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Comparative Print Showing Changes Proposed in Subchapter 2 E of the Internal Revenue Code—Excess Profits Tax

Existing law proposed to be omitted is printed in *line type*.

New matter is printed in *italio*.

Existing law in which no change is proposed is printed in roman.

SUBCHAPTER E—EXCESS PROFITS TAX

Part I

SEC. 710. IMPOSITION OF TAX.

(a) IMPOSITION.—

(1) GENERAL RULE.—There shall be levied, collected, and paid, for each taxable year, ~~on~~ *upon* the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) ~~the tax shown in the following table:~~

If the adjusted excess profits net income is:	The tax shall be:
Not over \$20,000.....	35% of the adjusted excess profits net income.
Over \$20,000, but not over \$50,000,	\$7,000, plus 40% of excess over \$20,000.
Over \$50,000, but not over \$100,000,	\$17,000, plus 45% of excess over \$50,000.
Over \$100,000, but not over \$250,000,	\$41,500, plus 50% of excess over \$100,000.
Over \$250,000, but not over \$500,000,	\$116,500, plus 55% of excess over \$250,000.
Over \$500,000.....	\$261,000, plus 60% of excess over \$500,000.

a tax equal to 90 per centum of the amount thereof.

1 ~~(2)~~ APPLICATION OF RATES IN CASE OF CERTAIN
2 EXCHANGES.—If the taxpayer's highest bracket amount
3 for the taxable year computed under section 752 (relat-
4 ing to certain exchanges) is less than \$500,000, then in
5 the application of the table in paragraph (1) of this sub-
6 section to such taxpayer, in lieu of each amount, other
7 than the percentages, specified in such table, there shall
8 be substituted an amount which bears the same ratio to
9 the amount so specified as the highest bracket amount so
10 computed bears to \$500,000.

11 (3) DEFERMENT OF PAYMENT IN CASE OF ABNOR-
12 MALITY.—If the adjusted excess profits net income (com-
13 puted without reference to section 722) for the taxable
14 year of a taxpayer which claims on its return, in accord-
15 ance with regulations prescribed by the Commissioner
16 with the approval of the Secretary, the benefits of sec-
17 tion 722, is in excess of 50 per centum of its normal
18 tax net income for such year, computed without the
19 credit provided in section 26 (e) (relating to adjusted
20 excess profits net income) the amount of tax payable
21 at the time prescribed for payment may be reduced by
22 an amount equal to 33 per centum of the amount of
23 the reduction in the tax so claimed. For the purposes of
24 section 271, if the tax payable is the tax so reduced, the

1 *tax so reduced shall be considered the amount shown on*
 2 *the return.*

3 (b) **DEFINITION OF ADJUSTED EXCESS PROFITS NET**
 4 **INCOME.**—As used in this section, the term “adjusted excess
 5 profits net income” in the case of any taxable year means the
 6 excess profits net income (as defined in section 711) minus
 7 the sum of:

8 (1) **SPECIFIC EXEMPTION.**—A specific exemption
 9 of ~~\$5,000~~ \$10,000, and in the case of a mutual insurance
 10 company other than life a specific exemption of \$50,000;

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

13 (3) **UNUSED EXCESS PROFITS CREDIT.**—The
 14 amount of the excess profits credit carry-over for the tax-
 15 able year, computed in accordance with subsection (c).

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

17 (1) **DEFINITION OF UNUSED EXCESS PROFITS**
 18 **CREDIT.**—The term “unused excess profits credit” means
 19 the excess, if any, of the excess profits credit for any
 20 taxable year beginning after December 31, 1939, over
 21 the excess profits net income for such taxable year, com-
 22 puted on the basis of the excess profits credit applicable
 23 to such taxable year. For such purpose the excess-profits
 24 credit and the excess-profits net income for any taxable

4

1 year beginning in 1940 shall be computed under the law
2 applicable to taxable years beginning in 1941. For such
3 purpose, in the case of taxable years beginning after
4 December 31, 1941, the excess-profits credit and the
5 excess-profits net income for any taxable year beginning
6 in 1940 or in 1941 shall be computed under the law
7 applicable to taxable years beginning in 1942.

8 (2) COMPUTATION OF EXCESS PROFITS CREDIT
9 CARRY-OVER.—The excess profits credit carry-over for
10 any taxable year shall be the sum of the following:

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

13 (B) The unused excess profits credit for the
14 second preceding taxable year reduced by the
15 amount, if any, by which the excess profits net
16 income for the first preceding taxable year exceeds
17 the sum of—

18 (i) the excess profits credit for such first
19 preceding taxable year, plus

20 (ii) the unused excess profits credit for the
21 third preceding taxable year.

22 **SEC. 71L. EXCESS PROFITS NET INCOME.**

23 (a) TAXABLE YEARS BEGINNING AFTER DECEMBER
24 31, 1939.—The excess profits net income for any taxable
25 year beginning after December 31, 1939, shall be the normal-

1 tax net income, as defined in section 18 (a) (2), and, in
2 the case of a life insurance company, for any taxable year
3 beginning after December 31, 1941, the adjusted normal-tax
4 net income, as defined in section 202 (a), minus 3½ per
5 centum of the unearned premiums and unpaid losses on
6 cancellable health and accident insurance contracts, for such
7 year except that the following adjustments shall be made:

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

11 (A) Income Taxes Subject to Excess-Profits
12 Tax.—In computing such normal-tax net income the
13 deduction for the tax imposed by this subchapter
14 credit provided in section 26 (e) (relating to income
15 subject to the tax imposed by this subchapter) shall
16 not be allowed;

17 (B) Long-Term Gains and Losses From Sales
18 or Exchanges of Capital Assets.—There shall be ex-
19 cluded long-term capital gains and losses from sales
20 or exchanges of capital assets held for more than 15
21 months. There shall be excluded the excess of gains
22 from the sale or exchange of property held for more
23 than eighteen months which is of a character which
24 is subject to the allowance for depreciation provided

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

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

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

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

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

1 **(G) Computation of Charitable, Etc., Deduc-**
 2 **tions.**—In determining any deduction the amount of
 3 which is limited to a percentage of the taxpayer's net
 4 income (or net income from the property), such net
 5 income (or net income from the property) shall be
 6 computed without regard to the deduction on account
 7 of the tax imposed by this subchapter.

8 **(H) Bonus Income.**—There shall be excluded
 9 income derived from bonus payments made by any
 10 agency of the United States government on account
 11 of the production in excess of a specified quota of a
 12 product the exhaustion of which gives rise to an al-
 13 lowance for depletion under section 23 (m).

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

18 **(A) Dividends Received.**—The credit for divi-
 19 dends received shall apply, without limitation, to all
 20 dividends on stock of all corporations, except divi-
 21 dends (actual or constructive) on stock of foreign
 22 personal-holding companies. This subparagraph
 23 shall not apply to dividends on stock which is not a
 24 capital asset;

25 **(B) Interest.**—The deduction for interest shall

1 be reduced by an amount equal to 50 per centum
2 of so much of such interest as represents interest on
3 the indebtedness included in the daily amounts of
4 borrowed capital (determined under section 719
5 (a));

6 (C) *Income Taxes Subject to Excess Profits*
7 *Tax.*—In computing such normal-tax net income the
8 deduction for the tax imposed by this subchapter
9 credit provided in section 26 (e) (relating to income
10 subject to the tax imposed by this subchapter) shall
11 not be allowed;

12 (D) *Long-Term Gains and Losses From Sales*
13 *or Exchanges of Capital Assets.*—There shall be ex-
14 cluded long-term capital gains and losses from sales
15 or exchanges of capital assets held for more than
16 15 months. There shall be excluded the excess of
17 gains from the sale or exchange of property held for
18 more than eighteen months which is of a character
19 which is subject to the allowance for depreciation
20 provided in section 23 (1) over the losses from the
21 sale or exchange of such property;

22 (E) *Income From Retirement or Discharge of*
23 *Bonds, and So Forth.*—There shall be excluded, in
24 the case of any taxpayer, income derived from the
25 retirement or discharge by the taxpayer of any bond,

1 debenture, note, or certificate or other evidence of
2 indebtedness, if the obligation of the taxpayer has
3 been outstanding for more than eighteen months,
4 including, in case the issuance was at a premium,
5 the amount includible in income for such year solely
6 because of such retirement or discharge;

7 (F) Refunds and Interest on Agricultural Ad-
8 justment Act Taxes.—There shall be excluded in-
9 come attributable to refund of tax paid under the
10 Agricultural Adjustment Act of 1933, as amended,
11 and interest upon any such refund;

12 (G) Interest on Certain Government Obliga-
13 tions.—The normal-tax net income shall be increased
14 by an amount equal to the amount of the interest on
15 obligations held during the taxable year which are
16 described in section 22 (b) (4) any part of the in-
17 terest from which is excludible from gross income
18 or allowable as a credit against net income, if the
19 taxpayer has so elected under section 720 (d); and

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

25 (I) Computation of Charitable, Etc., Deduc-

1 **tions.—In determining any deduction the amount of**
 2 **which is limited to a percentage of the taxpayer's**
 3 **net income (or net income from the property), such**
 4 **net income (or net income from the property) shall**
 5 **be computed without regard to the deduction on**
 6 **account of the tax imposed by this subchapter.**

7 *(J) In the case of a life insurance company,*
 8 *the reserve and other policy liability credit shall be*
 9 *reduced by 50 per centum thereof.*

10 *(K) Bonus Income.—There shall be excluded*
 11 *income derived from bonus payments made by any*
 12 *agency of the United States government on account*
 13 *of the production in excess of a specified quota of a*
 14 *product the exhaustion of which gives rise to an al-*
 15 *lowance for depletion under section 23 (m).*

16 **(3) TAXABLE YEAR LESS THAN TWELVE**
 17 **MONTHS.—**

18 *(A) General Rule.—If the taxable year is a*
 19 *period of less than twelve months the excess profits*
 20 *net income for such taxable year (referred to in this*
 21 *paragraph as the "short taxable year") shall be*
 22 *placed on an annual basis by multiplying the amount*
 23 *thereof by the number of days in the twelve months*
 24 *ending with the close of the short taxable year and*
 25 *dividing by the number of days in the short taxable*

1 year. The tax shall be such part of the tax com-
2 puted on such annual basis as the number of days
3 in the *short taxable year* is of the number of days
4 in the twelve months ending with the close of the
5 *short taxable year*.

6 *(B) Exception.—If the taxpayer establishes its*
7 *adjusted excess profits net income for the period of*
8 *twelve months beginning with the first day of the*
9 *short taxable year, computed as if such twelve-month*
10 *period were a taxable year, under the law applicable*
11 *to the short taxable year, and using the credits ap-*
12 *plicable in determining the adjusted excess profits*
13 *net income for such short taxable year, then the tax*
14 *for the short taxable year shall be reduced to an*
15 *amount which is such part of the tax computed on*
16 *such adjusted excess profits net income so established*
17 *as the excess profits net income for the short taxable*
18 *year is of the excess profits net income for such*
19 *twelve-month period. The taxpayer (other than a*
20 *taxpayer to which the next sentence applies) shall*
21 *compute the tax and file its return without the ap-*
22 *plication of this subparagraph. If, prior to one year*
23 *from the date of the beginning of the short taxable*
24 *year, the taxpayer has disposed of substantially all*
25 *its assets, in lieu of the twelve-month period provided*

1 in the preceding provisions of this subparagraph,
2 the twelve-month period ending with the close of the
3 short taxable year shall be used. For the purposes
4 of this subparagraph, the excess profits net income
5 for the short taxable year shall not be placed on an
6 annual basis as provided in subparagraph (A), and
7 the excess profits net income for the twelve-month
8 period used shall in no case be considered less than
9 the excess profits net income for the short taxable
10 year. The benefits of this subparagraph shall not
11 be allowed unless the taxpayer, at such time as regu-
12 lations prescribed hereunder require, makes applica-
13 tion therefor in accordance with such regulations,
14 and such application, in case the return was filed
15 without regard to this subparagraph, shall be con-
16 sidered a claim for credit or refund. The Com-
17 missioner, with the approval of the Secretary, shall
18 prescribe such regulations as he may deem necessary
19 for the application of this subparagraph.

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

21 **(1) GENERAL RULE AND ADJUSTMENTS.—**The ex-
22 cess profits net income for any taxable year subject to
23 the Revenue Act of 1936 shall be the normal-tax net
24 income, as defined in section 13 (a) of such Act; and

1 for any other taxable year beginning after December 31,
2 1937, and before January 1, 1940, shall be the special-
3 class net income, as defined in section 14 (a) of the
4 applicable revenue law. In either case the following
5 adjustments shall be made (for additional adjustments in
6 case of certain reorganizations, see section 742 (e)) :

Note.—Subparagraph (A) was repealed by section 202 (c) (2) of
the 1941 Revenue Act.

