INVESTIGATION OF BUREAU OF INTERNAL REVENUE

HEARINGS

BEFORE THE

SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE UNITED STATES SENATE

SIXTY-EIGHTH CONGRESS

SECOND SESSION

PURSUANT TO

S. Res. 168

AUTHORIZING THE APPOINTMENT OF A SPECIAL COMMITTEE TO INVESTIGATE THE BUREAU OF INTERNAL REVENUE

FEBRUARY 23, 24, 26, 27, AND MARCH 2, 1925

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SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

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INVESTIGATION OF BUREAU OF INTERNAL REVENUE

MONDAY, FEBRUARY 23, 1925

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to call of the chairman.

Present: Senators Couzens (presiding), Ernst, and Jones of New Mexico.

Present also: Mr. L. C. Manson, of counsel for the committee; Mr. L. H. Parker, chief engineer for the committee; and Mr. A. H. Fay, consulting engineer for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. A. W. Gregg, special assistant to the Secretary of the Treasury; Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. S. M. Greenidge, head engineering division, Bureau of Internal Revenue; and Mr. W. N. Thayer chief oil and gas section, Bureau of Internal Revenue.

The CHAIRMAN. You may proceed, Mr. Manson.

Mr. MANSON. The matter to be presented this morning deals with discovery values allowed to the Gypsy Oil Co., one of the subsidiaries of the Gulf Oil Corporation.

The principal feature brought out is the market price of oil used as the basis for these valuations The regulations do not specify what price of oil should be taken to determine valuations for discovery. The customary practice, however, in the department, has been to utilize the posted price of oil at or within 30 days after discovery, although there are instances, as in this case, where discovery prices have been used. In the instance cited herein the taxpayer made discoveries when the price of oil was low, and in order to obtain a higher oil-depletion unit he has assumed that the price depression can not last long, and has therefore taken what he calls an average price of the preceding months and utilizes this in setting up his valuation. Whenever peak prices prevail, he takes advantage of these prices, as will be shown in this discussion.

I will now ask Mr. Fay to present the details.

STATEMENT (RESUMED) OF MR. A. H. FAY, CONSULTING ENGINEER FOR THE COMMITTEE

Mr. FAY. Mr. Chairman, I have listed here 10 or 12 leases in the Oklahoma field, wherein the taxpayer has actually used what he considered the average price of oil in the previous few months.

The CHAIRMAN. How many months?

Mr. FAY. He does not specify.

The CHAIRMAN. Has there been any check up on the part of the bureau to ascertain what months were taken?

Mr. FAY. No; not so far as this case was concerned, Mr. Chairman.

I have written one lease up here pretty much in detail, and then as to the rest of them I have simply added them more or less as exhibits, so that there would not be a repetition of the details. This first one covers two pages of detail, and I will give that.

The taxpayer, in making his claim for discovery, states ——

Mr. MANSON. You might state what this is.

Mr. FAY. This is the A. Focht lease, No. 682, well No. 5, Chandler, Battlesville sand, Cushing and Shamrock districts, Oklahoma.

The CHAIRMAN. Who was the lessee in that case?

Mr. MANSON. The Gypsy Oil Co.

Mr. FAY. The Gypsy Oil Co.

The CHAIRMAN. You did not state that, and I thought we ought to have it in.

Mr. FAY. Yes; the Gypsy Oil Co., a subsidiary of the Gulf Oil Co.

The taxpayer, in making his claim for discovery, states that the well was completed on June 30, 1916. The log record of this well, filed by the taxpayer, states that drilling commenced on May 19, 1916; that drilling was finished on August 4, 1916, and that the well began producing on August 4, 1916. Notwithstanding this, the date of discovery is placed as of June 30, 1916.

The CHAIRMAN. Will you state right there what is the date of discovery of an oil well?

Mr. FAY. I should say that is when it shows a production sufficient to be of commercial importance.

Mr. MANSON. Is not that so defined under the regulations?

Mr. FAY. The regulations define a discovery valuation as one that shows a disproportionate value as between cost and a value estimated on the basis of the production.

Mr. MANSON. So, until that is shown, there is no discovery within the meaning of the regulations?

Mr. FAY. There would not be; no.

The CHAIRMAN. I would like to ask Mr. Gregg, as he is familiar with the oil situation, what his interpretation is of when an oil well is discovered.

Mr. GREGG. I should say when oil is brought in in such quantities as to make its value as of that date materially disproportionate to its cost. I think the act makes that interpretation necessary. It describes the discovery of an oil well as increasing its value to such an extent that the discovery value is disproportionate to the cost. That is the date of discovery.

Mr. FAY. I think that is fairly well brought out in the regulations and in the case just cited.

Mr. MANSON. As I understand it, in this case the well began producing on August 4, yet the date of discovery is fixed as of June 30.

Mr. FAY. Yes.

Mr. MANSON. Go ahead.

Mr. FAY. The price of oil on June 30, 1916, was $1.55 per barrel. On July 30, $1.50 per barrel; on August 4, the date of first production, $1.15 per barrel; and on September 4, 30 days later, 90 cents

per barrel. In setting up this discovery valuation, as well as a number of others at about this time, the taxpayer explained why he uses what he calls the average price of oil as a basis for discovery valuation.

The CHAIRMAN. What was the price they used in arriving at the average?

Mr. FAY. $1.49.

Mr. GREGG. May I ask a question there so as to keep it straight as we go along?

The CHAIRMAN. Yes, Mr. Gregg.

Mr. GREGG. You say they used $1.49.

Mr. FAY. Wait a minute.

Mr. GREGG. I did not get the values as of the different dates.

Mr. FAY. The price of oil on June 30, 1916, was $1.55 per barrel; on July 30, $1.50 per barrel; on August 4, the date of first production, it was $1.15 per barrel, and on September 4, 30 days later, 90 cents per barrel. In setting up this discovery valuation, as well as a number of others at about this time, the taxpayer explains why he uses what he calls the average price of oil as a basis for discovery valuation, Exhibit 1. Apparently the only time that the taxpayer uses the average price of oil is when the price of oil is exceedingly low. Then the average price for a period of months is considerably above the market price. No cases have been found as yet where the taxpayer considered using the average price of oil when a discovery well came in at a peak price. He very carefully utilizes the peak prices when there is a possibility of a drop and he uses the average price of oil after the drop has occurred. In this way he secures the advantage of the peak prices for discovery valuations, but is not willing to accept the low prices for the same purpose. In order to be consistent, he should either use the average price for all valuations, or in the event that he uses the market price of oil for valuation purposes, he should use the market price as of that date and no other price.

Mr. MANSON. Let me interrupt you at this point. You refer here to what the taxpayer does. I believe you have already stated that in all of the Gulf Oil Co. valuations the taxpayer's figures were accepted by the bureau.

Mr. FAY. They were.

In the present case of Focht lease, well No. 5, Chandler, the average price for oil for six months prior to August 4, 1916, was $1.49½ per barrel, and for nine years previous to December, 1915, the price had ranged from 26 cents to $1.03, with only eight months in the nine years, when the price was $1 or more per barrel. For five months after the discovery, or until December 31, the price varied from 90 cents to $1.15 per barrel, which is above the average nine-year price. Beginning with January, 1917, the price was $1.62 and gradually increased until it reached $3.50 in December, 1920, and in March, 1921, it again dropped to $1.75. The taxpayer has used in this instance $1.50, which is approximately the average for six months and the actual quotation as of July 30, 1916. He has dated his discovery back to June 30, 1916, when, as a matter of fact, the well was completed and production began on August 4, 1916, at which time the price was $1.15.

Cost of discovery well: Another point to take into consideration in connection with this well is the matter of cost of the discovery well. The taxpayer considers that one more well will have to be drilled to

secure all of the oil from the 20 acres valued. This second well is deducted from the anticipated earnings, which is proper. However, the discovery well which should properly be paid for out of the proceeds of this well does not appear in the taxpayer's computations as a liability against the anticipated income. The value, however, of this well is included therein, and the well would go to a purchaser of the oil if one could be found at this price. Evidently this well has been charged to general development and operating expenses. (Art. 223. Regulations 45 and 62.) That being the case, there should be no further deductions for return of capital on this particular well. However, having deducted this from gross income as a general development and operating expense leaves a larger anticipated income from this particular well of approximately $16,200, the estimated cost of the second well. This amount, if not deducted, will be written off as depletion on this well, thus giving a double deduction, which is not permitted under the regulations.

Mr. GREGG. Mr. Chairman, may I ask a question at this point?

The CHAIRMAN. Yes, Mr. Gregg.

Mr. GREGG. I just want to get clear in my own mind as to whether the cost of this first well was deducted as an expense at the time the costs were incurred?

Mr. FAY. This has not as yet been deducted, and, as far as the discovery valuations are concerned, it shows that it has not been deducted.

Mr. MANSON. In other words, the cost of the discovery well was not deducted from anticipated profits for the purpose of arriving at the discovery value of the well.

Mr. FAY. It was not deducted.

Now, with reference to the royalty oil: The taxpayer's valuation calculations do not reveal whether he has taken into account the cost of pumping, piping, and storing the royalty oil. It is customary that all leases provide that the lessee shall produce and deliver to storage the oil due the royalty owner, or settle monthly on basis of pipe-line runs. In the case of the two wells under consideration, this would amount to 11,864 barrels. It will certainly cost the lessee as much to pump and store this oil as he considers it will cost for producing and storing his own oil, namely, 20 cents per barrel. It is possible that operating costs may be determined on such a basis that this item will be provided for. Unless this is done there should be an additional deduction from his anticipated gross income (11,864 barrels × 20 cents = $2,373) before the application of the discount factor to determine the present worth.

