable to the year in which such sale or disposition was made, are retained. As used in this subsection the term "recognized" relates to a realized gain or loss which is recognized pursuant to the provisions of law, for example, see section 112 of the Internal Revenue Code. It does not relate to losses disallowed or not taken into account.

The provision in the House bill and Senate amendment, for cases in which the adjustment, prescribed in section 113, to the basis indicated in paragraph (1) or (2), as the case may be, of subsection (*l*), differs from the adjustment to such basis proper for the purpose of determining earnings or profits, and the provisions with respect to tax-free distributions, are also retained.

Subsection (m) provides rules for determining, for the purposes of section 115 (b) of the code, that part of the earnings and profits which is represented by increase in value of property accrued prior to March 1, 1913, but realized on or after such date.

Paragraph (1) of subsection (m) sets forth the general rule with respect to computing the increase to be made in that part of the

earnings and profits consisting of increase in value of property accrued before March 1, 1913. Illustrations of the application of this paragraph are set forth in examples (1) and (4) of the Senate Finance Committee Report No. 2114, pages 25 and 26.

Paragraph (2) of subsection (m) is an exception to the general rule in paragraph (1) of subsection (m) and also operates as a limitation on the application of subsection (l). It provides that, if the application of subsection (l) 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 (l) and in lieu of the rule provided in paragraph (1) of subsection (m), 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. If the amount so applied in reduction of the loss 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. The following examples will show the application of subsection (m) (2):

Example (1). Nondepreciable property was acquired prior to March 1, 1913, at a cost of $8, its value as of March 1, 1913, was $12, and it was sold in 1939 for $10. Under subsection (l) (2) the adjusted basis would be $12 and there would be a loss of $2. Assuming that such loss is recognized under section 112 of the Internal Revenue Code, the application of subsection (l) (2) would result in a loss from the sale in 1939 to be applied in decrease of earnings and profits for that year. Subsection (m) (2), however, applies and the loss of $2 is reduced by the amount by which the adjusted basis of $12 exceeds the cost of $8, namely $4. The amount of the loss is, accordingly, reduced from $2 to 0 and there is no decrease in earnings and profits for the year 1939 as the result of the sale. The amount applied in reduction of the decrease, namely $4, exceeds $2. Accordingly, as a result of the sale the excess of $2 increases that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

Example (2). Nondepreciable property was acquired prior to March 1, 1913, at a cost of $10, its value as of March 1, 1913, was $12, and it was sold in 1939 for $8. Under subsection (l) (2) the adjusted basis would be $12 and there would be a loss of $4. Assuming that such loss is recognized under section 112 of the Internal Revenue Code, the application of subsection (l) (2) would result in a loss from the sale in 1939 to be applied in decrease of earnings and profits for that year. Subsection (m) (2), however, applies and the loss of $4 is reduced by the amount by which the adjusted basis of $12 exceeds the cost of $10, namely $2. The amount of the loss is, accordingly, reduced from $4 to $2 and the decrease in earnings and profits for the year 1939 as the result of the sale is $2 instead of $4. The amount applied in reduction of the decrease, namely $2, does not exceed $4. Accordingly, as the result of the sale there is no increase in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

The House bill and Senate amendment provided that, in order to effect a uniform rule for all prior years, the stated rules are made applicable to prior acts, but the Senate amendment added a provision providing that such rules should not affect the tax liability of any

taxpayer for any year now pending before, or heretofore determined by, the Board of Tax Appeals, or any court of the United States. The tax liability may be that of the corporation the earnings or profits of which are being determined, or the tax liability of a shareholder of such corporation, or of some other taxpayer. These tax liabilities are left to be determined according to such decisions as the Board or courts may make under existing law. As to all matters except such tax liabilities, such stated rules are applicable, and res judicata will not be applicable. The House recedes with an amendment providing that the exception added by the Senate amendment relative to pending or decided cases shall apply only if the tax liability in question was pending before the Board of Tax Appeals or any court of the United States on September 20, 1940, or was determined prior to such date by the Board of Tax Appeals or any court of the United States.

Amendments Nos. 25 to 33, both inclusive: These amendments are changes in section numbers and cross-references. The House recedes on amendments Nos. 25, 28, 29, 30, 31, 32, and 33, and with amendments making further changes in cross-references on amendments Nos. 26 and 27.

Amendment No. 34: This amendment adds at the end of supplement A of subchapter C of chapter 1 of the Internal Revenue Code a new section providing a special rule for the taxation of certain compensation received from the United States for patent infringement. The Senate recedes.

Amendment No. 35: This amendment was inserted by the Senate to carry out the recommendations contained in the President's message of September 14, 1940. Due to the time element, the amendment was written in broad language so that the entire subject matter of such message would be before the conferees for such action as they deemed appropriate to take. As the amendment passed the Senate, it conferred authority on the President (1) to establish a system of allotments and allowances for the dependents of persons serving in the land or naval forces of the United States, (2) to provide a system of insurance for such persons, (3) to provide unemployment allowances for them upon termination of their service, and (4) to preserve and modify their benefit rights under the Social Security Act and the Railroad Retirement Acts. There was no comparable provision in the House bill. The House recedes with an amendment which is divided into two parts.