7 (B) ~~Long-Term~~ Gains and Losses from Sales
8 or Exchanges of Capital Assets.—There shall be
9 excluded long-term capital gains and losses from
10 sales or exchanges of capital assets held for more than
11 fifteen months. There shall be excluded the excess
12 of gains from the sale or exchange of property held
13 for more than eighteen months which is of a charac-
14 ter which is subject to the allowance for depreciation
15 provided in section 23 (1) over the losses from the
16 sale or exchange of such property;

17 (C) Income From Retirement or Discharge of
18 Bonds, and So Forth.—There shall be excluded, in
19 the case of any taxpayer, income derived from the
20 retirement or discharge by the taxpayer of any bond,
21 debenture, note, or certificate or other evidence of
22 indebtedness, if the obligation of the taxpayer has

1 been outstanding for more than eighteen months, in-
2 cluding, in case the issuance was at a premium, the
3 amount includible in income for such year solely
4 because of such retirement or discharge;

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

13 (i) The deduction allowable under section
14 23 (a) for expenses paid or incurred in con-
15 nection with such retirement or discharge;

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

18 (iii) In case the issuance was at a discount,
19 the amount deductible for such year solely be-
20 cause of such retirement or discharge;

21 (E) Casualty, Demolition, and Similar
22 Losses.—Deductions under section 23 (f) for losses
23 arising from fires, storms, shipwreck, or other cas-
24 ualty, or from theft, or arising from the demolition,
25 abandonment, or loss of useful value of property, not

1 compensated for by insurance or otherwise, shall not
2 be allowed;

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

18 (G) Dividends Received.—The credit for divi-
19 dends received shall apply, without limitation, to
20 dividends on stock of domestic corporations;

21 (H) Payment of Judgments, and So Forth.—
22 Deductions attributable to any claim, award, judg-
23 ment, or decree against the taxpayer, or interest on
24 any of the foregoing, if abnormal for the taxpayer,
25 shall not be allowed, and if normal for the taxpayer,

1 but in excess of 125 per centum of the average
2 amount of such deductions in the four previous tax-
3 able years, shall be disallowed in an amount equal
4 to such excess;

5 (I) Intangible Drilling and Development
6 Costs.—Deductions attributable to intangible drilling
7 and development costs paid or incurred in or for
8 the drilling of wells or the preparation of wells for
9 the production of oil or gas, and for development
10 costs in the case of mines, if abnormal for the tax-
11 payer, shall not be allowed, and if normal for the
12 taxpayer, but in excess of 125 per centum of the
13 average amount of such deductions in the four pre-
14 vious taxable years, shall be disallowed in an amount
15 equal to such excess; and

16 (J) Abnormal Deductions.—Under regulations
17 prescribed by the Commissioner, with the approval
18 of the Secretary, for the determination, for the pur-
19 poses of this subparagraph, of the classification of
20 deductions—

21 (i) Deductions of any class shall not be
22 allowed if deductions of such class were abnor-
23 mal for the taxpayer, and

24 (ii) If the class of deductions was normal
25 for the taxpayer, but the deductions of such

10 which were in excess of 125 per centum of the
 21 average amount of deductions of such class for
 30 the four previous taxable years, they shall be
 4 disallowed in an amount equal to such excess.

5 (K) Rules for Application of Subparagraphs
 6 (H), (I), and (J).—For the purposes of sub-
 7 paragraphs (H), (I), and (J) —

8 (i) If the taxpayer was not in existence
 9 for four previous taxable years, then such aver-
 10 age amount specified in such subparagraphs
 11 shall be determined for the previous taxable
 12 years it was in existence and the succeeding
 13 taxable years which begin before the beginning
 14 of the taxpayer's second taxable year under this
 15 subchapter. If the number of such succeeding
 16 years is greater than the number necessary to
 17 obtain an aggregate of four taxable years there
 18 shall be omitted so many of such succeeding
 19 years, beginning with the last, as are necessary
 20 to reduce the aggregate to four.

21 (ii) Deductions shall not be disallowed
 22 under such subparagraphs unless the taxpayer
 23 establishes that the abnormality or excess is
 24 not a consequence of an increase in the gross

income of the taxpayer in its base period or a decrease in the amount of some other deduction in its base period, and is not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer.

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

(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) (1) 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 be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess profits credit in case of certain reorganizations of corporations, see section 741.)

(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 be an amount computed under section 713 or section 714, whichever amount results in the

1. lesser tax under this subchapter for the taxable year for which
 2. the tax under this subchapter is being computed. In the case
 3. of all other foreign corporations the excess profits credit for
 4. any taxable year shall be an amount computed under section
 5. 714.

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

13. (d) **SPECIAL RULE IN CONNECTION WITH CERTAIN**
 14. **REORGANIZATIONS.**—For existence of taxpayer through com-
 15. plement corporation, see section 740 (f).

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

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

20. (1) **DOMESTIC CORPORATIONS.**—In the case of a
 21. domestic corporation—
 22. (A) 95 per centum of the average base period
 23. net income, as defined in subsection (d), plus
 24. (B) Plus 8 per centum of the net capital addi-
 25. tion as defined in subsection (g), or 10 per centum

(C) **Minus 8 per centum of the net capital re-
duction as defined in subsection (g).**

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

(b) **BASE PERIOD.**—

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

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

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

(2) **DIVISION INTO HALVES.**—For the purposes of
subsections (d) and (f) the base period of the taxpayer
shall be divided into halves, the first half to be composed

1 ~~ratio of one-half the entire number of months in the base~~
 2 ~~period and to begin with the beginning of the base period.~~

3 ~~(c) DEFICIT IN EXCESS PROFITS NET INCOME.—For~~
 4 ~~the purposes of this section the term “deficit in excess profits~~
 5 ~~net income” with respect to any taxable year means the~~
 6 ~~amount by which the deductions plus the credit for dividends~~
 7 ~~received and the credit provided in section 26 (a) (relating~~
 8 ~~to interest on certain obligations of the United States and its~~
 9 ~~instrumentalities) exceeded the gross income. For the pur-~~
 10 ~~poses of this subsection in determining whether there was~~
 11 ~~such an excess and in determining the amount thereof, the~~
 12 ~~adjustments provided in section 711 (b) (1) shall be made.~~

13 ~~(d) AVERAGE BASE PERIOD NET INCOME—DETER-~~
 14 ~~MINATION.—~~

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

25 ~~(2) For the purposes of subsections (e) and (f),~~

14 if the taxpayer was in existence during only part of the
 2 48 months preceding the beginning of its first taxable
 3 year under this subchapter, its excess profits net in-
 4 come—

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

9 (i) the daily invested capital for the first
 10 day of the taxpayer's first taxable year begin-
 11 ning after December 31, 1939, over

12 (ii) an amount equal to the same percent-
 13 age of such daily invested capital as is appli-
 14 cable under section 720 in reduction of the aver-
 15 age invested capital of the preceding taxable
 16 year;

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

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

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

(e) AVERAGE BASE PERIOD NET INCOME—GENERAL

AVERAGE.—The average base period net income determined under this subsection 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 in the base period, reduced, if for more than one of such taxable years there was a deficit in excess profits net income, by the sum of such deficits, excluding the greatest;

(2) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. If the excess profits net income (or deficit in excess profits net income) for one taxable year in the base period divided by the number of months in such taxable year is less than 75 per centum of the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other taxable years in the taxpayer's base period divided by the number of months in such other taxable

17 years (herein called "average monthly amount") the
 amount used for such one year under this paragraph
 shall be 75 per centum of the average monthly amount
 multiplied by the number of months in such one year, and
 the year increased under this sentence shall be the year
 the increase in which will produce the highest average
 base period net income;

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

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

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

(1) By computing, for each of the taxable years of
 the taxpayer in its base period, the excess profits net
 income for such year, or the deficit in excess profits net
 income for such year;

(2) By computing for each half of the base period
 the aggregate of the excess profits net income for each of
 the taxable years in such half, reduced, if for one or more
 of such years there was a deficit in excess profits net
 income, by the sum of such deficits. For the purposes

1 of such computation, if any taxable year is partly within
 2 each half of the base period there shall be allocated to
 3 the first half an amount of the excess profits net income
 4 or deficit in excess profits net income, as the case may
 5 be, for such taxable year, which bears the same ratio
 6 thereto as the number of months falling within such half
 7 bears to the entire number of months in such taxable
 8 year; and the remainder shall be allocated to the second
 9 half;

10 (3) If the amount ascertained under paragraph
 11 (2) for the second half is greater than the amount ascer-
 12 tained for the first half, by dividing the difference by
 13 two;

14 (4) By adding the amount ascertained under para-
 15 graph (3) to the amount ascertained under paragraph
 16 (2) for the second half of the base period;

17 (5) By dividing the amount found under paragraph
 18 (4) by the number of months in the second half of the
 19 base period and by multiplying the result by twelve;

20 (6) The amount ascertained under paragraph (5)
 21 shall be the average base period net income determined
 22 under this subsection, except that the average base period
 23 net income determined under this subsection shall in no
 24 case be greater than the highest excess profits net income
 25 for any taxable year in the base period.

of such limitation if any taxable year is of less than twelve months, the excess profits net income for such taxable year shall be placed on an annual basis by multiplying by twelve and dividing by the number of months included in such taxable year.

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

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

(B) By adding to the amount ascertained under subparagraph (A) an amount which bears the same ratio to the excess profits net income for the last preceding taxable year as such number of months after May 31, 1940, bears to the number of months in such preceding year. The amount added under this subparagraph shall not exceed the amount of the excess profits net income for such last preceding taxable year.

(C) If the number of months in such preceding taxable year is less than such number of months after

May 31, 1940, by adding to the amount ascertained

under subparagraph (B) an amount which bears the same ratio to the excess profits net income for the second preceding taxable year as the excess of such number of months after May 31, 1940, over the number of months in such preceding taxable year bears to the number of months in such second preceding taxable year.

(g) 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 contribution to capital, after the begin-

1. ...ning of the taxpayer's first taxable year under this sub-
 2. ...chapter and prior to such day. In determining the
 3. ... amount of any property paid in, such property shall be
 4. ...included in an amount determined in the manner pre-
 5. ...vided in section 718 (a) (2). A distribution by the
 6. ...taxpayer to its shareholders in its stock or rights to ac-
 7. ...quire its stock shall not be regarded as money or property
 8. ...paid in for stock, or as paid-in surplus, or as a contribu-
 9. ...tion to capital. The amount ascertained under this para-
 10. ...graph shall be reduced by the excess, if any, of the
 11. ...excluded capital for such day over the excluded capital
 12. ...for the first day of the taxpayer's first taxable year under
 13. ...this subchapter. For the purposes of this paragraph the
 14. ...excluded capital for any day shall be an amount equal
 15. ...to the sum of the following:

16. ... (A) The aggregate of the adjusted basis (for
 17. ...determining loss upon sale or exchange) as of the
 18. ...beginning of such day, of obligations held by the tax-
 19. ...payer at the beginning of such day, which are de-
 20. ...scribed in section 22 (b) (4) (A), (B), or (C)
 21. ...any part of the interest from which is excludible from
 22. ...gross income or allowable as a credit against net
 23. ...income; and

24. ... (B) The aggregate of the adjusted basis (for
 25. ...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.

(5) If, on any day of the taxable year, the taxpayer and any one or more other corporations are members of the same controlled group, then the daily capital reduction of the taxpayer for such day shall be increased by whichever of the following amounts is the lesser:

(A) The aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in such other corporation (or if more than one, in such other corporations) acquired by the taxpayer after the beginning of the taxpayer's first taxable year under this subchapter, minus the aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in such other corporation (or if more than one, in such other corporations) disposed

1 of by the taxpayer prior to such day and after the
2 beginning of the taxpayer's first taxable year under
3 this subchapter; or

4 (B) The excess of the aggregate of the adjusted
5 basis (for determining loss upon sale or exchange)
6 of stock in all domestic corporations and of obliga-
7 tions described in section 22 (b) (4), held by the
8 taxpayer at the beginning of such day over the aggre-
9 gate of the adjusted basis (for determining loss upon
10 sale or exchange) of stock in all domestic corpora-
11 tions and of obligations described in section 22 (b)
12 (4), held by the taxpayer at the beginning of its first
13 taxable year under this subchapter.

14 If any stock or obligations described in subparagraph
15 (A) or (B) was disposed of prior to such day, its basis
16 shall be determined under the law applicable to the year
17 in which so disposed of. The excluded capital of the tax-
18 payer for such day shall be reduced by the amount by
19 which the taxpayer's daily capital reduction for such
20 day is increased under this paragraph. As used in this
21 paragraph, a controlled group means one or more chains
22 of corporations connected through stock ownership with a
23 common parent corporation if (i) more than 50 per
24 centum of the total combined voting power of all classes
25 of stock entitled to vote, or more than 50 per

1 centum of the total value of shares of all classes of stock,
 2 of each of the corporations (except the common parent
 3 corporation) is owned directly by one or more of the
 4 other corporations and (ii) the common parent corpora-
 5 tion owns directly more than 50 per centum of the total
 6 combined voting power of all classes of stock entitled to
 7 vote, or more than 50 per centum of the total value of
 8 shares of all classes of stock, of at least one of the other
 9 corporations.

10 **SEC. 714. EXCESS PROFITS CREDIT—BASED ON INVESTED**
 11 **CAPITAL.**

12 The excess profits credit, for any taxable year, computed
 13 under this section, shall be the amount shown in the following
 14 table:

If the invested capital for the tax- able year, determined under section 715, is:	The credit shall be:
Not over \$5,000,000	8% of the invested capital.
Over \$5,000,000, but not over \$10,000,000.	\$400,000, plus 7% of the excess over \$5,000,000.
Over \$10,000,000, but not over \$200,000,000.	\$750,000, plus 6% of the excess over \$10,000,000.
Over \$200,000,000	\$12,150,000, plus 5% of the excess over \$200,000,000.

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

16 For the purposes of this subchapter the invested capital
 17 for any taxable year shall be the average invested capital for
 18 such year, determined under section 716, reduced by an
 19 amount computed under section 720 (relating to inadmissible
 20 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

1 paid for stock, or as paid-in surplus, or as a contribution to
 2 capital;

3 (2) **PROPERTY PAID IN.**—Property (other than
 4 money) previously paid in (regardless of the time paid
 5 in) for stock, or as paid-in surplus, or as a contribution
 6 to capital. Such property shall be included in an amount

7 equal to its basis (unadjusted) for determining loss upon

8 sale or exchange. If the property was disposed of be-

9 fore such taxable year, such basis shall be determined in

10 the same manner as if the property were still held at the

11 beginning of such taxable year under the law applicable

12 to the year of disposition, but without regard to the value

13 of property as of March 1, 1913. If the property was

14 disposed of before March 1, 1913, its basis shall be

15 considered to be its fair market value at the time paid in.