With reference to the discount rate, it is noted that the taxpayer had discounted his so-called net value at 4.15 per cent. It is difficult to understand how 4.15 per cent can even be considered as a composite 5 per cent discount factor unless it be that he considers no discount whatever for the first year's returns. The oil wells in the Bartlesville sand are fairly long-lived and ranging from 6 to 8 to possibly 16 years. Assuming that this well would produce for 13 years, with annual production based on the decline curve, as published in the Oil and Gas Manual, the application of the 5 per cent discount factor would give a composite for this period of 9.9 per cent, as compared with 4.15 per cent used by the taxpayer. This valuation could hardly induce a buyer to invest in the oil business when he can only

see 4.15 per cent for his money that would be returned over a period of about 13 years.

Mr. MANSON. That 4.15 per cent is the composite factor and not the annual factor?

Mr. FAY. It is not the annual factor.

Mr. MANSON. In other words, that would represent the gross return for the whole period?

Mr. FAY. It would.

The CHAIRMAN. What would the discount rate be other than the composite rate, then. It must be very much lower than 4.15 per cent; is not that correct? I am asking Mr. Manson that question.

Mr. MANSON. He states here that the composite rate is 4.15 per cent.

The CHAIRMAN. I assumed that, because, in looking over the last hearings that we had on the oil situation, I noticed that the composite rate in some of the cases that we had under consideration, was shown as 11 and a fraction per cent.

Mr. MANSON. Yes.

The CHAIRMAN. And I want to know if that composite rate of 11 and a fraction per cent was in relation to the 4.15 per cent in this case?

Mr. MANSON. It would represent the same thing. If they used 5 per cent as the annual discount factor, the only way you could get the 4.15 per cent would be to assume that the life of the well was less than one year.

Mr. FAY. I find, in looking over some of the later figures of the Gypsy Oil Co., they do not apply any discount whatever to the first year's returns.

Mr. MANSON. In other words, they assume that the first year's return is already recovered at the date of discovery?

Mr. FAY. Apparently.

Mr. MANSON. You may proceed, Mr. Fay.

Mr. FAY. I have here another lease, that of Eliza Lowe, lease No. 1382, well No. 3, Layton sand. (See Exhibit 3.)

The well was completed on April 22, 1915, when the market price of oil, according to the taxpayers' price chart, and substantiated by prices taken from the Oil and Gas Journal, was 40 cents per barrel. The taxpayer computes his valuation on the basis of $1 per barrel, assuming this to be the average and expected price of oil. In this case, the price of oil had not been as high as 80 cents for 13 months previous. From June, 1913, to April, 1914, the price had ranged from 83 cents to $1.03 per barrel. Following this was a period of 13 months to date of discovery when the prices ranged from 75 cents. to as low as 40 cents per barrel. Two months after discovery the price advanced somewhat, but did not actually reach 80 cents until practically six months after discovery. Here again, when price is low, the taxpayer has taken advantage of an anticipated average price of oil, when in other cases he uses the posted market price of oil at date of discovery. During the six months that elapse before the 80-cent price is reached he will recover approximately one-fourth of his ultimate reserves, and receive a depletion deduction such that there is no possibility of any operating profit.

Mr. Chairman, would you care to have me read their statement regarding the use of this, and why they have taken this price?

The CHAIRMAN. Yes.

Mr. FAY. I have it as an exhibit, but I can read it.

The CHAIRMAN. I think perhaps the bureau would like to hear it.

Mr. FAY. This is taken from the Gypsy Oil Co.'s valuation, depletion and depreciation schedules, Cushing and Shamrock districts, No. 1061:

Cushing-Shamrock district: The gross value of each of the leases enumerated below is the product of the number of barrels of recoverable oil, times the average price per barrel, which corresponds very closely with the price during the periods immediately preceding and following the Cushing boom. This price was used instead of the actual prices on the dates of valuation, because there was a sudden slump and quick recovery in price when the pool was first opened. A number of factors contributed to this decline, among them being the large amount of oil that was produced within a short time and the impossibility of building tanks and pipe lines rapidly enough to take care of all the new production. It was recognized that this decline in price was only temporary and that the general price trend was as indicated on the diagram, showing the range of prices, which is submitted with this volume. Confirmation of the belief that the drop in prices at the time the Cushing-Shamrock pool was being opened is seen in the rapid recovery to the price which prevailed before the opening of the district. The depression in price lasted only a few months, and it is probable that if it had not been necessary for business reasons, such as drilling offset wells in accordance with the provisions of the leases, the completion of the discovery wells would have been deferred until normal conditions, when the price would have been normal also.

In the cases of a number of discoveries made during the period of the so-called war slump in prices, during the latter part of 1916, a value somewhat above the price prevailing at the date of discovery has been used. This sharp decline was not due to a general lack of demand for oil, but to other conditions, which were recognized as temporary, and the price used in connection with these valuations is used for the same reason that the average price trend was used in valuing other Cushing-Shamrock leases.

This applies to half a dozen leases reported at this particular time for 1916, but from what I can find, they had used this same method back as early as 1914, and as late as 1918, covering a period of four years, showing typical examples of the practice during that four-year period.

Mr. MANSON. Mr. Fay, in that connection, while they anticipate a rise when the market is low, did you find any case where they anticipated a drop when the market was high?

Mr. FAY. No.

To continue with the Eliza Lowe lease, No. 1382, well No. 1, Bartlesville sand (Exhibits 3 and 4), discovery was claimed on September 9, 1914. The market price of oil at date of discovery, according to the taxpayer's books, was 75 cents per barrel. The price 30 days after discovery was 55 cents per barrel. The taxpayer again assumes that the price of oil will increase and that a reasonable average price of oil would be $1 per barrel, and on this basis he sets up his valuation. It is more than one year before the price reaches $1, and in the meantime the taxpayer has recovered approximately 50 per cent of this well's reserves and obtained an excessive depletion unit. The discovery claim was allowed as set up.

These two discoveries on the Eliza Lowe lease utilize the vagueness of the regulations regarding discovery on a second or third sand within a proven area. The Layton sand, upon which the first discovery was set up, is at a depth of 1,200 to 1,500 feet and has an average thickness of about 50 feet. The Bartlesville sand (second discovery) is from 2,500 to 2,700 feet deep and ranges in thickness from 50 to 200 feet.

I have here another lease, the J. A. Lapham lease No. 1060, well No. 6, Layton sand. (See Exhibit No. 5.)

The well was completed on October 17, 1916, and discovery valuation set up as of the same date. At date of discovery the price of oil was 90 cents per barrel. The price of oil 30 days after date of discovery, admitted by the taxpayer, was 90 cents per barrel. Here, again, the taxpayer, by reason of this low price, assumes that it can not last long and that $1.50 per barrel would be a reasonable basis for valuation of this discovery well, and discovery claim is made and allowed.

The CHAIRMAN. What was the actual price following the discovery in October, 1916?

Mr. FAY. For about two months the price remained at 90 cents, and then it stepped up by small amounts until January, 1917, when it got to $1.50. By the end of January it was $1 60 to $1.70.

The foregoing discussion is applicable to the following leases as regards the utilization of a price of oil for valuation that is higher than the market price:

Robert Posey, No. 625, Bixby Field. (Exhibit 6.)
Nellie Call, No. 627, Bixby Field. (Exhibit 7.)
Bernice Stevens, No. 553, Bald Hill Field. (Exhibit 8.)
D. D. Adams, No. 117, Okmulgee. (Exhibit 9.)
H. Starr, No. 1499, Bald Hill Field. (Exhibit 10.)
M. L. Chance, No. 708, Cushing. (Exhibit 11.)

A summary of all the leases listed herein is arranged as Exhibit No. 12, showing the value claimed by and allowed the taxpayer, depletion unit, price of oil, and, further, the approximate cost of the discovery wells which should be charged to income from these wells to determine the net value of the oil in the ground. As previously stated, the discovery costs have been taken care of under article 223, regulations 45 and 62, and at the same time are being depleted in each case above listed.

The value of the 12 discovery wells claimed by and allowed the taxpayers amounts to $256,056.15. The amount of excess valuation due to utilizing a price of oil higher than market which has been computed on the number of barrels and discounted according to the taxpayer's discount in each case, amounts to $100,656.05. This would then leave a net value of approximately $156,000. Taking from this amount the cost of 12 discovery wells, namely, $82,000, leaves only about $75,000 as the actual net worth of the oil in the ground. This net worth has resulted from the low discount factor applied to gross income by the taxpayer. Furthermore, 8 of the 12 wells show a negative value—in other words, a liability rather than an asset.

Out of 70 discovery valuations examined 29 have been based on a price in excess of posted price within the discovery period of 30 days.

The CHAIRMAN. In the case of that difference between 29 and 70, they used the market price, did they?

Mr. FAY. Yes.

The CHAIRMAN. As to that 70, was that in connection with all of the Gulf Oil Co. subsidiaries?

Mr. FAY. No; the Gypsy Oil Co.

The CHAIRMAN. The Gypsy Oil Co.?

Mr. FAY. Yes.

Mr. MANSON. I would like to offer as an exhibit the balance of this report of Mr. Fay, to be inserted in this record at this point.