Part I establishes a new system of insurance, called National Service Life Insurance, for persons in the active service of the land or naval forces (including the Coast Guard) of the United States. Such insurance (1) will be payable only in the event of death; (2) will carry premium rates based upon the American Experience Table of Mortality and interest at the rate of 3 per centum; (3) will be first issued as five-year level premium term insurance with the privilege of converting it into ordinary life, 20-payment life, or 30-payment life; (4) will contain provision for waiver of premiums, in the discretion of the Administrator, in the event of the continuous total disability of the insured for six months; (5) will provide that the United States will bear the excess mortality cost and the cost of waiver of premiums on account of total disability, when death or disability is traceable to the extra hazard of military or naval service; (6) will be payable in 240 equal monthly installments if the beneficiary is under 30 years of age, and in 120 equal monthly installments if the beneficiary is 30 years of age or over with payments continuing during the remaining life-

time of such beneficiary; and (7) will provide that unpaid installments remaining at the death of the beneficiary will be paid at the same rate and, unless designated in a different order by the insured, to the persons specified and in the order enumerated in section 602 (h) (3) of the amendment.

Persons in the active service may not take out United States Government life insurance after the date of enactment of this Act, but will be limited to National Service Life Insurance as provided in this part. The rights of World War Veterans under existing law with respect to United States Government life insurance is, however, not changed. No person may carry more than $10,000 of National Service Life Insurance nor a combined amount of National Service Life Insurance and United States Government life insurance in excess of $10,000 at any one time. The decision of the Administrator is made final and conclusive on all questions of law and fact, and there is specific provision that such decision shall not be reviewable by any other official or court of the United States, except in the event of suit as provided in section 817. The right to waiver of premiums is the only item which would involve any considerable amount of controversy between the insured or his beneficiaries and the Government, and as the waiver of premiums is an entirely gratuitous feature, it is not believed that suit against the United States to secure such gratuity should be authorized. For this reason section 817 authorizing a suit pursuant to section 19 of the World War Veterans Act specifically makes the decisions of the Administrator as to waiver or nonwaiver of premiums binding on the court.

Part II of the amendment prevents loss of annuity credit under the Railroad Retirement Acts, which occurred by reason of the interruption of service in the railroad industry by military service during periods prior to January 1, 1937, when a Federal Conscription Act was in effect or during periods of war or during periods when members of the National Guard or of other Reserve forces of the United States may have been required by any act of Congress, or by a call of the President pursuant to such act, to serve in the armed forces of the United States. In some cases individuals have failed to qualify for annuities because the time they spent in military service during the last World War or in other war periods could not be included in their years of service, and in other cases, although the individuals have qualified for annuities, such annuities were in amounts less than would be the case could such periods of military service have been taken into consideration. To prevent such losses to individuals whose railroad service has been interrupted by military service in such periods as above described, part II of the amendment provides for the inclusion of such military service, both for eligibility for an annuity and for computing the amount of the annuity. It provides methods for adjudicating again claims which have been adjudicated in the past but in which military service was not considered; and for the adjudication of claims in the future in which military service prior to January 1, 1937, may be a factor. Inasmuch as the additional costs resulting from the payment of benefits under the Railroad Retirement Acts on the basis of military service is not properly chargeable to the railroad industry, provision is made in the amendment for the payment of these costs by specific Government appropriations.

The managers on the part of the House desire to state that they agree with the managers on the part of the Senate that all of the proposals contained in Senate amendment numbered 35 should be given prompt and careful consideration. Inherent in those proposals, however, are broad and important problems of public policy which need intensive study and investigation before intelligent decisions may be reached with respect thereto. It is hoped that a comprehensive study of the subject matter contained in the President's message of September 14, 1940, be made as soon as practicable to the end that the proposals contained therein may be enacted into law with all reasonable dispatch.

Amendment No. 36: This amendment is intended to permit credit against the Federal unemployment tax for the calendar year 1936, 1937, 1938, or 1939, on employers of eight or more employees, for contributions paid by the employer before the sixtieth day after the date of enactment of this act into an unemployment fund under a State law. If the employer has paid the Federal tax without the benefit of the credit, a refund based on the credit would be permitted. With certain limited exceptions, the time has expired under existing law for paying contributions upon which credit against the tax for such years may be based. The House recedes with an amendment allowing the same extension of time as is provided in the Senate amendment, permitting credit against the tax for the same years, and providing for refunds based on the credit. However, in the case of the tax for 1939 and subsequent years, the provisions of existing law contained in section 1601 (a) (3) of the Federal Unemployment Tax Act limit the amount of credit, on account of contributions paid after the due date of the Federal return of the tax against which credit is taken but before July 1 next following such due date, to 90 percent of the amount which would have been allowable as credit on account of such contributions if they had been paid on or before the due date. The conference agreement retains that limitation on the credit against the tax for 1939 with respect to contributions paid before the sixtieth day after the date of enactment of this act. No similar limitation is provided with respect to the tax for prior years. In addition to certain clarifying changes from the Senate amendment, the conference agreement permits credit for contributions paid, without regard to the date of payment, if the assets of the taxpayer are at any time during the 59-day period following the date of enactment of this act, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

Amendment No. 37: This amendment adds a new title, entitled "War-Profits Tax", imposing increased income and excess-profits taxes in the event of war. The Senate recedes.

R. L. Doughton,
Thomas H. Cullen,
John W. McCormack,
Jere Cooper,
Allen T. Treadway,
Frank Crowther,
Harold Knutson,
Managers on the part of the House.

O