16 If such the unadjusted basis of the property is a sub-

17 stituted basis it, such basis shall be adjusted, with respect

18 to the period before the property was paid in, in the

19 manner provided in section 113 (b) (2) by an amount

20 equal to the adjustments proper under section 115 (l)

21 for determining earnings and profits;

22 (3) **DISTRIBUTIONS IN STOCK.**—Distributions in

23 stock—

24 (A) Made prior to such taxable year to the

1 extent to which they are considered distributions of
 2 earnings and profits; and

3 (B) Previously made during such taxable year
 4 to the extent to which they are considered distribu-
 5 tions of earnings and profits other than earnings and
 6 profits of such taxable year;

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

10 (5) INCREASE ON ACCOUNT OF GAIN ON TAX-FREE
 11 LIQUIDATION.—In the case of the previous receipt of
 12 property (other than property described in the last sen-
 13 tence of section 113 (a) (15)) by the taxpayer in com-
 14 plete liquidation of another corporation under section
 15 112 (b) (6), or the corresponding provision of a prior
 16 revenue law, an amount, with respect to each such liqui-
 17 dation, equal to the amount by which the aggregate of
 18 the amount of the money so received and of the adjusted
 19 basis, at the time of receipt, of all property (other than
 20 money) so received, exceeds the sum of:

21 (A) The aggregate of the adjusted basis of each
 22 share of stock with respect to which such property
 23 was received; such adjusted basis of each share to be
 24 determined immediately prior to the receipt of any

25 (G) (1) (2) (3) (4) (5) (6) (7) (8) (9) (10) (11) (12) (13) (14) (15) (16) (17) (18) (19) (20) (21) (22) (23) (24) (25)

1 property in such liquidation with respect to such
 2 share, and
 3 (B) The aggregate of the liabilities of such other
 4 corporation assumed by the taxpayer in connection
 5 with the receipt of such property, of the liabilities
 6 (not assumed by the taxpayer) to which such
 7 property so received was subject, and of any other
 8 consideration (other than the stock with respect to
 9 which such property was received) given by the
 10 taxpayer for such property so received; and

11 (6) NEW CAPITAL.—An amount equal to 25 per
 12 centum of the new capital for such day. The term “new
 13 capital” for any day means so much of the amounts of
 14 money or property includible for such day under para-
 15 graphs (1) and (2) as was previously paid in during
 16 a taxable year beginning after December 31, 1940, and
 17 so much of the distributions in stock includible for such
 18 day under paragraph (3) as was previously made dur-
 19 ing a taxable year beginning after December 31, 1940,
 20 subject to the following limitations:

21 (A) There shall not be included money or
 22 property paid in by a corporation in an exchange
 23 to which section 112 (b) (3), (4), or (5), or so
 24 much of section 112 (c), (d), or (e) as refers to
 25 section 112 (b) (3), (4), or (5) is applicable

1 ~~shall be~~ (or would be applicable except for section 371 (g)),
2 ~~shall be~~ or would have been applicable if the term "control"
3 had been defined in section 112 (h) to mean the
4 ownership of stock possessing more than 50 per
5 centum of the total combined voting power of all
6 classes of stock entitled to vote or more than 50 per
7 centum of the total value of shares of all classes of
8 stock.

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

1 or more than 50 per centum of the total value of
 2 shares of all classes of stock, of at least one of the
 3 other corporations.

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

9 (D) Increase in Inadmissible Assets.—The new
 10 capital for any day of the taxable year, computed
 11 without the application of subparagraph (E), shall
 12 be reduced by the excess, if any, of the amount
 13 computed under section 720 (b) with respect to
 14 inadmissible assets held on such day, over the
 15 amount computed under section 720 (b) with re-
 16 spect to inadmissible assets held on the first day of
 17 the taxpayer's first taxable year beginning after
 18 December 31, 1940. For the purposes of this sub-
 19 paragraph, in determining whether obligations which
 20 are described in section 22 (t) (4) any part of the
 21 interest from which is excludible from gross income
 22 or allowable as a credit against net income are to
 23 be treated as admissible or inadmissible assets, such
 24 obligations shall be treated in the same manner as

1 they are treated for the taxable year for which tax
 2 under this subchapter is being computed.

3 (E) Maximum New Capital Allowable.—The

4 new capital for any day of the taxable year shall not
 5 be more than the amount, if any, by which—

6 (i) the sum of the equity invested capital

7 (computed without regard to this paragraph)

8 and the borrowed capital (as defined in section

9 719 (a)) of the taxpayer as of such day, re-

10 duced by the amount of money or property paid

11 in which is excluded by reason of the limitation

12 of subparagraph (A) or (B) of this paragraph,

13 exceeds

14 (ii) the sum of such equity invested capital

15 and borrowed capital as of the beginning of the

16 first day of such taxpayer's first taxable year

17 beginning after December 31, 1940, reduced by

18 the amount, if any, by which the accumulated

19 earnings and profits as of such first day of such

20 first taxable year exceed the accumulated earn-

21 ings and profits (computed without regard to

22 distributions made in taxable years beginning

23 after December 31, 1940) as of the beginning

of the first day of the taxable year for which the tax under this subchapter is being computed.

(E) Reduction on Account of Distributions Out of Pre-1941 Accumulated Earnings and Profits.—

The new capital for any day of the taxable year, computed without the application of subparagraph (E), shall be reduced by the amount which, after the beginning of the first taxable year which begins after December 31, 1940, has been distributed out of earnings and profits accumulated prior to the beginning of such first taxable year.

(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 accu-

1 mulated earnings and profits by reason of a transaction
 2 described in section 112 (b) to (e), both inclusive, or
 3 in the corresponding provision of a prior revenue law,
 4 or by reason of the transfer by such other corporation to
 5 the taxpayer of property the basis of which in the hands
 6 of the taxpayer is or was determined with reference to its
 7 basis in the hands of such other corporation, or would
 8 have been so determined if the property had been other
 9 than money; and

10 ~~(4) REDUCTION ON ACCOUNT OF LOSS ON TAX-~~
 11 ~~PNHS LIQUIDATION.~~—In the case of the previous receipt
 12 of property (other than property described in the last
 13 sentence of section 113 (a) (15)) by the taxpayer in
 14 complete liquidation of another corporation under section
 15 112 (b) (6), or the corresponding provision of a prior
 16 revenue law, an amount, with respect to each such liqui-
 17 dation, equal to the amount by which the sum of—

18 (A) The aggregate of the adjusted basis of
 19 each share of stock with respect to which such prop-
 20 erty was received, such adjusted basis of each share
 21 to be determined immediately prior to the receipt
 22 of any property in such liquidation with respect to
 23 such share, and

24 (B) The aggregate of the liabilities of such
 25 other corporation assumed by the taxpayer in con-

1 ~~in connection with the receipt of such property, of the li-~~
 2 ~~abilities (not assumed by the taxpayer) to which~~
 3 ~~such property so received was subject, and of any~~
 4 ~~other consideration (other than the stock with re-~~
 5 ~~spect to which such property was received) given~~
 6 ~~by the taxpayer for such property so received,~~
 7 exceeds the aggregate of the amount of the money so
 8 received and of the adjusted basis, at the time of receipt,
 9 of all property (other than money) so received. The
 10 amount of the reduction under this paragraph shall not
 11 exceed the accumulated earnings and profits as of the
 12 beginning of such taxable year.

13 (c) RULES FOR APPLICATION OF SUBSECTIONS (a)
 14 AND (b).—For the purposes of subsections (a) and (b)—

15 (1) DISTRIBUTIONS TO SHAREHOLDERS.—The
 16 term “distribution” means a distribution by a corpora-
 17 tion to its share holders, and the term “distribution in
 18 stock” means a distribution by a corporation in its stock
 19 or rights to acquire its stock. To the extent that a dis-
 20 tribution in stock is not considered a distribution of earn-
 21 ings and profits it shall not be considered a distribution.
 22 A distribution in stock shall not be regarded as money
 23 or property paid in for stock, or as paid-in surplus, or as
 24 a contribution to capital.

25 (2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF TAX-

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) (3) 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 or chapter 1 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 trans-~~

1 action which results in the elimination of such stock
 2 in a manner similar to that resulting from a statu-
 3 tory merger or consolidation,
 4 then such stock shall not be considered as property paid
 5 in for stock of, or as paid-in surplus of, or as a contribu-
 6 tion to capital of, the corporation resulting from the
 7 transaction referred to in subparagraph (A) or (B).

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

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

13 (f) *The reserves of an insurance company shall not be*
 14 *included in computing equity invested capital under this*
 15 *section but shall be treated as borrowed capital as provided*
 16 *in section 719.*

17 **SEC. 719. BORROWED INVESTED CAPITAL.**

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

21 (1) The amount of the outstanding indebtedness
 22 (not including interest, and not including indebtedness
 23 described in section 751 (b) relating to certain ex-
 24 changes) of the taxpayer which is evidenced by a bond,

1 note, bill of exchange, debenture, certificate of indebted-
2 ness, mortgage, or deed of trust, plus,
3 (2) In the case of a taxpayer having a contract
4 (made before the expiration of 90 days after the date
5 of the enactment of the Second Revenue Act of 1940)
6 with a foreign government to furnish articles, materials,
7 or supplies to such foreign government, if such contract
8 provides for advance payment and for repayment by the
9 vendor of any part of such advance payment upon can-
10 cellation of the contract by such foreign government, the
11 amount which would be required to be so repaid if can-
12 cellation occurred at the beginning of such day, but no
13 amount shall be considered as borrowed capital under
14 this paragraph which has been includible in gross income,
15 income, plus,

16 (3) In the case of an insurance company, the mean
17 of the amount of the pro rata unearned premiums deter-
18 mined at the beginning and end of the taxable year, plus,
19 (4) In the case of a life insurance company, the
20 mean of the amount of the life insurance reserves, and
21 the mean of the amount of the reserves on insurance
22 contracts (or contracts arising out of insurance con-
23 tracts) which do not involve, at the time with reference
24 to which the computation was made, life, health, or

1 *total accident contingencies, determined at the beginning and*
 2 *end of the taxable year.*

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

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

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

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

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

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

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

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

23 The amount by which the average invested capital for any
 24 taxable year shall be reduced as provided in section 715 shall
 25 be an amount which is the same percentage of such average

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

13 (c) COMPUTATION IF SHORT-TERM CAPITAL GAIN.—

14 If during the taxable year there has been a short-term capital
15 gain from the sale or exchange of a capital asset held for not
16 more than 15 months with respect to an inadmissible asset,
17 then so much of the amount attributable to such inadmissible
18 asset under subsection (b) as bears the same ratio thereto as
19 such gain bears to the sum of such gain plus the dividends and
20 interest on such asset for such year, shall, for the purpose of
21 determining the ratio of inadmissible assets to the total of
22 admissible and inadmissible assets, be added to the total of
23 admissible assets and subtracted from the total of inadmissible
24 assets.

25 (d) TREATMENT OF GOVERNMENT OBLIGATIONS AS

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

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

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

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

1 ~~but~~ *Income of a class derived from any activity of the busi-*
2 *ness which is taken into account in the determination of*
3 *a constructive average base period net income under*
4 *section 722 shall not constitute "abnormal income" for*
5 *the purposes of this section.*

6 (2) **SEPARATE CLASSES OF INCOME.**—Each of the
7 following paragraphs shall be held to describe a
8 separate class of income:

9 (A) Income arising out of a claim, award, judg-
10 ment, or decree, or interest on any of the foregoing;
11 or

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

15 (C) Income resulting from exploration, dis-
16 covery, prospecting, research, or development of
17 tangible property, patents, formulae, or processes,
18 or any combination of the foregoing, extending over
19 a period of more than 12 months; or

20 (D) Income includible in gross income for the
21 taxable year rather than for a different taxable year
22 by reason of a change in the taxpayer's accounting
23 period or method of accounting; or

24 (E) In the case of a lessor of real property,

1 income included in gross income for the taxable
2 year by reason of the termination of the lease; or

3 (F) Income consisting of dividends on stock
4 of foreign corporations, except foreign personal hold-
5 ing companies.

6 All the income which is classifiable in more than one of
7 such subparagraphs shall be classified under the one
8 which the taxpayer irrevocably elects. The classification
9 of income of any class not described in subparagraphs
10 (A) to (F), inclusive, shall be subject to regulations
11 prescribed by the Commissioner with the approval of
12 the Secretary.

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

1 average amount bears to the amount of such abnormal
2 income.

3 (b) AMOUNT ATTRIBUTABLE TO OTHER YEARS.—

4 The amount of the net abnormal income that is attributable
5 to any previous or future taxable year or years shall be de-
6 termined under regulations prescribed by the Commissioner
7 with the approval of the Secretary. In the case of amounts
8 otherwise attributable to future taxable years, if the taxpayer
9 either transfers substantially all its properties or distributes
10 any property in complete liquidation, then there shall be
11 attributable to the first taxable year in which such transfer
12 or distribution occurs (or if such year is previous to the tax-
13 able year in which the abnormal income is includible in gross
14 income, to such latter taxable year) all amounts so attribut-
15 able to future taxable years not included in the gross income
16 of a previous taxable year.

17 (c) COMPUTATION OF TAX FOR CURRENT TAXABLE

18 YEAR.—The tax under this subchapter for the taxable year,
19 in which the whole of such abnormal income would without
20 regard to this section be includible, shall not exceed the sum
21 of:

22 (1) The tax under this subchapter for such taxable

23 year computed without the inclusion in gross income of

1 the portion of the net abnormal income which is attri-
2 table to any other taxable year, and

3 (2) The aggregate of the increase in the tax under
4 this subchapter which would have resulted for each pre-
5 vious taxable year to which any portion of such net
6 abnormal income is attributable, computed as if an
7 amount equal to such portion had been included in the
8 gross income for such previous taxable year.