(The exhibits referred to by Mr. Manson, comprising Mr. Fay's Exhibits Nos. 1 to 13, inclusive, are as follows:)

EXHIBIT No. 1

EXTRACT FROM GYPSY OIL CO., TULSA, OKLA., VALUATION, DEPLETION, AND DEPRECIATION SCHEDULES, CUSHING AND SHAMROCK DISTRICTS (GULF OIL CORPORATION)

CUSHING-SHAMROCK DISTRICT

The gross value of each of the leases enumerated below is the product of the number of barrels of recoverable oil times the average price per barrel, which corresponds very closely with the price during the periods immediately preceding and following the Cushing boom. This price was used instead of the actual prices on the dates of valuation, because there was a sudden slump and quick recovery in price when the pool was first opened. A number of factors contributed to this decline, among them being the large amount of oil that was produced within a short time and the impossibility of building tanks and pipe lines rapidly enough to take care of all the new production. It was recognized that this decline in price was only temporary and that the general price trend was as indicated on the diagram, showing the range of prices, which is submitted with this volume. Confirmation of the belief that the drop in prices at the time the Cushing-Shamrock pool was being opened is seen in the rapid recovery to the price which prevailed before the opening of the district. The depression in price lasted only a few months and it is probable that if it had not been necessary for business reasons, such as drilling offset wells in accordance with the provisions of the leases, the completion of the discovery wells would have been deferred until normal conditions, when the price would have been normal also.

In the cases of a number of discoveries made during the period of the so-called war slump, in prices, during the latter part of 1916, a value somewhat above the price prevailing at the date of discovery has been used. This sharp decline was not due to a general lack of demand for oil, but to other conditions, which were recognized as temporary, and the price used in connection with these valuations is used for the same reason that the average price trend was used in valuing other Cushing-Shamrock leases.

EXHIBIT No. 2

DISCOVERY VALUATION, SHAMROCK FIELD

A. Focht, lease No. 682, five discoveries:

No. 1, Chandler, Layton sand, completed November 19, 1915, proves 80 acres.

No. 1, A. Focht, Layton sand, completed December 23, 1915, proves 40 acres.

No. 2, Fields, Bartlesville sand, completed February 23, 1916, proves 115 acres.

No. 1, Selph Focht, Bartlesville sand, completed August 26, 1916, proves 28 acres.

WELL NO. 5, CHANDLER, BARTLESVILLE SAND, COMPLETED JUNE 30, 1916

No. 5 drains 10 acres and is estimated to produce 47,455, or an average of 4,746 per acre. As compared to the area drained by No. 5, the 45 acres proven will have a productivity as follows:

Twenty acres, estimated to produce 100 per cent, 94,910 barrels; 25 acres, not valued; total recoverable from this area, 94,910 barrels.

Gypsy's proportion, 83,046 barrels.

Value of oil July 30, 1916, $1.50 per barrel.

Gross value to Gypsy Oil Co		$124,569.00
Less development and operating costs:		
Future operating costs, at 20 cents	$16,609.20	
Cost of drilling one more well	8,200.00	
Cost of equipping one more well	8,000.00	
Total estimated expenditures		32,869.20
Net value		91,759.80
Less 4.15 per cent for discount		3,808.03
Present worth		87,951.77
Plus value casinghead gas, discounted, at 4.15 per cent		8,381.83
Total present worth to Gypsy Oil Co. on date of discovery, June 30, 1916		$96,333.60

(NOTE.—Value of casinghead gas applicable for depletion purposes as of July 1, 1917.)

WELL RECORD

1. Field, Shamrock.
2. Gypsy Oil Co.
3. Log or record of well No. 5.
4. Farm name, R. E. Chandler.
5. Description of property, NW. ¼ of NE. ¼.
6. Sec. 9, T. 16, R. 7.
7. Location of well, NE. corner of NW. ¼ of NE. ¼ of sec. 9, T. 16, R. 7.
8. Drilling commenced May, 1916.
9. Drilling finished August 14, 1916.
10. Oil well, initial production 350 barrels.

Date well began producing, August 4, 1916.

Price of oil: June 30, $1.55; August 4, $1.15; September 4, $0.90.

EXHIBIT No. 3

DISCOVERY VALUATION, CUSHING DISTRICT

Eliza Lowe, lease No. 1382.

Well data: Well No. 1; sand, Bartlesville; date completed, September 9, 1914; initial production, 496 barrels.

On page 3, under computation of value gives Gypsy Oil Co.'s value of oil 30 days after discovery, $1 per barrel.

On price chart in fore part of book, value of oil at discovery (as per taxpayer's actual price chart), $0.75 per barrel; given as 30 days after discovery, $0.55 per barrel.

EXHIBIT No. 4

DISCOVERY VALUATION, CUSHING DISTRICT

Eliza Lowe, lease No. 1382.

Well data: Well No. 3; sand, Layton; date completed, April 22, 1915; initial production, 80 barrels.

On page 4, under computation of value gives Gypsy Oil Co.'s value of oil 30 days after discovery, $1 per barrel.

On price chart in fore part of book, value of oil 30 days after discovery (as per taxpayer's actual price chart) given as $0.40 per barrel.

EXHIBIT No. 5

DISCOVERY VALUATION, CUSHING DISTRICT

J. B. Lapham, lease No. 1060.

Computation of value: Well No. 6, Layton sand discovery proves entire lease. Total recoverable well No. 6, 22,414 barrels. This well proves 10 acres, making the productivity of this area 2,241 barrels per acre. Of the balance of the

proven area, 10 acres are estimated to have a productivity of 60 per cent as compared to the area about the discovery well (10 x 2,214 x 0.60), 13,446 barrels. Balance of proven area worthless. Total recoverable from No. 6 proven area, 35,860 barrels.

Gypsy Oil Co.'s interest (one-half of seven-eighths), 15,688 barrels; value of oil 30 days after discovery, $1.50 per barrel.

Gross value to Gypsy Oil Co. of oil reserve in No. 6 proven area		$23,532.00
Less operating cost, at 23 cents per barrel	$3,608.24	
Cost drilling one more well (Gypsy's one-half estimated)	1,500.00	
Cost equipment same (Gypsy's one-half, estimated)	2,950.00	
		8,058.24
Net value		15,473.76
Less 3.31 per cent for discount		512.18
Present worth of Layton discovery No. 6, proven area as of date of discovery		$14,961.58

On price chart in forepart of book, value of oil 30 days after discovery (as per taxpayer's actual price chart) given as $0.90.

EXHIBIT No. 6

DISCOVERY VALUATION EIXBY DISTRICT

Robt. Posey: Lease No. 625.
Description: NW. ¼ of sec. 9, 17 N. 13 E.

COMPUTATION OF VALUE

Area proven by discovery well No. 1

Total recoverable well No. 1, 3,985 barrels. Balance of acreage outside that around well No. 1 worthless.

Gypsy Oil Co.'s interest (seven-eighths), 3,487 barrels.

Value of oil 30 days after discovery, $1 per barrel.

Gross value to Gypsy Oil Co. of oil reserve in No. 1 proven area		$3,487.00
Less operating cost, at $0.165 per barrel (no costs for further development)		575.36
Net value		2,911.64
Less 3.6060 per cent for discount		104.99
Present worth to Gypsy Oil Co., on date of discovery, Jan. 7, 1914		2,806.65

Area proven by discovery well No. 2

		Barrels
Total recoverable from well No. 2, date of completion to exhaustion		9,374
This well is estimated to drain 10 acres, so that the productivity per acre of the area would be 937 barrels.		
Of the area proven by this well, 10 acres are estimated to have a productivity of 50 per cent as compared to the area drained by the discovery well 10×937×0.50		4,687
Total recoverable from area proven by No. 2		14,061
Gypsy's interest in same (seven-eighths)		12,303

Value of oil 30 days after discovery, $1 per barrel.

Gross value to Gypsy Oil Co. of oil reserves in proven area		$12,303.00
Less operating cost, at $0.165 per barrel	$2,030.00	
Cost of one additional well (estimated)	1,650.00	
Cost of equipment for same (estimated)	1,750.00	
Total estimated expenditures		5,430.00
Net value to Gypsy Oil Co.		6,873.00
Less 3.6060 per cent for discount (1915)		247.84
Present worth to Gypsy Oil Co. on date of discovery, Apr. 27		6,625.16

Chart price January 7, 1914, $1.03 $1.05; April 27, 1915, $0.40.

EXHIBIT No. 7

DISCOVERY VALUATION, BIXBY DISTRICT

Nellie call: Lease No. 627.
Description: SW. ¼ of sec. 31, 17 N. 13 E.
Total acreage: 160.

COMPUTATION OF VALUE

Total recoverable from discovery well, 10,086 barrels. The balance of the acreage proven by this well is not valued, as it is estimated that it is worthless for oil.

Gypsy Oil Co. interest in total recoverable, (seven-eighths), 8,825 barrels.
Value of oil 30 days after date of discovery, $1 per barrel.

Gross value to Gypsy Oil Co. of proven area on date of discovery	$8, 825. 00
Less operating costs, at $0.165 per barrel	1, 456. 13
Net value	7, 368. 87
Less 3.6060 per cent discount	265. 72
Present worth to Gypsy Oil Co. on date of discovery	7, 103. 15

Price chart, $0.55.

EXHIBIT No. 8

OKMULGEE-MUSKOGEE DISTRICTS—DISCOVERY VALUATION

Bernice Stevens: Lease No. 553, Bald Hill District.
Description: N. ½ of SW. ¼ of sec. 10, Tp. 14 N., R. 14 E., Okmulgee County.