9 (d) COMPUTATION OF TAX FOR FUTURE TAXABLE
10 YEAR.—The amount of the net abnormal income attributable
11 to any future taxable year shall, for the purposes of this sub-
12 chapter, be included in the gross income for such taxable
13 year. The tax under this subchapter for such future taxable
14 year shall not exceed the sum of—

15 (1) the tax under this subchapter for such future
16 taxable year computed without the inclusion in excess
17 profits net income of the portion of such net abnormal
18 income which is attributable to such year, and

19 (2) the decrease in the tax under this subchapter
20 for the previous taxable year in which the whole of such
21 abnormal income would without regard to this section
22 be includible, which resulted by reason of the exclusion
23 of the whole or a part of the abnormal income from the
24 gross income for such previous taxable year; but the

amount of such decrease shall be diminished by the aggregate of the increases in the tax under this subchapter which have resulted for the taxable years intervening between such previous taxable year and such future taxable year because of the inclusion in the gross income of the portions of such net abnormal income attributable to such intervening years.

SEC. 722. ADJUSTMENT OF ABNORMAL BASE PERIOD NET INCOME.

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

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

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

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

(A) if the character of the business as of Janu-

1 ary 1, 1940, had been the same during each of the
2 taxable years of such base period; and

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

5 (C) if in each of such taxable years none of the
6 items of gross income had been abnormally large,
7 and none of the items of deductions had been ab-
8 normally small; and

9 (4) that the amount established under paragraph
10 (3) is greater than the average base period net income
11 computed under section 713 (d) or section 742, as the
12 case may be;

13 than the amount established under paragraph (3) shall be
14 considered as the average base period net income of the
15 taxpayer for the purposes of this subchapter.

16 (b) RULES FOR APPLICATION OF SUBSECTION (a).—

17 For the purposes of subsection (a)—

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

23 (2) The character of the business engaged in by the
24 taxpayer as of January 1, 1940, shall be considered dif-
25 ferent from the character of the business engaged in dur-

ing one or more of the taxable years in its base period only if—

(A) there is a difference in the products or services furnished; or

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

(C) there is a difference in the ratio of nonborrowed capital to total capital; or

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

(E) the taxpayer acquired, before January 1, 1940, all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished.

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

(4) If subsection (a) (1), or both subsections (a) (1) and (a) (2) are applicable to any taxpayer, its average base period net income under subsection (a) (3) shall not exceed the excess profits net income (as com-

1 puted for the purposes of subsection ~~(a)~~ ~~(2)~~ for the
 2 last taxable year in such base period. For the purposes
 3 of this paragraph, if such last taxable year is of less than
 4 twelve months, the excess profits net income for such
 5 taxable year shall be placed on an annual basis by multi-
 6 plying by twelve and dividing by the number of months
 7 included in such taxable year.

8 ~~(c)~~ **LIMITATION ON APPLICATION OF GENERAL**
 9 **RULE.**—This section shall not be applicable unless—

10 ~~(1)~~ the tax under this subchapter for the taxable
 11 year computed without reference to this section, exceeds
 12 6 per centum of the taxpayer's normal-tax net income
 13 for such year; and

14 ~~(2)~~ the application of this section would result in
 15 a diminution of the tax otherwise payable under this
 16 subchapter for the taxable year by more than 10 per
 17 centum thereof.

18 For the purposes of this subsection and subsection ~~(d)~~ the
 19 taxpayer's normal-tax net income shall be computed without
 20 deduction of the tax imposed by this subchapter.

21 ~~(d)~~ **EXTENT OF REDUCTION IN TAX UNDER THIS**
 22 **SECTION.**—The application of this section shall not reduce
 23 the tax payable under this subchapter for the taxable year
 24 below 6 per centum of the taxpayer's normal-tax net income
 25 for such year. The tax under this subchapter computed with

1 the application of subsection (a) shall be increased by an
2 amount equal to 10 per centum of the tax computed without
3 reference to this section.

4 ~~(c) APPLICATION FOR RELIEF UNDER THIS SEC-~~
5 ~~TION.~~—The taxpayer shall compute its tax and file its return
6 under this subchapter without the application of this section.
7 The benefits of this section shall not be allowed unless the
8 taxpayer, within six months from the date prescribed by law
9 for the filing of its return, makes application therefor in ac-
10 cordance with regulations to be prescribed by the Commis-
11 sioner with the approval of the Secretary, except that if the
12 Commissioner in the case of any taxpayer with respect to
13 the tax liability of any taxable year—

14 ~~(1)~~ issues a preliminary notice stating a deficiency
15 in the tax imposed by this subchapter such taxpayer may,
16 within ninety days after the date of such notice, make
17 such application, or

18 ~~(2)~~ mails a notice of deficiency ~~(A)~~ without having
19 previously issued a preliminary notice thereof or ~~(B)~~
20 within ninety days after the date of such preliminary
21 notice, such taxpayer may claim the benefits of this
22 section in its petition to the Board or in an amended
23 petition in accordance with the rules of the Board.

24 If the application is not filed within six months after the date
25 prescribed by law for the filing of the return, the application

1 of this section shall not reduce the tax otherwise determined
 2 under this subchapter by an amount in excess of the amount
 3 of the deficiency finally determined under this subchapter
 4 without the application of this section. If the average base
 5 period net income has been determined under subsection (a)
 6 for any taxable year, the Commissioner may, by regulations
 7 approved by the Secretary, prescribe the extent to which the
 8 limitations proscribed by this subsection may be waived for
 9 the purpose of determining the tax under this subchapter for
 10 a subsequent taxable year.

11 **SEC. 722. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE**
 12 **PERIOD NET INCOME.**

13 *(a) GENERAL RULB.—In any case in which the tax-*
 14 *payer establishes that the tax computed under this sub-*
 15 *chapter (without the benefit of this section) results in an*
 16 *excessive and discriminatory tax and establishes what would*
 17 *be a fair and just amount representing normal earnings to*
 18 *be used as a constructive average base period net income*
 19 *for the purposes of an excess profits tax based upon a com-*
 20 *parison of normal earnings and earnings during an excess*
 21 *profits tax period, the tax shall be determined by using*
 22 *such constructive average base period net income in lieu*
 23 *of the average base period net income otherwise determined*
 24 *under this subchapter. In determining such constructive*
 25 *average base period net income, no regard shall be had to*

1 events or conditions affecting the taxpayer, the industry of
2 which it is a member, or taxpayers generally occurring or
3 existing after December 31, 1939.

4 (b) **TAXPAYERS USING AVERAGE EARNINGS**
5 **METHOD.**—The tax computed under this subchapter (with-
6 out the benefit of this section) shall be considered to be
7 excessive and discriminatory in the case of a taxpayer en-
8 titled to use the excess profits credit based on income pur-
9 suant to section 713, if its average base period net income is
10 an inadequate standard of normal earnings because—

11 (1) in one or more taxable years in the base period
12 normal production, output, or operation was interrupted
13 or diminished because of the occurrence, either imme-
14 diately prior to, or during the base period, of events
15 unusual and peculiar in the experience of such taxpayer,

16 (2) the business of the taxpayer was depressed in
17 the base period because of temporary economic circum-
18 stances unusual in the case of such taxpayer or because
19 of the fact that an industry of which such taxpayer was
20 a member was depressed by reason of temporary eco-
21 nomic events unusual in the case of such industry,

22 (3) the business of the taxpayer was depressed
23 in the base period by reason of conditions generally pre-
24 vailing in an industry of which the taxpayer was a
25 member, subjecting such taxpayer to

1 (A) a profits cycle differing materially in
2 length and amplitude from the general business
3 cycle, or

4 (B) sporadic and intermittent periods of high
5 production and profits, and such periods are inade-
6 quately represented in the base period,

7 (4) the taxpayer, either during or immediately
8 prior to the base period, commenced business or changed
9 the character of the business and the average base period
10 net income does not reflect the normal operation for the
11 entire base period of the business. If the business of the
12 taxpayer did not reach, by the end of the base period,
13 the earning level which it would have reached if the
14 taxpayer had commenced business or made the change
15 in the character of the business two years before it did
16 so, it shall be deemed to have commenced the business
17 or made the change at such earlier time. For the pur-
18 poses of this subparagraph, the term "change in the char-
19 acter of the business" includes a change in the operation
20 or management of the business, a difference in the prod-
21 ucts or services furnished, a difference in the capacity
22 for production or operation, a difference in the ratio
23 of nonborrowed capital to total capital, and the acquisi-
24 tion before January 1, 1940, of all or part of the assets
25 of a competitor, with the result that the competition of

1 such competitor was eliminated or diminished. Any
 2 change in the capacity for production or operation of
 3 the business consummated during any taxable year end-
 4 ing after December 31, 1939, as a result of commitments
 5 made prior to January 1, 1940, binding the taxpayer to
 6 make the change, or any acquisition before May 31,
 7 1941, from a competitor engaged in the dissemination of
 8 information through the public press, of substantially all
 9 the assets of such competitor employed in such business
 10 with the result that competition between the taxpayer
 11 and the competitor existing before January 1, 1940,
 12 was eliminated, shall be deemed to be a change on
 13 December 31, 1939, in the character of the business, or

14 (5) of any other factor affecting the taxpayer's
 15 business which may reasonably be considered as resulting
 16 in an inadequate standard of normal earnings during the
 17 base period and the application of this section to the tax-
 18 payer would not be inconsistent with the principles
 19 underlying the provisions of this subsection, and with
 20 the conditions and limitations enumerated therein.

21 (c) **INVESTED CAPITAL CORPORATIONS, ETC.**—The
 22 tax computed under this subchapter (without the benefit of
 23 this section) shall be considered to be excessive and dis-
 24 criminatory in the case of a taxpayer, not entitled to use
 25 the excess profits credit based on income pursuant to section

1 713, if the excess profits credit based on invested capital is
2 an inadequate standard for determining excess profits,
3 because—

4 (1) the business of the taxpayer is of a class in
5 which intangible assets not includible in invested capital
6 under section 718 make important contributions to
7 income,

8 (2) the business of the taxpayer is of a class in
9 which capital is not an important income-producing
10 factor, or

11 (3) the invested capital of the taxpayer is abnor-
12 mally low.

13 In such case for the purposes of this subchapter, such tax-
14 payer shall be considered to be entitled to use the excess
15 profits credit based on income, using the constructive average
16 base period net income determined under subsection (a).

17 For the purposes of section 713 (g) and section 743, the
18 beginning of the taxpayer's first taxable year under this sub-
19 chapter shall be considered to be that date after which capital
20 additions and capital reductions were not taken into account
21 for the purposes of this subsection.

22 (d) **LIMITATION ON APPLICATION OF GENERAL**
23 **RULE.**—The constructive average base period net income
24 determined under subsection (a) shall not be used for any
25 taxable year unless—

1 (1) the tax under this subchapter for such tax-
2 able year computed without reference to this section, ex-
3 ceeds 6 per centum of the taxpayer's normal tax net in-
4 come for such year computed without the credit provided
5 in section 26 (e) (relating to adjusted excess profits net
6 income); and

7 (2) the tax under this subchapter for the taxable
8 year computed by using the constructive average base
9 period net income determined under subsection (a) (but
10 without regard to subsection (e)) would be less than 95
11 per centum of the tax for the taxable year computed
12 without reference to this section.

13 (e) EXTENT OF REDUCTION OF TAX UNDER THIS

14 SECTION.—The tax under this subchapter, determined with
15 the use of the constructive average base period net income
16 determined under subsection (a), shall not be less than
17 either—

18 (1) The amount of such tax, determined without
19 regard to this subsection but with the use of the construc-
20 tive average base period net income determined under
21 subsection (a), plus 5 per centum of the tax so deter-
22 mined, or

23 (2) 6 per centum of the taxpayer's normal tax net
24 income, computed without the credit provided in section
25 26 (e) (relating to adjusted excess profits net income).

1 (f) **APPLICATION FOR RELIEF UNDER THIS SEC-**
2 **TION.**—The taxpayer shall compute its tax, file its return, and
3 pay its tax under this subchapter without the application of
4 this section, except as provided in section 710 (a) (3). The
5 benefits of this section shall not be allowed unless the tax-
6 payer, not later than six months after the date prescribed by
7 law for the filing of its return, makes application therefor in
8 accordance with regulations to be prescribed by the Commis-
9 sioner with the approval of the Secretary, except that if the
10 Commissioner in the case of any taxpayer with respect to the
11 tax liability of any taxable year—

12 (1) issues a preliminary notice proposing a defi-
13 ciency in the tax imposed by this subchapter such tax-
14 payer may, within ninety days after the date of such
15 notice make such application, or

16 (2) mails a notice of deficiency (A) without hav-
17 ing previously issued a preliminary notice thereof or
18 (B) within ninety days after the date of such prelimi-
19 nary notice, such taxpayer may claim the benefits of
20 this section in its petition to the Board or in an amended
21 petition in accordance with the rules of the Board.

22 If the application is not filed within six months after the
23 date prescribed by law for the filing of the return, the opera-
24 tion of this section shall not reduce the tax otherwise de-
25 termined under this subchapter by an amount in excess of

1 the amount of the deficiency finally determined under this
 2 subchapter without the application of this section. If a
 3 constructive average base period net income has been de-
 4 termined under the provisions of this section for any taxable
 5 year, the Commissioner may, by regulations approved by
 6 the Secretary, prescribe the extent to which the limitations
 7 prescribed by this subsection may be waived for the purpose
 8 of determining the tax under this subchapter for a subsequent
 9 taxable year.

10 (g) **RULES FOR APPLICATION OF SECTION.**—For the
 11 purposes of this section—

12 (1) the tax imposed by this subchapter shall be
 13 the tax before the allowance of the foreign tax credit
 14 pursuant to section 729 (c) and (d);

15 (2) in the case of a taxpayer, the average base
 16 period net income of which is computed under Supple-
 17 ment A, for the period for which the income of any
 18 other person is included in the computation of the
 19 average base period net income of the taxpayer, the
 20 taxpayer shall be treated as if such other person's busi-
 21 ness were a part of the business of the taxpayer.

22 **SEC. 723. EQUITY INVESTED CAPITAL IN SPECIAL CASES:**

23 Where the Commissioner determines that the equity in-
 24 vested capital as of the beginning of the taxpayer's first

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

17 **SEC. 724. FOREIGN CORPORATIONS AND CORPORATIONS**
 18 **ENTITLED TO BENEFITS OF SECTION 251—IN-**
 19 **VESTED CAPITAL.**

20 Notwithstanding section 715, in the case of a foreign
 21 corporation engaged in trade or business within the United
 22 States or having an office or place of business therein, and
 23 in the case of a corporation entitled to the benefits of section
 24 251, the invested capital for any taxable year shall be deter-
 25 mined in accordance with rules and regulations prescribed by

1 the Commissioner with the approval of the Secretary, under
2 which—

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

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

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

1 SEC. 721. PERSONAL SERVICE CORPORATIONS.

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

17 **(b) ELECTION AS TO TAXABILITY.**—If a personal serv-
18 ice corporation signifies, in its return under Chapter 1 for
19 any taxable year, its desire not to be subject to the tax
20 imposed under this subchapter for such taxable year, it shall
21 be exempt from such tax for such year, and the provisions of
22 Supplement B of Chapter 1 shall apply to the shareholders in
23 such corporation who were such shareholders on the last day
24 of such taxable year of the corporation.

1 SEC. 726. CORPORATIONS COMPLETING CONTRACTS UN-
2 DER MERCHANT MARINE ACT, 1936.

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

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

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

20 (2) The amount of such payments.

21 SEC. 727. EXEMPT CORPORATIONS.

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

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

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

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

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

13 *(c) Regulated investment companies as defined in section
14 361 without the application of section 361 (b) (3).*

15 (e) Personal-holding companies, as defined in section
16 501.

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

20 (g) Domestic corporations satisfying the following
21 conditions:

22 (1) If 95 per centum or more of the gross income
23 of such domestic corporation for the three-year period
24 immediately preceding the close of the taxable year (or
25 for such part of such period during which the corpo-

1 ration was in existence) was derived from sources other
2 than sources within the United States; and

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

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

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

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

17 **SEC. 729. LAWS APPLICABLE.**

18 (a) **GENERAL RULE.**—All provisions of law (including
19 penalties) applicable in respect of the taxes imposed by
20 Chapter 1, shall, insofar as not inconsistent with this sub-
21 chapter, be applicable in respect of the tax imposed by this
22 subchapter. *In the application of section 108 to the com-
23 putation of the tax imposed by this subchapter, in addition
24 to the amendments made inapplicable for the purposes of the
25 computations under subsection (a) (2) of such section, the*

- 1 *amendment made by section 206 of the Revenue Act of 1942*
2 *shall not be deemed to be applicable.*

3 (b) RETURNS.—

4 (1) COMPUTATION OF EXCESS PROFITS CREDITS.—

5 In the case of a taxpayer which under section 712 or
6 section 741 is entitled to have the excess profits credit
7 computed under section 713 or section 714, whichever
8 results in the lesser tax under this subchapter, the return
9 under this subchapter for any taxable year shall contain
10 computations of two tentative taxes, one with the credit
11 computed under section 713 and one with the credit
12 computed under section 714; and the return shall contain
13 all information which the Commissioner, by regulations
14 prescribed by him with the approval of the Secretary,
15 may prescribe as necessary for such computations. If
16 the taxpayer states in such return that it disclaims the
17 use of one of such credits in the computation of the tax
18 under this subchapter for the taxable year, the computa-
19 tion and information based on such credit may be omitted
20 from the return.

21 (2) NO RETURN REQUIRED.—Notwithstanding sub-
22 section (a), no return under section 52 (a) shall be
23 required to be filed by any taxpayer under this sub-
24 chapter for any taxable year for which its excess profits
25 net income, computed with the adjustments provided in

1 section 711 (a) (2) and placed on an annual basis as
2 provided in section 711 (a) (3), is not greater than
3 ~~\$5,000~~ \$10,000, or, in the case of a mutual insurance
4 company other than life, is not greater than \$50,000.

5 (3) Consolidated returns.—For provisions relating
6 to consolidated returns, see section 141.

7 (c) FOREIGN TAXES PAID.—In the application of sec-
8 tion 131 for the purposes of this subchapter the tax paid or
9 accrued to any country shall be deemed to be the amount of
10 such tax reduced by the amount of the credit allowed with
11 respect to such tax against the tax imposed by Chapter 1.

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

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

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

1 SEC. 79A. CONSOLIDATED RETURNS.**2 (a) PRIVILEGE TO FILE CONSOLIDATED RETURNS.—**

3 An affiliated group of corporations shall, subject to the pro-
4 visions of this section, have the privilege of making a con-
5 solidated return for the taxable year in lieu of separate re-
6 turns. The making of a consolidated return shall be upon
7 the condition that all the corporations which have been mem-
8 bers of the affiliated group at any time during the taxable year
9 for which the return is made consent to all the regulations
10 under subsection (b) prescribed prior to the last day pre-
11 scribed by law for the filing of such return; and the making
12 of a consolidated return shall be considered as such consent.
13 In the case of a corporation which is a member of the
14 affiliated group for a fractional part of the year the con-
15 solidated return shall include the income of such corporation
16 for such part of the year as it is a member of the affiliated
17 group.

18 (b) REGULATIONS.—The Commissioner, with the ap-
19 proval of the Secretary, shall prescribe such regulations as
20 he may deem necessary in order that the tax liability of any
21 affiliated group of corporations making a consolidated return
22 and of each corporation in the group, both during and after
23 the period of affiliation, may be returned, determined, com-
24 puted, assessed, collected, and adjusted, in such manner as
25 clearly to reflect the excess profits tax liability and the

1 various factors necessary for the determination of such li-
 2 bility, and in order to prevent avoidance of such tax liability.

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

11 (d) **DEFINITION OF "AFFILIATED GROUP".**—As used
 12 in this section, an "affiliated group" means one or more chains
 13 of includible corporations connected through stock owner-
 14 ship with a common parent corporation which is an includible
 15 corporation if—

16 (1) At least 95 per centum of each class of the stock
 17 of each of the includible corporations (except the com-
 18 mon parent corporation) is owned directly by one or
 19 more of the other includible corporations; and

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

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

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

1 As used in this section, the term "includible corporation"
2 means any corporation except—

3 (1) Corporations exempt from the tax imposed by
4 this subchapter.

5 (2) Foreign corporations.

6 (3) Corporations organized under the China Trade
7 Act, 1922.

8 (4) Corporations entitled to the benefits of section
9 251, by reason of receiving a large percentage of their
10 income from possessions of the United States.

11 (5) Personal service corporations.

12 (6) Insurance companies subject to taxation under
13 section 201 or 207.

14 (f) **INCLUDIBLE INSURANCE COMPANIES.**—Despite the
15 provisions of paragraph (6) of subsection (e), two or more
16 domestic insurance companies each of which is subject to
17 taxation under the same section of Chapter 1 shall be con-
18 sidered as includible corporations for the purpose of the
19 application of subsection (d) to such insurance companies
20 alone.

21 (g) **SUBSIDIARY FORMED TO COMPLY WITH FOREIGN**
22 **LAW.**—In the case of a domestic corporation owning or con-
23 trolling, directly or indirectly, 100 per centum of the capital
24 stock (exclusive of directors' qualifying shares) of a corpora-
25 tion organized under the laws of a contiguous foreign country

1 and maintained solely for the purpose of complying with the
2 laws of such country as to title and operation of property, such
3 foreign corporation may, at the option of the domestic cor-
4 poration, be treated for the purpose of this subchapter as a
5 domestic corporation.

6 ~~(h)~~ **SUSPENSION OF RUNNING OF STATUTE OF LIMITATIONS.**—If a notice under section 272 (a) in respect of a
7 deficiency for any taxable year is mailed to a corporation,
8 the suspension of the running of the statute of limitations,
9 provided in section 277, shall apply in the case of corpora-
10 tions with which such corporation made a consolidated return
11 for such taxable year.

13 **SEC. 732. REVIEW OF ABNORMALITIES BY BOARD OF TAX**
14 **APPEALS.**

15 (a) **PETITION TO THE BOARD.**—If a claim for refund
16 of tax under this subchapter for any taxable year is disal-
17 lowed in whole or in part by the Commissioner, and the
18 disallowance relates to the application of section 711 (b)
19 (1) (H), (I), (J), or (K), section 721, or section 722;
20 relating to abnormalities, the Commissioner shall send notice
21 of such disallowance to the taxpayer by registered mail.
22 Within ninety days after such notice is mailed (not counting
23 Sunday or a legal holiday in the District of Columbia as the
24 ninetieth day) the taxpayer may file a petition with the
25 Board of Tax Appeals for a redetermination of the tax

1 under this subchapter. If such petition is so filed, such
2 notice of disallowance shall be deemed to be a notice of
3 deficiency for all purposes relating to the assessment and
4 collection of taxes or the refund or credit of overpayments.

5 (b) DEFICIENCY FOUND BY BOARD IN CASE OF
6 CLAIM.—If the Board finds that there is no overpayment
7 of tax in respect of any taxable year in respect of which the
8 Commissioner has disallowed, in whole or in part, a claim
9 for refund described in subsection (a) and the Board further
10 finds that there is a deficiency for such year, the Board
11 shall have jurisdiction to determine the amount of such de-
12 ficiency and such amount shall, when the decision of the
13 Board becomes final, be assessed and shall be paid upon
14 notice and demand from the collector.

15 (c) FINALITY OF DETERMINATION.—If in the deter-
16 mination of the tax liability under this subchapter the deter-
17 mination of any question is necessary solely by reason of
18 section 711 (b) (1) (H), (I), (J), or (K), section 721,
19 or section 722, the determination of such question shall not
20 be reviewed or redetermined by any court or agency except
21 the Board.

22 (d) SPECIAL DIVISION OF BOARD.—*The determinations*
23 *and redeterminations by the Board provided for in this section*
24 *shall be made by a special division of the Board which shall*
25 *be constituted by the Chairman and consist of not less than*

1 *three members of the Board. Such determinations and red-*
2 *terminations shall not be reviewable by the Board, and the*
3 *decisions of such division making such determinations and*
4 *redeterminations shall be deemed decisions of the Board.*

5 **SEC. 733. CAPITALIZATION OF ADVERTISING, ETC., EX-**
6 **PENDITURES.**

7 (a) **ELECTION TO CHARGE TO CAPITAL ACCOUNT.—**

8 For the purpose of computing the excess profits credit, a
9 taxpayer may elect, within six months after the date pre-
10 scribed by law for filing its return for its first taxable year
11 under this subchapter, to charge to capital account so much
12 of the deductions for taxable years in its applicable base
13 period on account of expenditures for advertising or the pro-
14 motion of good will, as, under rules and regulations prescribed
15 by the Commissioner with the approval of the Secretary,
16 may be regarded as capital investments. Such election must
17 be the same for all such taxable years, and must be for the
18 total amount of such expenditures which may be so regarded
19 as capital investments. In computing the excess profits
20 credit, no amount on account of such expenditures shall be
21 charged to capital account:

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

24 (2) For any taxable year prior to the beginning of
25 the base period.

1 (b) **ERROR OF ELECTION.**—If the taxpayer exercises
2 the election authorized under subsection (a)—

3 (1) The net income for each taxable year in the
4 base period shall be considered to be the net income
5 computed with such deductions disallowed, and such
6 deductions shall not be considered as having diminished
7 earnings and profits. This paragraph shall be retroac-
8 tively applied as if it were a part of the law applicable
9 to each taxable year in the base period; and

10 (2) The treatment of such expenditures as deduc-
11 tions for a taxable year in the base period shall, for the
12 purposes of section 734 (b) (2), be considered treat-
13 ment which was not correct under the law applicable to
14 such year.

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

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

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

21 (2) **INCOME TAX.**—The term “income tax” means
22 an income tax imposed by chapter 1 or chapter 2A of
23 this title; Title I and Title IA of the Revenue Acts of
24 1938, 1936, and 1934; Title I of the Revenue Acts of
25 1932 and 1928; Title II of the Revenue Acts of 1926

1 and 1924; Title II of the Revenue Acts of 1921 and
2 1918; Title I of the Revenue Act of 1917; Title I of
3 the Revenue Act of 1916; or section II of the Act of
4 October 3, 1913; a war profits or excess profits tax im-
5 posed by Title III of the Revenue Acts of 1921 and
6 1918; or Title II of the Revenue Act of 1917; or an
7 income, war profits, or excess profits tax imposed by
8 any of the foregoing provisions, as amended or supple-
9 mented.

10 (3) PRIOR TAXABLE YEAR.—A taxable year begin-
11 ning after December 31, 1939, shall not be considered
12 a prior taxable year.

13 (b) CIRCUMSTANCES OF ADJUSTMENT.—

14 (1) If—

15 (A) in determining at any time the tax of a
16 taxpayer under this subchapter an item affecting the
17 determination of the excess profits credit is treated
18 in a manner inconsistent with the treatment accorded
19 such item in the determination of the income-tax
20 liability of such taxpayer or a predecessor for a prior
21 taxable year or years, and

22 (B) the treatment of such item in the prior
23 taxable year or years consistently with the deter-
24 mination under this subchapter would effect an in-

1 increase or decrease in the amount of the income taxes
2 previously determined for such taxable year or years,
3 and

4 (O) on the date of such determination of the
5 tax under this subchapter correction of the effect of
6 the inconsistent treatment in any one or more of the
7 prior taxable years is prevented (except for the pro-
8 visions of section 3801) by the operation of any law
9 or rule of law (other than section 3761, relating to
10 compromises),

11 then the correction shall be made by an adjustment under
12 this section. If in a subsequent determination of the tax
13 under this subchapter for such taxable year such incon-
14 sistent treatment is not adopted, then the correction shall
15 not be made in connection with such subsequent deter-
16 mination.

17 (2) Such adjustment shall be made only if there is
18 adopted in the determination a position maintained by
19 the Commissioner (in case the net effect of the adjust-
20 ment would be a decrease in the income taxes previously
21 determined for such year or years) or by the taxpayer
22 with respect to whom the determination is made (in case
23 the net effect of the adjustment would be an increase
24 in the income taxes previously determined for such year
25 or years) which position is inconsistent with the treat-

1 ment accorded such item in the prior taxable year or
2 years which was not correct under the law applicable
3 to such year.