COMPUTATION OF VALUE

Discovery well No. 1—proven area—completed May 20, 1915.
Total recoverable from well No. 1, 9,627 barrels.
Well No. 1 is estimated to drain 8 acres; hence the recoverable oil per acre is 1,203 barrels. The balance of the acreage proven by well No. 1 has no value.
NOTE.—All of the NE. of SW., excepting an area 400 feet square surrounding well No. 1, was released on July 2, 1918.

Gypsy Oil Co.'s interest (one-half of seven-eighths), 4,212 barrels.
Value of oil 30 days after discovery, $1 per barrel.

Gross value to Gypsy Oil Co. 30 days after discovery	$4, 212. 00
Less operating costs, at $0.165 per barrel (no drilling or equipping costs and no further development)	678. 48
Net value	3, 533. 52
Less 11.4491 per cent for discount	404. 56
Present worth to Gypsy Oil Co. as of date of discovery	3, 128. 96

Discovery well No. 2 completed August 2, 1917. Total recoverable, 6,465 barrels. It is estimated that well No. 2 drains 8 acres; hence the recoverable oil per acre is 808 barrels. Eight acres are estimated to be 60 per cent as productive as the area drained by well No. 2; hence recoverable oil from these 8 acres is 3,879 barrels. The balance of the proven area has no value.
NOTE.—All of the NW. of SW., excepting the west 400 feet, was released on July 2, 1918.

Total recoverable from area proven by well No. 2, 10,344 barrels.
Gypsy Oil Co.'s interest (one-half of seven-eighths), 4,526 barrels.
Value of oil 30 days after discovery, $2 per barrel.

Gross value to Gypsy Oil Co. of oil recoverable from discovery area No. 2		$9,052.00
Less operating costs, at 33 cents per barrel	$1,493.58	
Our one-half of the expense of drilling one additional well	3,650.00	
Total cost of development and operating		5,143.58
Net value of No. 2 discovery area		3,908.42
Less 11.4491 per cent for discount		447.48
Present worth to Gypsy Oil Co. as of date of discovery		3,460.94

Chart price, $0.40, well No. 1; well No. 2, $2.

EXHIBIT No. 9

DISCOVERY VALUATION, YOUNGSTOWN DISTRICT

David Adams: Lease No. 117.
Description: N. ½ of N. ½ of NE. ¼ of sec. 26, Tp. 14 N., R. 11 E., Okmulgee County.
Total acreage: 40.
Well No. 1, discovery, proves 20 acres completed October 29, 1918.

COMPUTATION OF VALUE

Well No. 1 proves 20 acres.
Well No. 1 drains 10 acres and is estimated to produce 15,161 barrels, making productivity 1,516 barrels per acre.

	Barrels
10 acres, the area drained by well No. 1, will produce	15,161
10 acres, not valued, no further wells are contemplated	0
Total expected recovery from discovery area	15,161
Gypsy's part, seven-eighths	13,266

Value of oil Nov. 27, 1918, $2.50 per barrel: Gross value of Gypsy oil	$33,165.00
Less operating and development costs: Operating expense, at 51 cents per barrel	6,765.66
Net value of oil content to Gypsy Oil Co	26,399.34
Less 11.4491 per cent for discount	3,022.49
Present worth to Gypsy Oil Co. as of Oct. 28, 1918	23,376.85

Chart price, $2.25.

EXHIBIT No. 10

DISCOVERY VALUATION, BALD HILL DISTRICT

Henry Starr: Lease No. 1499.
Description: SW. of SE. of sec. 2, tp. 14 N., R. 11 E.

COMPUTATION OF VALUE

	Barrels
Recoverable from Well No. 1	13,307
Well No. 1 is estimayed to drain 10 acres; hence the recoverable oil per acre is 1,331 barrels. Of the remaining proven area 10 acres are estimated to be 75 per cent as productive as the area drained by well No. 1; hence recoverable oil from these 10 acres is	9,980
Total recoverable from proven area from discovery to exhaustion	23,287
Gypsy Oil Co.'s interest (one-half of seven-eighths)	10,188

Value of oil 30 days after discovery, $1 per barrel: Gross value to Gypsy Oil Co. of oil reserve	$10,188.00

Less operating cost, at $0.165 per barrel	$1,681.02
(No well cost; two wells drilled for one-half interest).	
Gypsy Oil Co.'s net value date of discovery	8,506.98
Less 11.4491 per cent for discount	973.97
Present worth to Gypsy Oil Co. as of	7,533.01

Chart price, $0.55.

EXHIBIT No. 11

DISCOVERY VALUATION, CUSHING DISTRICT

M. L. Chance: Lease No. 708.
Description: SW. ¼ of SW. ¼ and S. ½ of NW. ¼ of SW. ¼ of sec. 1, 17 N., 7 E.
Total acreage: 60.

COMPUTATION OF VALUE

	Barrels
Bartlesville discovery well No. 1: Total recoverable Well No. 1	22,500
The balance of the area proven by this well would be unprofitable to drill.	
Gypsy Oil Co.'s interest in total recoverable (one-fourth of seven-eighths)	4,922
Value of oil 30 days after discovery, $1.55 per barrel. Gross value of Gypsy Oil Co. of oil reserves in well No. 1	$7,639.10
Less operating cost, at 19 cents per barrel	935.18
Net value	6,693.92
Less 7.96 per cent for discount	532.84
Present worth to Gypsy Oil Co. as of date of discovery, Mar. 22, 1916	6,161.08

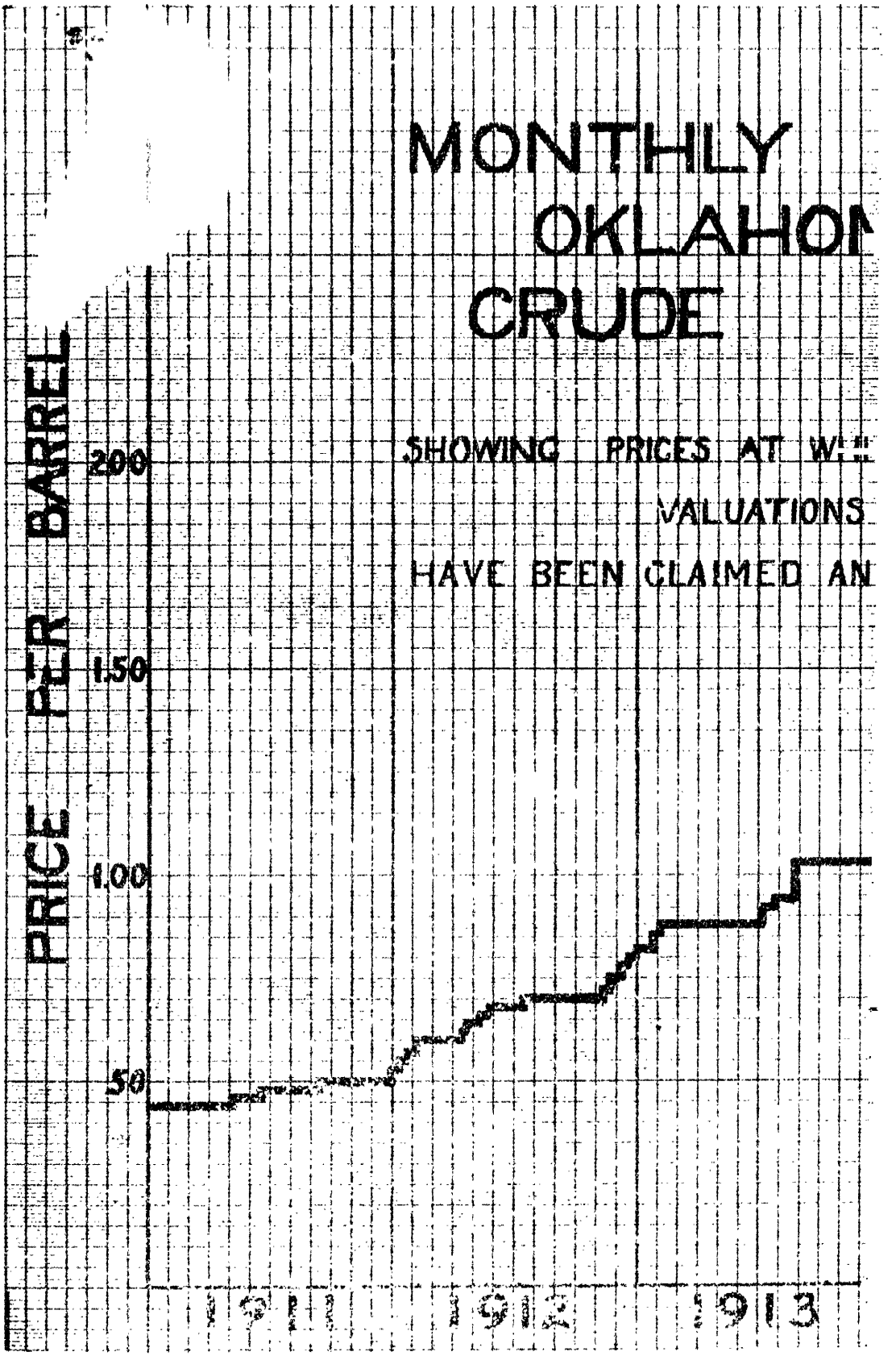
Example of use of peak price, $1.55.