4 (c) METHOD AND EFFECT OF ADJUSTMENT.—(1)

5 The adjustment authorized by subsection (b), in the amount
6 ascertained as provided in subsection (d), if a net increase
7 shall be added to, and if a net decrease shall be subtracted
8 from, the tax otherwise computed under this subchapter for
9 the taxable year with respect to which such inconsistent
10 position is adopted.

11 (2) If more than one adjustment under this section is
12 made because more than one inconsistent position is adopted
13 with respect to one taxable year under this subchapter, the
14 separate adjustments, each an amount ascertained as pro-
15 vided in subsection (d), shall be aggregated, and the ag-
16 gregate net increase or decrease shall be added to or sub-
17 tracted from the tax otherwise computed under this sub-
18 chapter for the taxable year with respect to which such
19 inconsistent positions are adopted.

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

1 (d) ASCERTAINMENT OF AMOUNT OF ADJUSTMENT.—
2 In computing the amount of an adjustment under this section
3 there shall first be ascertained the amount of the income
4 taxes previously determined for each of the prior taxable
5 years for which correction is prevented. The amount of
6 each such tax previously determined for each such taxable
7 year shall be (1) the tax shown by the taxpayer, or by the
8 predecessor, upon the return for such prior taxable year,
9 increased by the amounts previously assessed (or collected
10 without assessment) as deficiencies, and decreased by the
11 amounts previously abated, credited, refunded, or otherwise
12 repaid in respect of such tax; or (2) if no amount was shown
13 as the tax by such taxpayer or such predecessor upon the
14 return, or if no return was made by such taxpayer or such
15 predecessor, then the amounts previously assessed (or col-
16 lected without assessment) as deficiencies, but such amounts
17 previously assessed, or collected without assessment, shall be
18 decreased by the amounts previously abated, credited, re-
19 funded, or otherwise repaid in respect of such tax. There
20 shall then be ascertained the increase or decrease in each such
21 tax previously determined for each such year which results
22 solely from the treatment of the item consistently with the
23 treatment accorded such item in the determination of the tax
24 liability under this subchapter. To the increase or decrease
25 so ascertained for each such tax for each such year there shall

1 be added interest thereon computed as if the increase or de-
2 crease constituted a deficiency or an overpayment, as the case
3 may be, for such prior taxable year. There shall be ascer-
4 tained the difference between the aggregate of such increases,
5 plus the interest attributable to each, and the aggregate of
6 such decreases, plus the interest attributable to each, and the
7 net increase or decrease so ascertained shall be the amount
8 of the adjustment under this section with respect to the incon-
9 sistent treatment of such item.

10 **SEC. 735. RELIEF FOR INSTALMENT BASIS TAXPAYERS.**

11 *(a) ELECTION TO ACCRUE INCOME.—In the case of*
12 *any taxpayer computing income from instalment sales under*
13 *the method provided by section 44 (a), if such taxpayer*
14 *establishes that the average volume of credit extended to pur-*
15 *chasers on the instalment plan in the four preceding taxable*
16 *years was more than 125 per centum of the volume of such*
17 *credit extended to such purchasers in the taxable year, it may*
18 *elect, in its first return for the taxable year, for the purposes*
19 *of the tax imposed by this subchapter, to compute, pursuant*
20 *to regulations prescribed by the Commissioner with the*
21 *approval of the Secretary, its gross income from instalment*
22 *sales on the basis of the taxable period for which such income*
23 *is accrued, in lieu of the basis provided by section 44 (a).*
24 *Such election shall be irrevocable when once made and shall*
25 *apply also to all subsequent taxable years, and the gross*

1 *income from instalment sales for each taxable year before the*
2 *first year with respect to which the election is made but begin-*
3 *ning after December 31, 1939, shall be adjusted for the*
4 *purposes of this subchapter to conform to such election. In*
5 *making such adjustments, no amount shall be included in com-*
6 *puting excess profits net income for any excess profits tax*
7 *taxable year on account of instalment sales made in taxable*
8 *years beginning before January 1, 1940.*

9 **(b) ADJUSTMENT ON ACCOUNT OF CHANGE.**—*If an*
10 *adjustment specified in subsection (a) is, with respect to any*
11 *taxable year, prevented, on the date of the election by the tax-*
12 *payer to change its method of computing income from instal-*
13 *ment sales, or within two years from such date, by any pro-*
14 *vision or rule of law (other than this section and other than*
15 *section 3761, relating to compromises), such adjustment shall*
16 *nevertheless be made if in respect of the taxable year for which*
17 *adjustment is sought a notice of deficiency is mailed or a claim*
18 *for refund is filed, as the case may be, within two years after*
19 *the date such election is made. If at the time of the mailing*
20 *of such notice of deficiency or the filing of such claim for*
21 *refund, the adjustment is so prevented, then the amount of the*
22 *adjustment authorized by this subsection shall be limited to*
23 *the increase or decrease in the tax previously determined for*
24 *such taxable year which results solely from the effect of sub-*
25 *section (a), and such amount shall be assessed and collected,*

1 *or credited or refunded, in the same manner as if it were*
2 *a deficiency or an overpayment, as the case may be, for such*
3 *taxable year and as if on the date of such election, two years*
4 *remain before the expiration of the periods of limitation upon*
5 *assessment or the filing of claim for refund for the taxable*
6 *year. The tax previously determined shall be ascertained in*
7 *accordance with section 734 (d). The amount to be assessed*
8 *and collected under this subsection in the same manner as if*
9 *it were a deficiency or to be refunded or credited in the same*
10 *manner as if it were an overpayment, shall not be diminished*
11 *by any credit or set-off based upon any item, inclusion, deduc-*
12 *tion, credit, exemption, gain or loss, other than one resulting*
13 *from the effect of subsection (a). Such amount, if paid, shall*
14 *not be recovered by a claim or suit for refund, or suit for*
15 *erroneous refund based upon any item, inclusion, deduction,*
16 *credit, exemption, gain or loss, other than one resulting from*
17 *the effect of subsection (a).*

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

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

21 **SEC. 740. DEFINITIONS.**

22 For the purposes of this Supplement—

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

25 (1) A corporation which has acquired—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3 (4) In the case of a statutory consolidation, all cor-
4 porations consolidated, except the corporation resulting
5 from the consolidation; or

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

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

13 (c) *INCOME OF CERTAIN COMPONENT CORPORATIONS*
14 *NOT INCLUDED.—For the purposes of section 712, section*
15 *741, and section 742 in the case of a corporation which is a*
16 *component corporation in a transaction described in subsection*
17 *(a), for the purposes of computing, for any taxable year*
18 *beginning after December 31, 1941, the excess profits credit*
19 *of such component corporation or of an acquiring corporation*
20 *of which the acquiring corporation in such transaction is not*
21 *a component, no account shall be taken of the net income,*
22 *capital addition, or capital reduction of such component cor-*
23 *poration before such transaction, or of the net income, capital*
24 *addition, or capital reduction before such transaction, of its*

1 *component corporations in any transaction before such trans-*
 2 *action.*

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

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

8 (2) If the tax is being computed for any taxable
 9 year beginning after December 31, 1940, and before
 10 January 1, 1942, the forty-eight months preceding
 11 what would have been its first taxable year beginning in
 12 1940 if it had had a taxable year beginning in 1940 on
 13 the date on which the taxable year for which the tax is
 14 being computed began; or

15 (3) *If the tax is being computed for any taxable*
 16 *year beginning after December 31, 1941, the four cal-*
 17 *endar years 1936 to 1939, both inclusive.*

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

22 (f) **EXISTENCE OF ACQUIRING CORPORATION.**—For
 23 the purposes of subsection (c) and section 744 section 712
 24 (a), if any component corporation of the taxpayer was an

1 existence on the date of the beginning of the taxpayer's base
2 period (either actually or by reason of this subsection), its
3 acquiring corporation before January 1, 1940, the taxpayer
4 shall be considered to have been in existence on before such
5 date.

6 (g) COMPONENT CORPORATIONS OF COMPONENT COR-
7 PORATIONS.—If a corporation is a component corporation
8 of an acquiring corporation, under subsection (b) or under
9 this subsection, it shall (except for the purposes of section
10 ~~742 741~~ (d) (1) and (2) and section ~~743 (a)~~ section 742
11 (a) (1), (2), and (3)) also be a component corporation of
12 the corporation of which such acquiring corporation is a
13 component corporation.

14 (h) SOLE PROPRIETORSHIP.—For the purposes of sec-
15 tions 740 (a) (1) (D), 740 (b) (5), and ~~742 741~~ (g),
16 a business owned by a sole proprietorship shall be considered
17 a partnership.

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

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

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

8 SEC. 742. 741. SUPPLEMENT A AVERAGE BASE PERIOD NET
 9 INCOME.

10 In the case of a taxpayer which is an acquiring corpora-
 11 tion the excess profits credit of which is allowed under section
 12 741, its average base period net income (for the purpose of
 13 the credit computed under section 713) if the taxpayer was
 14 actually in existence before January 1, 1940, shall, at the
 15 election of the taxpayer made in its return for the taxable
 16 year, be computed as follows, and if the taxpayer was not
 17 actually in existence before such date, shall be computed as
 18 follows, in lieu of the method provided in section 713 shall
 19 be the amount computed under section 713 or the amount of
 20 its Supplement A average base period net income, whichever is
 21 the greater. The Supplement A average base period net
 22 income shall be the amount computed without regard to sub-
 23 section (h) of this section or computed under subsection (h)
 24 of this section, whichever is the greater. The Supplement A
 25 average base period net income shall be computed as follows:

1 (a) By ascertaining with respect to each of its base
2 period years—

3 (1) The amount of its *and each of its component*
4 *corporation's* excess profits net income for each of its
5 *and such component corporation's* taxable years begin-
6 ning after December 31, 1935, and ending with or
7 within such base period year; or, in the case of each
8 such taxable year *of the taxpayer or of such com-*
9 *ponent corporation, as the case may be, in which the*
10 *deductions plus the credit for dividends received and the*
11 *credit provided in section 26 (a) (relating to interest*
12 *on certain obligations of the United States and its in-*
13 *strumentalities)* exceeded the gross income, the amount
14 of such excess;

15 ~~(2)~~ With respect to each of its qualified component
16 corporations, the amount of its excess profits net income
17 for each of its taxable years beginning after December
18 31, 1935, and ending with or within such base period
19 year of the taxpayer; or, in the case of each such tax-
20 able year in which the deductions plus the credit for
21 dividends received exceeded the gross income, the amount
22 of such excess;

23 ~~(2)~~ (2) (A) The aggregate of the amounts of ex-
24 cess profits net income ascertained under paragraphs ~~(1)~~
25 and ~~(2)~~ paragraph (1); (B) the aggregate of the ex-

1 ~~cesses~~ ascertained under ~~paragraphs (1) and (2)~~ para-
2 ~~graph~~ (1); and (C) the difference between the
3 aggregates found under clause (A) and clause (B). If
4 the aggregate ascertained under clause (A) is greater
5 than the aggregate ~~found~~ *ascertained* under clause (B),
6 the difference shall for the purposes of subsection (b)
7 be designated a "plus amount", and if the aggregate
8 ascertained under clause (B) is greater than the aggre-
9 gate found under clause (A), the difference shall for
10 the purposes of subsection (b) be designated a "minus
11 amount".

12 *If, in the case of the taxpayer or any component corpora-*
13 *tion of the taxpayer, one and only one taxable year of the*
14 *taxpayer or such component corporation, as the case may*
15 *be, begins with or within such base period year and such tax-*
16 *able year is less than twelve months, the amount of the excess*
17 *profits net income, or the amount of such excess of deduc-*
18 *tions plus the credit for dividends received and the credit*
19 *provided in section 26 (a) (relating to interest on certain*
20 *obligations of the United States and its instrumentalities) over*
21 *gross income, as the case may be, for such taxable year, shall be*
22 *placed on an annual basis in the same manner as is provided*
23 *in section 711 (a) (3). If more than one taxable year*
24 *of the taxpayer or such component corporation, as the case*
25 *may be, begins with or within such base period year, the aggre-*

1. *gate of the amounts of excess profits net income minus the*
2. *aggregate of the excesses of deductions plus the credit for divi-*
3. *dents received and the credit provided in section 26 (a)*
4. *(relating to interest on certain obligations of the United States*
5. *and its instrumentalities) over gross income, or the aggregate*
6. *of such excesses minus the aggregate of the amounts of excess*
7. *profits net income, as the case may be, for such taxable years*
8. *shall be placed on an annual basis by dividing by the aggreg-*
9. *ate of the number of days in such taxable years and*
10. *multiplying by three hundred and sixty-five.*

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

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

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

23. (1) the taxpayer owned not less than 75 per centum
24. of each class of stock of each of the qualified component

1 corporations involved in the transaction in which the
2 taxpayer became an acquiring corporation; or

3 (2) one of the qualified component corporations in-
4 volved in the transaction owned not less than 75 per
5 centum of each class of stock of the taxpayer, and of each
6 of the other qualified component corporations involved
7 in the transaction,

8 the average base period net income of the taxpayer shall not
9 be less than (A) the average base period net income of that
10 one of its qualified component corporations involved in the
11 transaction the average base period net income of which is
12 greatest, or (B) the average base period net income of the
13 taxpayer computed without regard to the base period net
14 income of any of its qualified component corporations in-
15 volved in the transaction. *As used in this subsection, the*
16 *term "qualified component corporation" means a component*
17 *corporation which was in existence on the date of the begin-*
18 *ning of the taxpayer's base period.*

19 (e) For the purposes of subsection (a) (1) ~~and (2)~~ of
20 this section—

21 ~~(1)~~ There shall be excluded, in the various compu-
22 tations, any dividends paid by the taxpayer or any of its
23 qualified component corporations during any of the tax-
24 able years of the payer which are included in the com-