EXHIBIT No. 12

Discovery values compared on prices as used by taxpayer and market price of oil at date of discovery

Lease	Discovery date	Reserves barrel	Price of oil		Depletion unit allowed	Composite discount based on 5 per cent	Discounted value	Excess due to price used	Cost of discovery well	Net value
			Used	Market						
A. Focht lease No. 682: Shamrock field, Oklahoma, well No. 5 (Bart sand)	Aug. 4, 1916	83,046	$1.50	$1.15	$1.160	4.15	$80,333.60	$27,901.36	$[illegible]	$2,272.24
Eliza Lowe lease No. 1382: Cushing field, Oklahoma—										
Well No. 1 (Bart sand)	Sept. 9, 1914	107,069	1.00	.55	.616	7.96	65,995.08	34,580.29	8,850.00	22,724.79
Well No. 3 (Layton sand)	Apr. 22, 1915	23,002	1.00	.10	.807	3.31	18,570.93	13,344.38	6,000.00	—773.45
Lapham lease No. 1060: Cushing field, Oklahoma, well No. 6	Oct. 17, 1915	15,688	1.50	.90	.933	3.31	14,961.68	9,101.24	4,470.00	1,440.44
Robt. Posey lease No. 625: Bixby field, Oklahoma—										
Well No. 1	Jan. 7, 1914	3,487	1.00	1.00	.804	3.606	2,808.65	.....	4,400.00	—1,591.35
Well No. 2	Apr. 29, 1915	12,303	1.00	.40	.538	3.606	6,625.16	2,655.45	4,400.00	—449.29
Nellie Coll lease No. 627: Bixby field, Oklahoma, well No. 1	Feb. 2, 1915	8,825	1.00	.55	.804	3.606	7,103.15	3,828.97	4,400.00	—1,125.82
Bertrice Stevens lease No. 553: Bald Hill, Oklahoma—										
Well No. 1	May 20, 1915	4,215	1.00	.40	.742	11.449	3,128.96	2,237.86	3,650.00	—2,758.90
Well No. 2	Aug. 2, 1917	4,526	2.00	2.00	.764	11.449	3,460.00	.....	3,650.00	—208.00
D. Adams lease No. 117: Okmulgee, Oklahoma, well No. 1	Oct. 28, 1918	13,266	2.50	2.25	1.762	11.449	23,376.85	2,936.79	10,000.00	10,440.06
H. Starr lease No. 1496: Bald Hill, Oklahoma, well No. 1	Dec. 1, 1914	10,188	1.00	.55	.739	11.449	7,533.01	4,059.71	7,000.00	—2,525.99
M. L. Chance lease No. 708, Cushing, Oklahoma, well No. 1	Mar. 22, 1916 / Apr. 4, 1916	4,922	1.55	1.55	1.251	7.96	6,161.08	.....	9,000.00	—2,838.92
Total							256,056.15	100,656.65	$82,000.00	.....

NOTE.—Referring to M. L. Chance lease No. 708, Cushing, Okla., the discovery well, according to the record submitted by the taxpayer was completed and began producing Apr. 10, 1916. Yet discovery value is set up as Mar. 22, 1916. It can not be determined whether this is an error in dates or whether there was some particular reason for using the Mar. 22, 1916, date. Further, in all of the above examples the taxpayer has used what he considered an average or anticipated price of oil, which in every case was considerably above the market price at date of discovery. In this case the price of oil was $1.55 per barrel, the highest it had ever been in the midcontinent since production first became of importance in 1907. He did not anticipate that the price might drop, which it did in August and reached 90¢ per barrel in September, October, and November. He therefore took full advantage of the highest possible market price at date of discovery, while in the other cases, when the price of oil was low, he took advantage of the highest possible price that might be expected to follow soon after the date of discovery.


MONTHLY
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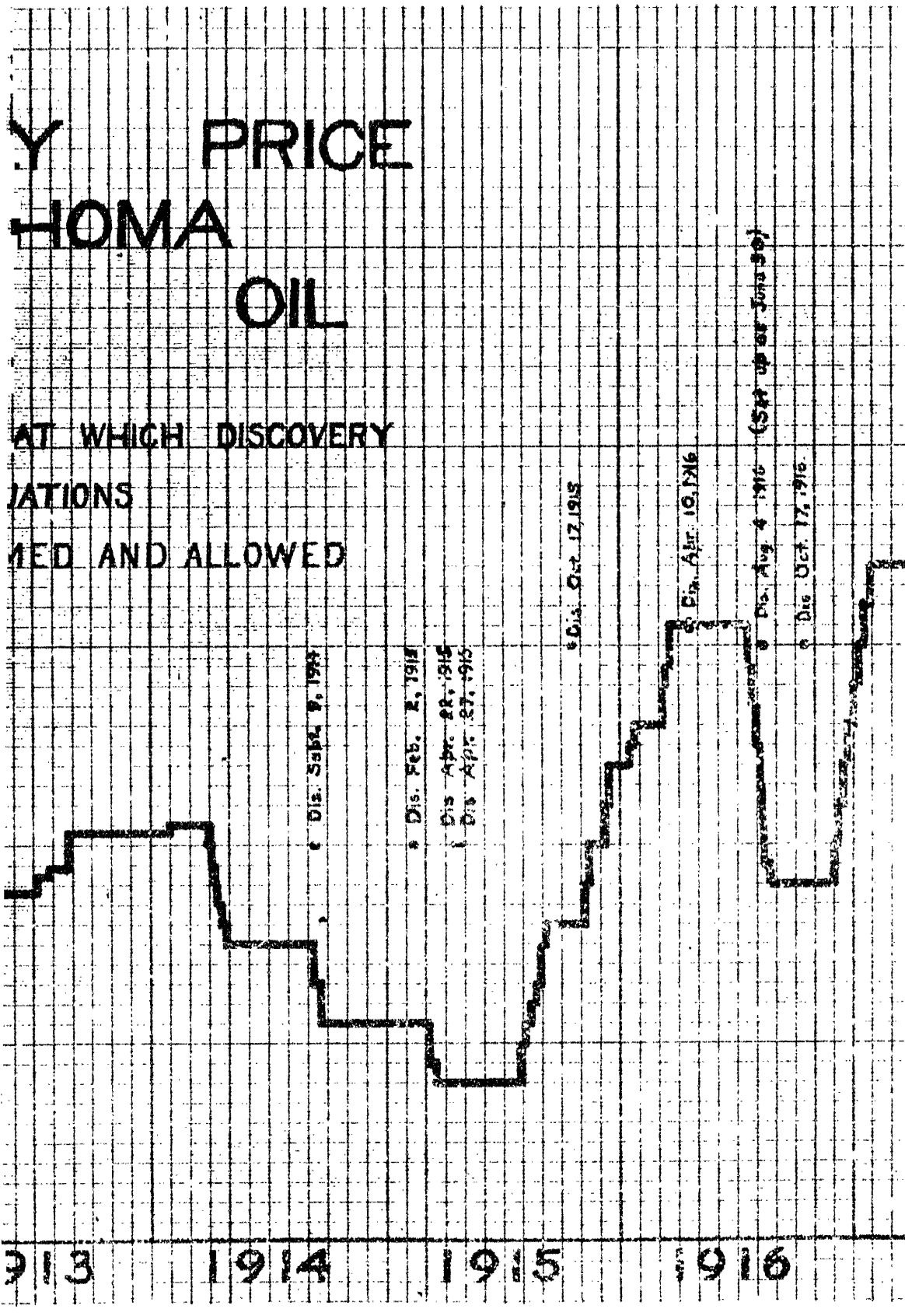
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Dis. Feb. 2, 1914
Dis Apr. 28, 1914
Dis Apr. 23, 1915
Dis. Oct. 12, 1915
Dis. Apr. 10, 1916
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Dis. Oct. 17, 1916
1913
1914
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Mr. MANSON. Mr. Fay, you have made some further investigations of these valuations of the Gypsy Oil Co., have you not?

Mr. FAY. Yes.

There is the Shumway lease of the Gypsy Oil Co. in southern Kansas, wherein they have utilized on the thirty-first day, an advance of 20 cents per barrel. The taxpayer has taken the posted price on the first day after the 30th and applied it back to the date of discovery.

The CHAIRMAN. Have you reduced that to net results?

Mr. FAY. I have.

The CHAIRMAN. What are the net results as they have been doing it?

Mr. FAY. On these particular 40 acres, it makes $1,000,000 difference in valuation.

The CHAIRMAN. Does that statement mean that they were given a depletion credit of $1,000,000?

Mr. FAY. On, yes; on that basis alone.

The CHAIRMAN. I see.

Mr. FAY. The discovery well No. 1, Gypsy, came in on July 15, 1917, and discovery valuation was set up as of August 14, 1917, 30 days after discovery.

I might say right here that the oil and gas section properly allowed the lessor discovery value as of August 14, 1917.

The CHAIRMAN. That was within the 30 day period.

Mr. FAY. That was at the end of the 30-day period, so that it came within that period, while the Gypsy Oil Co. got the thirty-first day valuation.

Mr. MANSON. In other words, the lessor's valuation came within the 30 days.

Mr. FAY. Yes.

Mr. MANSON. And the lessee's valuation came outside of it on the same well?

Mr. FAY. It did.

The market price of oil for six months preceding August 14, 1917, had been $1.70 per barrel, the highest on record for the mid-continent field. The taxpayer has in previous cases, as heretofore cited, when prices were extremely low, taken what he considered the average price or the expected price of oil. In this particular case he does not take the average price nor the ruling price, but takes $1.90 per barrel, which was the posted price one day after the 30-day limit. The price of oil did advance 20 cents per barrel on August 15, 1917, the thirty-first day after the discovery well came in. The taxpayer has taken advantage of this anticipated rise and increased the valuation of his lease to the extent of 20 cents per barrel on reserves estimated as 5,339,014 barrels——

The CHAIRMAN. You use the words "anticipated rise." It was an actual rise, was it not, instead of an anticipated rise.