1 putation of the taxpayer's average base period net in-
2 come. If the payer corporation is a corporation de-
3 scribed in subsection ~~(f)~~ ~~(1)~~ or ~~(2)~~ of this section,
4 the dividends to be excluded under this paragraph shall
5 be only such as are paid after such payer corporation
6 first became an acquiring corporation; and

7 (1) *If neither the taxpayer corporation nor any of*
8 *its component corporations was actually in existence on*
9 *December 31, 1936, the excess profits net income of each*
10 *such corporation (except a corporation which became a*
11 *component corporation of an acquiring corporation be-*
12 *fore the beginning of the acquiring corporation's first tax-*
13 *able year which began in 1940) for each base period year*
14 *at no time during which any of such corporations was ac-*
15 *tually in existence, shall be an amount equal to 8 per*
16 *centum of the excess of—*

17 (A) *the daily invested capital of such corpora-*
18 *tion for the first day of its first taxable year under*
19 *this subchapter beginning in 1940 plus, in case it*
20 *became, in such first taxable year but on a day in*
21 *any other such corporation's taxable year beginning*
22 *in 1939, an acquiring corporation with respect to*
23 *such other corporation, the daily invested capital of*
24 *such other corporation for such day, over*

25 (B) *an amount equal to the same percentage of*

1 *such daily invested capital as would be applicable*
2 *under section 720 in reduction of the average in-*
3 *vested capital of such corporation for the last taxable*
4 *year beginning in 1939 if such section had been*
5 *applicable to such year (computed as if the admis-*
6 *sible and inadmissible assets of any other such cor-*
7 *poration with respect to which it became, in such*
8 *taxable year, an acquiring corporation, had been*
9 *held by it).*

10 *(2) In case any corporation described in paragraph*
11 *(1) owned stock in any other such corporation on the*
12 *first day of such owning corporation's first taxable year*
13 *under this subchapter beginning in 1940, its and such*
14 *other corporation's excess profits net income for each base*
15 *period year described in paragraph (1) shall be de-*
16 *termined in accordance with regulations prescribed by*
17 *the Commissioner with the approval of the Secretary.*

18 ~~(2)~~ *(3) In determining whether, for any taxable*
19 *year, the deductions plus the credit for dividends received*
20 *and the credit provided in section 26 (a) (relating to*
21 *interest on certain obligations of the United States and*
22 *its instrumentalities) exceeded the gross income, and in*
23 *determining the amount of such excess, the adjustments*
24 *provided in section 711 (b) (1) shall be made.*

25 ~~(f) (1)~~ *In the case of a taxpayer which is an acquiring*

1 corporation and which was not actually in existence on the
2 date of the beginning of its base period, there shall be ex-
3 cluded from the various computations under subsection (a)
4 (1) of this section the portion of its excess profits net income,
5 or of the excess over gross income therein referred to, which
6 is attributable to any period before it first became an acquir-
7 ing corporation.

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

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

22 (f) (1) If, after December 31, 1935—

23 (A) the taxpayer acquired stock in another corpo-
24 ration, and thereafter such other corporation became a
25 component corporation of the taxpayer, or

1 (B) a corporation (hereinafter called "first corpora-
2 tion") acquired stock in another corporation (hereinafter
3 called "second corporation"), and thereafter the first
4 and second corporations became component corporations
5 of the taxpayer,
6 then to the extent that the consideration for such acquisition
7 was not the issuance of the taxpayer's or first corporation's,
8 as the case may be, own stock, the Supplement A average
9 base period net income of the taxpayer shall be reduced, and
10 the transferred capital addition and reduction adjusted, in
11 respect of the income and capital addition and reduction of
12 the corporation whose stock was so acquired and in respect
13 of the income and capital addition and reduction of any other
14 corporation which at the time of such acquisition was con-
15 nected directly or indirectly through stock ownership with
16 the corporation whose stock was so acquired and which
17 thereafter became a component corporation of the taxpayer,
18 in such amounts and in such manner as shall be determined
19 in accordance with regulations prescribed by the Commis-
20 sioner with the approval of the Secretary.

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

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

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

15 (h) *INCREASED EARNINGS IN LAST HALF OF BASE*
16 *PERIOD.—*

17 (1) *GENERAL RULE.—The Supplement A average*
18 *base period net income determined under this subsection*
19 *shall be computed by ascertaining for each half of the*
20 *base period the sum of the plus amounts determined*
21 *under subsection (a) reduced if for any year in such*
22 *half a minus amount was determined by the minus*
23 *amount for such year. If the amount ascertained for the*
24 *second half exceeds the amount ascertained for the first*
25 *half, the Supplement A average base period net income*

1 shall be the sum, divided by two, of the amount so as-
2 certained for the second half plus one-half of such ex-
3 cess, except that it shall not exceed the largest plus
4 amount determined under subsection (a) with respect
5 to any base period year.

6 (2) *LIMITATION ON AMOUNT INCLUDIBLE FOR*
7 *CERTAIN TAXABLE YEARS ENDING AFTER MAY 31,*
8 *1940.*—For the purposes of this subsection the excess
9 profits net income of any corporation for any taxable year
10 beginning in 1939 and ending after May 31, 1940, shall
11 in no case exceed an amount computed as follows:

12 (A) By reducing the excess profits net income
13 by an amount which bears the same ratio thereto as
14 the number of months after May 31, 1940, bears to
15 the total number of months in such taxable year; and

16 (B) By adding to the amount ascertained under
17 subparagraph (A) an amount which bears the same
18 ratio to the excess profits net income for the last
19 preceding taxable year as such number of months
20 after May 31, 1940, bears to the number of months
21 in such preceding year. The amount added under
22 this subparagraph shall not exceed the amount of the
23 excess profits net income for such last preceding
24 taxable year.

25 (C) If the number of months in such preceding

1 *taxable year is less than such number of months after*
 2 *May 31, 1940, by adding to the amount ascertained*
 3 *under subparagraph (B) an amount which bears the*
 4 *same ratio to the excess profits net income for the*
 5 *second preceding taxable year as the excess of such*
 6 *number of months after May 31, 1940, over the*
 7 *number of months in such preceding taxable year*
 8 *bears to the number of months in such second preced-*
 9 *ing taxable year.*

10 **SEC. 743 742. NET CAPITAL CHANGES.**

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

19 ~~(b)~~ For the purposes of this section—

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

24 ~~(2)~~ In computing the net capital reduction of each

1 such component corporation there shall be disregarded
2 distributions made to the taxpayer or to any of such
3 component corporations.

4 (a) *TAXPAYER USING THIS SUPPLEMENT.*—For the
5 purposes of section 713 (g), if the transaction which con-
6 stitutes the taxpayer an acquiring corporation occurs in a
7 taxable year of the taxpayer which begins after December 31,
8 1939, and the taxpayer's average base period net income
9 is computed under section 741, the following rules shall
10 apply in computing the daily capital addition and reduction of
11 the taxpayer for each day after such transaction:

12 (1) *The transferred capital addition or reduction*
13 *of the component corporation shall be treated as if it*
14 *were a capital addition or reduction, as the case may*
15 *be, of the taxpayer.*

16 (2) *The transferred capital addition of the com-*
17 *ponent corporation shall be its daily capital addition*
18 *as of the time immediately before the transaction (com-*
19 *puted under section 713 (g), but without regard to its*
20 *reduction under the fourth sentence of paragraph (3)*
21 *on account of excluded capital, but with the application*
22 *of paragraph (6) of this subsection).*

23 (3) *The transferred capital reduction of the com-*
24 *ponent corporation shall be its daily capital reduction*

1 *as of the time immediately before the transaction (com-*
2 *puted under section 713 (g) but with the application of*
3 *paragraph (7) of this subsection).*

4 (4) *In computing the daily capital addition of the*
5 *taxpayer, money or property paid in to the taxpayer*
6 *by any of its component corporations, and property*
7 *consisting of stock in any such component corporation*
8 *paid in by shareholders of such component corporation,*
9 *shall be disregarded.*

10 (5) *In computing the daily capital reduction of the*
11 *taxpayer, distributions by the taxpayer to any of its*
12 *component corporations not out of earnings and profits*
13 *shall be disregarded.*

14 (6) *In computing the transferred capital addition*
15 *of the component corporation, money or property paid*
16 *in to such component corporation by the taxpayer or any*
17 *other component corporation and property consisting of*
18 *stock in the taxpayer or any other component corporation*
19 *paid in by shareholders of the taxpayer or other com-*
20 *ponent corporation, shall be disregarded.*

21 (7) *In computing the transferred capital reduction*
22 *of the component corporation, distributions by such com-*
23 *ponent corporation to the taxpayer or any other com-*
24 *ponent corporation shall be disregarded.*

25 (8) *The daily capital addition of the taxpayer to*

1 revenue law, in or was applicable, by one corporation of its
2 property wholly or in part for stock or securities of another
3 corporation, or a transfer of property by one corporation to
4 another corporation after December 31, 1917, the basis of
5 which in the hands of such other corporation is or was deter-
6 mined under section 113 (a) (8) (B), or would have been
7 so determined had such section been in effect.

8 (b) TRANSFEROR UPON AN EXCHANGE.—The term
9 “transferor upon an exchange” means a corporation which
10 upon an exchange transfers property to another corporation
11 in exchange, wholly or in part, for stock or securities of such
12 other corporation, or transfers property to another corpora-
13 tion after December 31, 1917, the basis of which in the hands
14 of such other corporation is or was determined under section
15 113 (a) (8) (B), or would have been so determined had
16 such section been in effect.

17 (c) TRANSFEEE UPON AN EXCHANGE.—The term
18 “transferee upon an exchange” means a corporation which
19 upon an exchange acquires property from another corporation
20 in exchange, wholly or in part, for its stock or securities, or
21 which acquires property from another corporation after De-
22 cember 31, 1917, the basis of which in its hands is or was
23 determined under section 113 (a) (8) (B), or would have
24 been so determined had such section been in effect.

1 (d) **CONTROL.**—The term “control” means the own-
 2 ship of stock possessing at least 90 per centum of the total
 3 combined voting power of all classes of stock entitled to vote
 4 and at least 90 per centum of the total value of shares of all
 5 classes of stock of the corporation.

6 (e) **HIGHEST BRACKET AMOUNT.**—The term “highest
 7 bracket amount” means \$500,000 or the highest bracket
 8 amount computed under section 752, whichever is the smaller.

9 **SEC. 751. DETERMINATION OF PROPERTY PAID IN FOR**
 10 **STOCK AND OF BORROWED CAPITAL IN CON-**
 11 **NECTION WITH CERTAIN EXCHANGES.**

12 (a) **PROPERTY PAID IN FOR STOCK.**—In the applica-
 13 tion of section 718 (a) to a transferee upon an exchange in
 14 determining the amount paid in for stock of the transferee,
 15 or as paid-in surplus or as a contribution to capital of the
 16 transferee, in connection with such exchange, only an amount
 17 shall be deemed to have been so paid in equal to the excess
 18 of the basis in the hands of the transferee of the property
 19 of the transferor received by the transferee upon the exchange
 20 over the sum of—

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

24 (2) The aggregate of the amount of money and the

1 fair market value of any other property transferred to
 2 the transferor not permitted to be received by such
 3 transferor without the recognition of gain.

4 ~~(b) BORROWED CAPITAL.~~—In the application of sec-
 5 tion 710 ~~(a)~~ to a transferee upon an exchange, the term
 6 “borrowed capital” shall not include indebtedness originally
 7 evidenced by securities issued by the transferee upon such
 8 exchange as consideration for the property of the transferor
 9 received by the transferee upon such exchange if ~~(1)~~ such
 10 securities were property permitted to be received by the per-
 11 son to whom such securities were issued without the recog-
 12 nition of gain and ~~(2)~~ the indebtedness originally evidenced
 13 by such securities did not arise out of indebtedness of the
 14 transferor ~~(other than indebtedness which in the transferor’s~~
 15 ~~hands was subject to the limitations of this subsection)~~ as-
 16 sumed by the transferee in connection with such exchange.

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

19 ~~(a) SPECIAL APPLICATION OF DAILY INVESTED CAP-~~
 20 ~~ITAL OF TRANSFEROR UPON EXCHANGE.~~—For the pur-
 21 poses of this section, the daily invested capital of a transferor
 22 upon an exchange for the day after the exchange shall be
 23 the daily invested capital determined under section 717 re-
 24 duced by an amount equal to the amount by which the equity
 25 invested capital of the transferee upon such exchange was in-

1 creased by reason of the receipt of property from such trans-
 2 feror upon such exchange.

3 (b) HIGHEST BRACKET AMOUNT OF TRANSFEROR.—

4 (1) TAXABLE YEAR OF EXCHANGE.—In the case
 5 of a transferor upon an exchange after the beginning of
 6 its first taxable year under this subchapter, its highest
 7 bracket amount for the taxable year in which the ex-
 8 change takes place shall be the sum of—

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

13 (B) Its highest bracket amount for the taxable
 14 year after the exchange, multiplied by the number
 15 of days in the taxable year remaining after the day
 16 of the exchange,

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

18 (2) TAXABLE YEARS AFTER EXCHANGE INVOLV-
 19 ING CONTROL.—In the case of a transferor upon an ex-
 20 change after the beginning of its first taxable year under
 21 this subchapter, if immediately after the exchange the
 22 transferor or its shareholders, or both, are in control of
 23 the transferee, the transferor's highest bracket amount
 24 for any taxable year after the taxable year in which the
 25 exchange takes place shall be an amount which is a per-

1 centage of its highest bracket amount immediately pre-
2 ceding the exchange equal to the percentage which its
3 daily invested capital for the day after the exchange is of
4 its daily invested capital for the day of the exchange.