Mr. FAY. They assumed that within the 30 days it will rise.

The CHAIRMAN. Yes; but I mean they took the actual figures on the thirty-first day, and it was not an anticipated rise.

Mr. FAY. Yes; that would be correct. Evidently, the Gypsy Co. knew the day before what the price would be.

The CHAIRMAN. Well, that was not necessary.

Mr. FAY. No; that was not necessary.

The CHAIRMAN. Because they did not really file their claim until after that time.

Mr. FAY. Three years later.

The CHAIRMAN. Yes.

Mr. FAY. The taxpayer has taken advantage of this actual rise and increased the valuation of his lease to the extent of 20 cents a barrel on reserves estimated at 5,339,014 barrels, allowing for the taxpayers insignificant discount to determine present worth the net excess valuation of 40 acres by reason of this 20-cent margin in price amounts to $1,064,023.

The depletion unit obtained on this valuation of $8,161,398.13 for 5,339,014 barrels of oil is $1.528 per barrel. The operating costs are given as 32 cents per barrel and development costs at 4.6 cents per barrel, or a total, including depletion, of $1.891 per barrel, before any possibility of taxable profit on oil selling at $1.70 per barrel. The average price of oil during the first six months following discovery was $1.925 per barrel. During the 12 months following, the average price of oil was $2.033 per barrel. During this period of one year, the company anticipated that 95.4 per cent of the oil would be recovered. This, then, would leave a maximum taxable income of $2.033 minus $1.894 or 13.9 cents per barrel for oil that actually costs 36.6 cents per barrel.

Mr. MANSON. In other words, the cost of handling the oil exceeded what they estimated the net would be?

Mr. FAY. Yes.

The CHAIRMAN. Does anybody here know when that case was closed in the bureau?

Mr. FAY. I think I know, sir. This was in connection with the Gulf Oil Corporation, as I understand it, and the depletion units allowed went to the Gulf Oil Corporation before Secretary Mellon became Secretary of the Treasury.

THE CHAIRMAN. In other words, it was closed along in February of 1921, if I remember correctly?

Mr. FAY. In 1921.

Mr. MANSON. Depletion is now being allowed on these values here, is it not?

Mr. FAY. Yes; I presume so, unless there has been some change.

The CHAIRMAN. You have not looked it up?

Mr. FAY. I have not looked into it any further.

The CHAIRMAN. I would suggest that Mr. Manson or his engineers look into it and see if these valuations are still continuing.

Mr. FAY. But, so far as this particular well is concerned, there is not much more there. This one is about gone.

However, since this well came in at enormous production, and 95 per cent of it is anticipated as returnable during the first year, 75 per cent of the 95 per cent will be returnable during the first six months of the year, so that the major portion of the oil would actually go on the market or into storage at $1.925 per barrel. It will be seen that the depletion unit, as determined by the taxpayer and allowed by the oil and gas section of the Income Tax Unit represents approximately 90 per cent of the market price of oil at the date of discovery or 30 days thereafter.

Now, Mr. Chairman, I have some notes here on the sales of some leases on this same oil pool or oil dome that can go in as a part of the testimony, or would you like to have me read it?

Mr. MANSON. No; I wish you would read that into the record.

Mr. FAY. I will give a little history of it. This relates to the valuation in the Eldorado Pool, Kansas.

Oil was discovered in June, 1914, in the Augusta district, Butler County, Kans. This district included townships 27, 28, and 29, range 4 east, and is directly north and adjoining township 26, range 4, in which the lease in question is situated.

Mr. MANSON. When you say "the lease in question" do you mean the one that you have just discussed?

Mr. FAY. Yes; as in the record.

Mr. MANSON. Go ahead.

Mr. FAY. You might mark this as Shumway lease, section 11, township 26, range 4 east.

The Eldorado pool was adjacent to the Augusta pool and was opened in 1915. The experience of these pools showed that the larger portion of the production came from sands about 2,500 feet deep, with a thickness of approximately 30 feet.

The oil and gas manual, Treasury Department, 1921, states that, "Water has been a great menace in this district, and an economic limit of 300 barrels per well per year was taken because wells are frequently abandoned at this point on account of water which must be pumped out with the oil."

The extension to the Eldorado district wherein the Gypsy lease is situated, has five producing sands. The principal producing sand, however, is at 2,400 feet.

In connection with the Gypsy lease on the Shumway farm, NE. S. 11-26-4 E. Butler County, Kans., it may be stated that the extension of the Eldorado pool upon which this lease is located was discovered by the Alpine Oil Co., March, 1917. When the Alpine well came in it extended the Eldorado pool 3 miles west, so that at that date it could be considered an absolutely new oil pool. Shortly after this another well was brought in by the Southwestern Oil Co. about 2 miles east of the Alpine well on section 12-26-4 adjoining section 11 in which Gypsy Oil lease is located. The Carter Oil Co. also brought in a well within a mile or so of the Alpine discovery well.

Prior to this it was recognized as noted in the Oil and Gas Journal that "there was an ideal structure in Tonawanda Township that was cited by prominent geologists." It is also true that four or five dry wells had been drilled on this structure. With the discovery of oil in March, 1917, by the Alpine Oil Co., at a depth of 2,391 feet, a renewed interest in this structure was taken and an active drilling campaign begun. Under date of March 22, 1917, the Oil and Gas Journal states, "leasing is still active and fancy prices are being asked and paid."

Among the properties that were transferred at this time may be mentioned the following:

Three 40-acre leases sold for $24,000, the Prairie Oil & Gas Co. being a purchaser of one of them.

J. B. Vickers paid $350 per acre for an 80-acre lease in section 35-26-5.

C. B. Dillenbeck sold an undivided one-half interest in a 40-acre tract in the east half of the east half, northeast quarter section 4-26-5.

on which the National Refining Co. had three producing wells. This property was sold to Wallingford and Hoffman for $30,000.

One of the largest deals consummated in the Eldorado pool for some months was closed on Wednesday when the Trapshooter Oil & Gas Co. sold one-half interest in its lease on W. D. Williams' farm, the west half of the northwest quarter of section 11-26-4, Tonawanda Township—

One-quarter of a mile west of the Gypsy—

to the Eureka Oil & Gas Co. for a consideration of $150,000. S. H. Hale, of Kansas City, and W. F. Knox, of Eldorado, are interested with the purchaser (Oil and Gas Journal, March 29, 1917.)

The CHAIRMAN. Let me ask you right there whether you are referring to those wells or leases for the purpose of showing a comparison between the value of the lease and the price allowed for depletion on this particular Gypsy Oil well?

Mr. FAY. I am putting this in to show what oil people considered proven oil land as worth at that time, and it can be used as a comparison between what these were selling for and what the Gypsy set up as discovery valuation.

The CHAIRMAN. I understand that, but is it a correct interpretation of your statement to say that these leases had been changing hands at about this time for from $30,000 to $100,000, and in one case, I think $150,000, as a comparison with this $1,000,000 plus allowed for the Gypsy Oil lease?

Mr. FAY. $8,000,000 plus, Mr. Senator.

The CHAIRMAN. Maybe I am confused here. I understood you arrived at a depletion credit of $1,000,000.

Mr. FAY. The $1,000,000 that you have reference to was a depletion credit allowed on the basis of excess price of 20 cents per barrel.

The CHAIRMAN. Oh, yes; I see it now. Then, the use of this formula, system, or whatever you call it, for arriving at values, was greatly in excess of what actually leases were sold for at that particular time?

Mr. FAY. It is; and I also have the record of one Gypsy transaction which occurred 13 days before this well came in, which I shall read into the record.

The CHAIRMAN. All right.

Mr. FAY. The Trapshooter lease above referred to was one-quarter of a mile west of the Gypsy lease and in the same section. Early in May, 1917, the Trapshooter Oil Co. struck gas on this lease at 1,325 feet. About the first of June—prior to June 7—this company brought in a 15,000-barrel well, one-quarter of a mile west of the Gypsy lease. One-quarter of a mile farther west in the east edge of section 10 the Carter Oil Co. about June 1, brought in a 1,800-barrel well.

On June 17, approximately three weeks after the Trapshooter Co. had brought in its 15,000-barrel well, the Gypsy Co. began drilling well No. 1 in the southwest corner of its lease, with only 40 acres (a quarter of a mile) between it and the Trapshooter big well. With this big well on the Trapshooter lease, as a matter of self-preservation, it was to the interest of the Gypsy Co. to drill this well. It may not, in the true meaning of the term be technically an offset well, yet, in order to prevent the possibility of losing a known oil reserve, it was necessary to drill. The No. 1 well, therefore, was not to exceed 400 feet outside of the discovery area surrounding the

Trapshooter well, and 500 to 800 feet within the Carter discovery area. It is on this No. 1, 5,000-barrel well that the Gypsy Co. sets up a value in excess of $8,000,000 for only 40 acres. I have also found a case in which the Carter Co. had brought in another well still closer to the Gypsy, so that when the Gypsy well came in it was about 400 feet inside of the proven territory as developed by the Carter Oil Co.

The CHAIRMAN. Was this well of the Carter Oil Co. drilled after this Gypsy well, or was it before that?

Mr. FAY. The Carter well came in before the Gypsy did.

The CHAIRMAN. So that when the Gypsy well came in ——

Mr. FAY. When the Gypsy well came in, it was drilled on the Carter proven territory, that is, the Carter extension or 160 acre limit overlapped into the Gypsy lease, but the Gypsy people were perfectly within their rights, so far as the regulations were concerned, to drill within that territory.

The CHAIRMAN. The criticism, then, is directed at the regulations and not at the claim of the oil company?

Mr. FAY. It is directed at the regulations, and not so much at the claim of the taxpayer.

This is an ideal case showing how it is possible for anyone with a little capital to acquire leases on favorable ground, and then withhold drilling operations until someone else has proven the territory as oil bearing. There is no question as to the Gypsy Co.'s rights of discovery under the regulations as written, only it does go to show the absurdity of allowing discovery valuations on ground that is absolutely proven.

Now, as to the estimation of the reserves, on this particular discovery, the taxpayer has been exceedingly liberal in his calculations as at date of discovery, July 15, 1917, although the after results obtained check fairly well with the estimate. No other well had been drilled within the 30-day period after bringing in well No. 1.

Under date of July 9, 1920, the company's engineer addressed a letter to the Commissioner, stating that he was preparing a valuation of the producing properties of the Gulf Oil Corporation and computing the unit values for depletion.

It must, therefore, be remembered, that the taxpayer's valuations as submitted in Form O to the department were compiled and prepared three years after the discovery well came in, so that, with this information at hand, it would be very easy to go back to 1917 and anticipate what might be done. With the actual data of three years production in hand it would undoubtedly be difficult to be unbiased in making forecasts when such large sums are involved.

He estimates as of date of discovery that there will be nine more wells on this 40 acres that will each produce 75 per cent of what the discovery well produced, that is 75 per cent of 5,000 barrels, or 3,750 barrels each. Nine wells were drilled, and actually averaged 3,850 barrels each.

The CHAIRMAN. When they made that claim, they knew that that was the result?

Mr. FAY. They knew the result.

The CHAIRMAN. Yes.

Mr. FAY. That is why I am bringing this out.

Mr. CHAIRMAN. Yes.

Mr. FAY. This is such a very close estimate that the basis for it may properly be questioned, considering that this was made more than three years after discovery, when, according to taxpayer's estimate, more than 98 per cent of the ultimate reserves would be recovered; and they were recovered.

Article 206 (A), regulations 45 and 62, provide:

(a) Where the fair market value of the property at a specified date in lieu of the costs thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the commissioner, by the owner of the property in the light of conditions and circumstances known at that date, regardless of later discoveries or developments in the property, or subsequent improvements in methods of extraction and treatment of the oil and gas product. The value sought should be that established, assuming a transfer between a willing seller and a willing buyer as of that particular date.

KNOWN FACTORS

These are some of the known factors that they should have considered in making their valuation.

The specific gravity of the oil is from 34–37° Baumé which compared favorably with that of the Augusta district at 33° Baume. Water was considered a serious menace in parts of the Eldorado field, as early as 1915.

The well records of the August district indicate a life of about eight years while those of the original Eldorado in 1915, indicate a life of approximately 11 years. The taxpayer with these and other records before him at date of discovery has estimated the life of the wells in the Eldorado extension as only four years, with approximately 95 per cent of the oil being recoverable during the first year. The well which the taxpayer has used as a set-up for discovery value is an exceptional well, having an initial production of 5,000 barrels per day. The records of wells in Butler County, however, show that in 1914 the initial production of wells was 9.4 barrels per day. In 1915, 15.1 barrels per day; 1916, 255.8 barrels per day; 1917, 290.6 barrels per day. These records also show that 15 per cent of the total number of wells drilled in this county were dry, 5 per cent gas, and 80 per cent produced oil. These figures are based on United States Geological Survey records of 5,098 drilled in Butler County during the years 1914 to 1920, inclusive.

This well being so much above the average could not properly be considered as a representative well in face of the records of wells drilled in previous years in Butler County, notwithstanding the 15,000-barrel Trapshooter well that came in six weeks earlier. As a basis for valuation as between a willing seller and a willing buyer, no one would have considered nine additional wells at 75 per cent of the production of No. 1. No consideration was given to actual sales as a basis for valuation; the possibility of influx of water as pointed out as common knowledge prior to this date; nor is any allowance made for dry holes, of which the county as a whole has 15 per cent.

Mr. MANSON. As I understand it, your point is, Mr. Fay, that any person buying this well as of date of discovery or within 30 days thereafter, would have considered the known conditions which had existed up to that time, and he would not have had the advantage of valuations with relation to the developments, and that article 206

of the regulations requires the valuation to be made in the light of known conditions as of date of discovery, and requires the ignoring of later developments.

Mr. FAY. That is correct.

Mr. GREGG. Mr. Chairman, may I ask a question there?

The CHAIRMAN. All right, Mr. Gregg.

Mr. GREGG. Are there any definite facts which were not disclosed until after the date of the discovery which you know were taken into consideration in the valuation as of date of discovery?

Mr. FAY. None of them were taken into consideration here.

Mr. GREGG. You did not understand my question. Are there any facts which were not disclosed until after the discovery date, which you know, as a definite matter, were taken into consideration in the valuation as of date of discovery? That is along the same line as Mr. Manson's question.

Mr. FAY. Let me get that straight.

The CHAIRMAN. That is perfectly plain to me. In looking over these records, did you find any known values as of date of discovery having been used by the bureau in fixing the rates?

Mr. FAY. I did not, if that is the question.

Mr. GREGG. I am not sure that Mr. Fay understands me yet. Mr. Manson brought out that the regulation says that no facts disclosed after the date of discovery should be taken into consideration in setting a value as of date of discovery. Now, do you know, as a fact, that anything which was not disclosed until after the date of discovery was taken into consideration in setting the value of this well as of date of discovery?

Mr. MANSON. He has just set out a lot of them there.

The CHAIRMAN. No; he has stated things that were not taken into consideration.

Mr. FAY. The only thing that I can find that they took into consideration was their known production up to the end of 1920.

Mr. GREGG. Then, they did not take into consideration in setting the value as of date of discovery, and facts which were not disclosed until after the date of discovery?

Mr. FAY. I find no record of it.

Mr. GREGG. That is what I want to know.

Mr. MANSON. Let us clear that up.

If they had made their estimate of the recoverable reserves based upon information which was confined to the discovery, could they have justified any such estimate of recoverable reserves as they did make here, and which was justified by the subsequent production of these wells?

Mr. FAY. They could not have done it.

The CHAIRMAN. That does not clear it up. I would like to ask Mr. Manson whether they did use, in computing this valuation, any factors that were known at the date of discovery?

Mr. MANSON. That were not known at the date of discovery?

The CHAIRMAN. Oh, no; that were known at the date of discovery, and which they used in computing this value—any known factors that were used at the date of discovery?

Mr. FAY. The only known factor that I find they used was this one well, they used the 5,000 barrels, and then set it up as the average well.

The CHAIRMAN. That was as of date of discovery?

Mr. FAY. As of date of discovery. It was set up as the average well, while the previous record shows that it was not an average well.

The CHAIRMAN. I think that answers Mr. Gregg's question.

Mr. GREGG. Yes, sir.

The CHAIRMAN. The chairman understands it.

Mr. FAY. The taxpayer's records show that no dry holes were drilled, nor is there any mention of water. If these did not appear, it was simply a case of good luck for the company. The set-up is so true to actual conditions as to productivity that it has the appearance of being based on facts after discovery instead of facts and estimates as of date of discovery.

The CHAIRMAN. I think that is conclusive, Mr. Gregg. We must all agree to that.

Mr. GREGG. It has the appearance of being. I was just curious as to whether there were any definite, known facts taken into consideration.

Mr. FAY. I can find none.

Now, on this entire lease, six wells came in with an average initial daily production of 7,800 barrels, while 38 wells averaged 640 barrels per day. It must be granted that this was a most exceptional lease as to productivity.

Mr. GREGG. May I ask there whether the geological formation, if I am using proper terms, on this particular lease, was identical with that on the other leases on the other properties, that you have been comparing it with?

Mr. FAY. This is separate.

COMPUTATION OF VALUE (COPIED FROM TAXPAYER'S RETURN)

AREA PROVEN BY DISCOVERY WELL NO. 1, SOUTHWEST 10 ACRES

		Barrels
Total recoverable from well No. 1		787, 320
This well is estimated to drain 4 acres, making the productivity of this area 196,830 barrels per acre.		
The remaining 36 acres of this proven area is estimated to have a productivity of 75 per cent as compared to the area drained by well No. 1—36×196,830×.75		5, 314, 410
Total recoverable from No. 1 proven area		6, 101, 730
Gypsy Oil Co.'s interest seven-eighths		5, 339, 014
Value of oil 30 days after discovery, $1.90 per barrel.		
Gross value to Gypsy Oil Co. of oil reserve in No. 1 proven area		$10, 144, 126. 60
Less operating cost, $0.32 per barrel	$1, 708, 484. 48	
Cost drilling 9 additional wells at $8,750 per well, estimated	78, 750. 00	
Cost equipment for same at $18,500 per well, estimated	166, 500. 00	
		[1] 1, 953, 734. 48
Net value of No. 1 proven area		8, 190, 392. 12
Less 0.354 per cent per discount		28. 993. 99
Present worth to Gypsy Oil Co. on date of discovery, July 16, 1917		8. 161, 398. 13

[1] Total estimated expenditures

Mr. GREGG. It would not sound as if it were.

Mr. FAY. This is a separate and apparently distinct oil pool. The geological conditions indicated that the pool was there. The depth was the same as the other pools, and the gravity of the oil was the same.