5 (3) ~~TAXABLE YEARS AFTER EXCHANGE NOT IN-~~
6 ~~VOLVING CONTROL.~~—In the case of a transferor upon an
7 exchange (other than a transferor described in paragraph
8 (4) of this subsection) after the beginning of its first
9 taxable year under this subchapter, if immediately after
10 the exchange no transferor or its shareholders, or both,
11 upon the exchange are in control of the transferee, and
12 if the shareholders of the transferee immediately preced-
13 ing the exchange are not in control of the transferee
14 immediately after the exchange, the transferor's highest
15 bracket amount for any taxable year after the exchange
16 shall be the excess, if any, of the sum of the transferor's
17 highest bracket amount immediately preceding the ex-
18 change and the transferee's highest bracket amount im-
19 mediately preceding the exchange, over \$500,000.

20 (4) ~~TAXABLE YEARS AFTER CERTAIN EXCHANGES~~
21 ~~UNDER SECTION 112 (B) (5).~~—In the case of an exchange
22 after the beginning of the first taxable year under this
23 subchapter of any transferor or transferee upon such ex-
24 change, involving two or more transferors, or one or more
25 transferors and one or more other persons, if immediately

1 after the exchange no one of such transferors, or its share-
2 holders, or both; and no one or more of such other persons
3 are in control of the transferee and if such exchange is
4 an exchange described in section 112 (b) (5) or so
5 much of section 112 (c) or 112 (e) as refers to section
6 112 (b) (5), the highest bracket amount of any such
7 transferor for any taxable year after the exchange shall
8 be an amount equal to its highest bracket amount imme-
9 diately preceding the exchange—

10 (A) Minus an amount which bears the same
11 ratio to its highest bracket amount immediately pro-
12 ceeding the exchange as the excess of its daily in-
13 vested capital for the day of the exchange over its
14 daily invested capital for the day after the exchange
15 bears to its daily invested capital for the day of the
16 exchange, and

17 (B) Plus an amount which bears the same ratio
18 to the excess over \$500,000 of the sum of the
19 amounts computed under subparagraph (A) with
20 respect to each transferor, as the amount computed
21 under subparagraph (A) with respect to such trans-
22 feror bears to the sum of the amounts computed
23 under such subparagraph with respect to each trans-
24 feror.

1 ~~(c) HIGHEST BRACKET AMOUNT OF TRANSFEREE.~~

2 ~~(1) TAXABLE YEAR OF EXCHANGE INVOLVING~~
3 ~~CONTROL.~~—In the case of a transferee upon an exchange
4 after the beginning of the first taxable year under this
5 subchapter of a transferor upon such exchange the trans-
6 feree's highest bracket amount for the taxable year in
7 which the exchange takes place shall be the sum of—

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

12 (B) Its highest bracket amount for the taxable
13 year after the exchange multiplied by the num-
14 ber of days in the taxable year remaining after the
15 day of the exchange,

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

22 ~~(2) TAXABLE YEARS AFTER EXCHANGE INVOLV-~~
23 ~~ING CONTROL.~~—In the case of a transferee upon an ex-
24 change after the beginning of the first taxable year under
25 this subchapter of a transferor upon such exchange, if

1 immediately after the exchange any transferor upon such
2 exchange or its shareholders, or both, are in control of the
3 transferee, the transferee's highest bracket amount for
4 any taxable year after the exchange shall be an amount
5 which is a percentage of such transferor's highest bracket
6 amount immediately preceding the exchange equal to
7 the percentage which the excess of the transferee's daily
8 invested capital for the day after the exchange over its
9 daily invested capital for the day of the exchange is of
10 such transferor's daily invested capital for the day of the
11 exchange.

12 ~~(3) TAXABLE YEARS AFTER EXCHANGE NOT IN-~~
13 ~~VOLVING CONTROL.~~—In the case of a transferee upon an
14 exchange (other than a transferee described in paragraph
15 ~~(4)~~ of this subsection) after the beginning of the first
16 taxable year under this subchapter of a transferor upon
17 such exchange, if immediately after the exchange no
18 transferor or its shareholders, or both, are in control of
19 the transferee, and if the shareholders of the transferee
20 immediately preceding the exchange are not in control of
21 the transferee immediately after the exchange, the trans-
22 feree's highest bracket amount for any taxable year after
23 the exchange shall be an amount equal to ~~(A)~~ the sum
24 of the transferor's highest bracket amount immediately
25 preceding the exchange and the transferee's highest

1 bracket amount immediately preceding the exchange, or
 2 ~~(B) \$500,000, whichever is the smaller.~~

3 ~~(4) TAXABLE YEARS AFTER CERTAIN EXCHANGES~~
 4 ~~UNDER SECTION 112 (b) (5).~~—In the case of an ex-
 5 change described in subsection ~~(b) (4)~~ of this section,
 6 the highest bracket amount of the transferee upon such
 7 exchange for any taxable year after the exchange shall
 8 be an amount equal ~~(A)~~ to the sum of the amounts com-
 9 puted under subparagraph ~~(A)~~ of such subsection with
 10 respect to each transferor or ~~(B) \$500,000, whichever is~~
 11 the smaller.

12 ~~(5) TAXABLE YEARS AFTER LIQUIDATION IN CASE~~
 13 ~~OF CORPORATION RECEIVING PROPERTY UNDER SEC-~~
 14 ~~TION 112 (b) (6).~~—Upon the receipt by a corporation
 15 during any taxable year under this subchapter of prop-
 16 erty in complete liquidation of another corporation, gain
 17 or loss upon which is not recognized by reason of section
 18 ~~112 (b) (6)~~, the highest bracket amount of the cor-
 19 poration receiving such property for any taxable year
 20 after the liquidation is completed shall be an amount
 21 equal to its highest bracket amount immediately preced-
 22 ing the completion of the liquidation increased, but in no
 23 case to an amount above \$500,000, by an amount equal
 24 to the highest bracket amount of such other corporation
 25 immediately preceding the completion of such liquidation;

1 if previously and after the beginning of the first taxable
2 year under this subchapter of the corporation receiving
3 such property such corporation was a transferor upon an
4 exchange with respect to which such other corporation
5 was a transferee.

6 ~~(d) HIGHEST BRACKET AMOUNT IN CASE OF TWO OR~~
7 ~~MORE EXCHANGES IN SAME TAXABLE YEAR.—~~

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

20 ~~(2) If a transferee upon an exchange is in the same~~
21 ~~taxable year involved in more than one exchange (either~~
22 ~~as transferee or transferor), its highest bracket amount~~
23 ~~for such taxable year shall be the amount determined~~
24 ~~under subsection (c) (1) with respect to the last ex-~~
25 ~~change in such taxable year. Its highest bracket amount~~

1 immediately preceding any exchange in such taxable
 2 year subsequent to the first exchange therein shall be the
 3 amount computed under subsection (c) (1) with respect
 4 to the immediately preceding exchange as if the taxable
 5 year closed on the day of such subsequent exchange.

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

14 *Supplement C—Invested Capital in Connection With Certain*

15 *Exchanges and Liquidations*

16 **SEC. 760. EXCHANGES.**

17 (a) *DEFINITIONS.*—For the purpose of this section—

18 (1) *EXCHANGE.*—The term “exchange” means an
 19 exchange, to which section 112 (b) (3), (4), or (5) or
 20 so much of section 112 (c), (d), or (e) as refers to
 21 section 112 (b) (3), (4), or (5), or to which a cor-
 22 responding provision of a prior revenue law, is or was
 23 applicable, by one corporation of its property wholly or
 24 in part for stock or securities of another corporation, or
 25 a transfer of property by one corporation to another cor-

1 poration after December 31, 1917, the basis of which
2 in the hands of such other corporation is or was deter-
3 mined under section 113 (a) (8) (B), or would have
4 been so determined had such section been in effect.

5 (2) *TRANSFEEE UPON AN EXCHANGE.*—The
6 term “transferee upon an exchange” means a corporation
7 which upon an exchange acquires property in exchange,
8 wholly or in part, for its stock or securities, or which
9 acquires property from another corporation after De-
10 cember 31, 1917, the basis of which in its hands is or
11 was determined under section 113 (a) (8) (B), or
12 would have been so determined had such section been in
13 effect.

14 (b) *RULE.*—In the application of section 718 (a) to
15 a transferee upon an exchange in determining the amount
16 paid in for stock of the transferee, or as paid-in surplus or as
17 a contribution to capital of the transferee, in connection with
18 such exchange, only an amount shall be deemed to have been
19 so paid in equal to the excess of the basis (for determining
20 loss) in the hands of the transferee of the property of the
21 transferor received by the transferee upon the exchange over
22 the sum of—

23 (1) The amount of any liability of the transferor
24 assumed upon the exchange and of any liability subject
25 to which such property was so received, plus

1 (2) *The amount of any liability of the transferee*
 2 *(not arising out of any liability described in paragraph*
 3 *(1)) constituting consideration for the property so*
 4 *received, plus*

5 (3) *The aggregate of the amount of any money*
 6 *and the fair market value of any other property (other*
 7 *than such stock and other than property described in*
 8 *paragraphs (1) and (2)) transferred to the transferor.*

9 (c) *REDUCTION IN DAILY INVESTED CAPITAL.—In*
 10 *the application of section 717 to a transferee upon an ex-*
 11 *change, the daily invested capital for any day after such*
 12 *exchange shall be reduced by an amount equal to the amount*
 13 *by which the sum of the amounts specified in paragraphs*
 14 *(1), (2), and (3) of subsection (b) exceeds the basis (for*
 15 *determining loss) in the hands of the transferee of the prop-*
 16 *erty of the transferor received upon the exchange.*

17 **SEC. 761. TRANSACTIONS IN LIQUIDATION.**

18 (a) *DEFINITION OF LIQUIDATING TRANSACTION.—*
 19 *As used in this section, the term "liquidating transaction"*
 20 *means:*

21 (1) *The complete liquidation of another corpora-*
 22 *tion under section 112 (b) (6) or the corresponding*
 23 *provision of a prior revenue law, or*

24 (2) *The liquidation of another corporation, or a*

1 *transaction having the effect of liquidating in whole or*
 2 *in part, some or all of the stock of another corporation*

3 *(A) if gain or loss in whole or in part is not*
 4 *recognized either in a consolidated income or ex-*
 5 *cess profits tax return or because of the provisions of*
 6 *section 112 (b) (4) or (5), or so much of sec-*
 7 *tion 112 (c) to (e), inclusive, as refers to section*
 8 *112 (b) (4) or (5), or the corresponding pro-*
 9 *vision of a prior revenue law, and*

10 *(B) if the property received by the taxpayer*
 11 *has a basis described in section 113 (b) (2) (A).¹*

12 **(b) ADJUSTMENT OF EQUITY INVESTED CAPITAL.²**

13 *If property is received by the taxpayer in a liquidating*
 14 *transaction, the equity invested capital for each day following*
 15 *the transaction shall be adjusted as follows:*

16 *(1) If the stock of the transferor which is in effect*
 17 *canceled upon such liquidating transaction is determined*
 18 *to have been acquired by the issuance of stock in trans-*
 19 *actions in which gain or loss in whole or in part was not*
 20 *recognized, there shall be included, in lieu of the amounts*
 21 *determined to be otherwise includible in the equity in-*
 22 *vested capital of the taxpayer with respect to such stock,*
 23 *the amount determined to be necessary to reflect the*
 24 *equity invested capital and the deficit in earnings and*

1 profits, if any, of the transferor with respect to such
2 stock.

3 (2) If such stock of the transferor is determined
4 not to have been acquired by the issuance of stock in
5 transactions in which gain or loss in whole or in part
6 was not recognized, the equity invested capital of the
7 taxpayer shall be adjusted to the extent necessary to
8 reflect in its accumulated earnings and profits and its
9 earnings and profits for the taxable year the portion of
10 the earnings and profits or the deficit in earnings and
11 profits, as the case may be, of the transferor accumulated
12 subsequent to the date which is determined to be the date
13 of acquisition by the taxpayer of control (or, with re-
14 spect to stock acquired subsequent to the acquisition of
15 control, the date of acquisition of such stock) of the
16 transferor and determined to be attributable to such
17 stock. For the purposes of the computations under
18 this paragraph, the basis of the property held by the
19 transferor or its predecessor at the time of the acquisition
20 of control (or of acquisition of the stock in the case of
21 property determined to be attributable to stock acquired
22 since the acquisition of control) which is attributable
23 to such stock shall be, in lieu of the basis prescribed by
24 section 113 or the corresponding provision of a prior
25 revenue law, an amount determined by reference to

1 *the adjusted basis for determining loss upon a sale*
2 *or exchange of such stock in the hands of the tax-*
3 *payer or a predecessor. The basis so assigned shall*
4 *apply, in lieu of the basis otherwise prescribed in*
5 *computing any amount (determined by reference to the*
6 *basis of such property in the hands of the transferor)*
7 *entering into the computation of the equity invested*
8 *capital of the taxpayer or any other corporation comput-*
9 *ing equity invested capital by reference to the equity in-*
10 *vested capital of the taxpayer. For the purposes of this*
11 *paragraph the adjusted basis for determining loss upon*
12 *a sale or exchange of such stock shall be determined with-*
13 *out regard to any adjustment authorized by the last sen-*
14 *tence of section 113 (a) (11) which is already reflected*
15 *in the earnings and profits or deficit in earnings and*
16 *profits attributable to such stock.*

17 *(c) MERGERS AND CONSOLIDATIONS.—In determining*
18 *the amount of the adjustments under subsections (a) and*
19 *(b), if a corporation owned stock in another corporation, and*

20 *(1) such corporations are merged or consolidated*
21 *in a statutory merger or consolidation, or*

22 *(2) such corporations are parties to a liquidating*
23 *transaction which results in the liquidation of such stock*
24 *in a manner similar to that resulting from a statutory*
25 *merger or consolidation,*

1. for the purposes of this section such stock shall be considered
2. to have been acquired by the corporation resulting from the
3. merger, consolidation, or transaction, and the properties at-
4. tributable thereto received by it in liquidation of such stock.

5. (d) DETERMINATIONS.—Any determination which is
6. required to be made under this section shall be made in ac-
7. cordance with regulations which shall be prescribed by the
8. Commissioner with the approval of the Secretary.

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