Mr. GREGG. I want to get clear on that. Do you mean that the Gypsy pool was a separate pool from the adjoining pools which you have been comparing it with?

Mr. FAY. Oh, no.

Mr. GREGG. It is not different from the adjoining pools?

Mr. FAY. I had reference to the Augusta, which is undoubtedly a different pool. It is about four or five miles farther north.

Mr. GREGG. What I was trying to get at was some explanation of why there were no dry holes brought on this particular lease, and why the production on this particular lease was much higher than it had been in the rest of the field.

Mr. FAY. I might say this, that prior to the Gypsy Company drilling this well, they did drill five dry holes on this particular geological structure. That is a matter of record.

Mr. GREGG. But not on this lease.

Mr. FAY. Not on this particular lease, but on this particular structure, on property within a half a mile of it. That is all a matter of record in the Oil and Gas Journal, in summaries.

Now, as a further comment on what the Gypsy Oil Company considered proven ground to be worth as of that date, I have here a transaction of the Gypsy Oil Company in connection with a proven piece of ground a quarter of a mile from this well.

In order to show what the Gypsy Co., considered proven ground worth on July 2, 1917, in the same section in which the Shumway lease is situated, the following may be of interest.

On June 30, 1917, the Gypsy Co., purchased from the Gladys Bell Oil Co., a one-fourth interest in its leasehold for $175,000, and on July 2 a second one-fourth interest was assigned by Walker to the Gypsy Co., for $165,000, a total consideration of $340,000, including $15,090 for equipment. This gave the Gypsy Co., a one-half working interest in the 80-acre Dempsy lease. Of the total amount paid, $215,000 was in cash and $125,000 paid out of the first 60 per cent of oil produced. The company was partially protected, in that had there not been sufficient oil, it would not have had to pay all of that $125,000.

Mr. GREGG. May I interrupt there, and I am not trying to prove anything by these questions, but I just want to get the facts.

You are comparing this sale, which occurred at approximately the same time, with a lease a quarter of a mile from the lease, the value of which is now in question?

Mr. FAY. Yes.

Mr. GREGG. Were there any producing wells at the time of this purchase?

Mr. FAY. If you will just wait a minute, I will give you the whole history of it.

Mr. GREGG. All right, sir.

Mr. FAY. At the time the Gypsy Company purchased this property, it was surrounded by wells, all of whose proven area more or less overlapped a portion of this 80 acres. On the west, the Alpine Well was brought in on March 22, 1917, with an initial production

of 250 barrels; in May, 1917, the Trapshooter Well No. 2, across the north line of the Dempsy lease, with 15,000 barrels initial production.

Mr. GREGG. With what?

Mr. FAY. Fifteen thousand barrels initial production, just 300 feet over the line; on May 21, the Carter well No. 1, Orban lease, cornering the Dempsy lease on the northeast, at 895 barrels, and on June 10 the Carter Co., brought in a well on the Davis lease on the east at 4,800 barrels initial production.

The proven area of each of these wells overlapped the north portion of the lease to the extent of approximately 45 acres, which, in accordance with the regulations, is proven ground, and which the taxpayer admits in his purchase of this property. In addition to being surrounded by wells, well No. 1 on this lease was drilled by Gladys Bell Oil Co., and completed June 21, with an initial production of 160 barrels.

Mr. GREGG. Was that before the purchase by the Gypsy Co.?

Mr. FAY. Yes; and well No. 2, June 11, with an initial production of 2,250 barrels. With these productive wells on the lease and the lease surrounded by extraordinarily large wells, the taxpayer has paid the price abovementioned, namely, $340,000, for a one-half working interest in this property. This amounts to $4,250 per acre for a one-half interest, making the total working interest of $8,500 per acre. In the taxpayer's discovery valuation of well No. 1, Shumway, he sets up a value of over $200,000 per acre on the basis of a well that came in thirteen days later.

The discovery value set up by Carter for Well No. 1, Orban, was $23,719 per acre. Value set up per acre for a one-half working interest on Davis well No. 2, June 10, was $15,934, while a one-half interest on Well No. 5, Davis lease, as of August 25, 1917, was $21,801, all of which goes to show that as between a willing buyer and a willing seller, as of discovery date, $200,000 per acre is very much out of line.

Discovery valuation of Carter and Gypsy companies compared

Lessor	Carter Oil Co.			Gypsy Oil Co.		
	May 21, 1917, Orban	June 10, 1917, Davis [1]	Aug. 27, 1917, Davis [1]	Aug. 14, 1917, Shumway	Oct. 16, 1917, Shumway	Nov. 3, 1917, Shumway
Cost of drilling and equipping, per well	$25,000.00	$27,000.00	$27,000.00	$27,250.00	$25,000.00	$23,500.00
Depth of well, feet	2,415	2,386	2,397	2,330	2,350	2,387
Operating cost per barrel, cents	40	40	50	32	37	37
Productivity of future wells, per cent	50	50	50	75	60	60
Price of oil used	$1.50	$1.50	$2.00	$2.00	$2.00	$2.00
Discount to present worth, per cent				0.354	0.442	0.442
Initial production of, barrels	895	4,800	2,830	5,000	1,500	800
Reserves, barrels	1,276,427	[1] 459,446	[1] 654,705	5,339,014	897,792	489,282
Depletion unit per barrel	$0.873	$1.132	$1.568	$1.528	$1.364	$1.194
Number of wells as basis of estimate	12	6	9	10	10	10
Number of acres	47.6	32.4	47.6	40	40	40
Total value	$1,129,069.00	$516,280.00	$1,037,773.00	$8,161,398.00	$1,244,863.00	$583,439.00
Discovery value, per acre	$23,719.94	$15,934.57	$21,801.95	$204,039.00	$30,621.00	$13,586.00
Cost of lease, per acre	$126.32	$78.10	$78.10	$15.94	$15.94	$15.94

[1] Carter owns one-half of the working interest. Values and reserves obtained are therefore for one-half of the leasehold only.

The CHAIRMAN. I would like to know, right at this point, if I am correct in remembering that the testimony indicated some time ago that there was no check of these figures made at the time the settlement was made. Is that correct, Mr. Manson?

Mr. MANSON. Yes.

The CHAIRMAN. If I remember the testimony heretofore given, it shows that these figures were not checked, Mr. Gregg, when they came into the bureau, prior to Mr. Mellon taking over the Secretaryship.

Mr. NASH. Mr. Chairman, as I recall the testimony last spring, it was to the effect that the bureau agents worked along with the employees of Ernst & Ernst when they were setting up this claim, and checked it right along with them.

The CHAIRMAN. Yes; but I mean there was no check made in the field at the time, and no engineers' reports were made; nor was the field checked to compare the results as to other taxpayers or other conditions with those claimed by the Gulf Oil Co.

Mr. NASH. No.

The CHAIRMAN. That is correct, is it?

Mr. NASH. I think that is correct.

Mr. MANSON. I do not think, in any case, discovery value has been based upon comparative sales data in oil. Has it?

Mr. GREENIDGE. Oh, yes. Discovery values were checked on comparative sales wherever it was possible to get them.

The CHAIRMAN. Were you in the bureau at that time, Mr. Greenidge?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. Were you in charge of this section at that time?

Mr. GREENIDGE. No; I was one of the valuation engineers.

The CHAIRMAN. So you do not know whether these valuations claimed by the taxpayer were checked by sales in that section or that district at that time?

Mr. GREENIDGE. No; I can not state the circumstances as to that. Some checking was done by an engineer by the name of Mr. McWhirt. At that time, as I recall, he did what was known as "spot" checking.

The CHAIRMAN. What do you mean by "spot checking"?

Mr. GREENIDGE. Taking a lease on a valuation and taking the following tenth or the following twentieth valuation; instead of talking all intermediate ones, taking the ones at regular intervals.

The CHAIRMAN. Is there any evidence in the files to show that that was done in this case?

Mr. GREENIDGE. Yes. I do not know that there is evidence in the files.

The CHAIRMAN. Do you know, Mr. Parker?

Mr. GREENIDGE. I could not answer that with certainty, Mr. Chairman, because I have not seen the files for a long time, and I do not know that I ever saw them in the past.

Mr. PARKER. There were no working papers, Mr. Senator, prepared by the oil and gas section on this case. As Mr. Thayer, I think, will agree, we hunted for any individual papers, any working papers, in figuring the value that was shown by the unit's engineers, which, in the nature of things, would be preserved, but we could find nothing except a few pencil marks from time to time on the original data furnished by the taxpayer. It would look, practically

as Mr. Greenidge says, as though when this case came in they had only a few days—I think three or four days—and that a certain spot check was made; that is, they picked out a few at random, and if they did not find any mistakes in going over one-tenth or one-fiftieth of the working papers, they assumed that all of it was right.

The CHAIRMAN. Who was the Commissioner of Internal Revenue at that time?

Mr. NASH. William M. Williams.

The CHAIRMAN. Mr. William M. Williams was commissioner at that time?

Mr. NASH. Yes, sir.

The CHAIRMAN. How long had he been commissioner, do you know, Mr. Nash?

Mr. NASH. He went out in April, 1921, and M. F. West was acting commissioner for about 60 days. Then Mr. Blair came in.

Mr. GREGG. I would like to have it made clear as to just how far this Dempsey lease that the Gypsy Oil Co. purchased was from the lease, the valuation of which you are criticizing, Mr. Fay.

Mr. FAY. The corners are one-quarter of a mile apart.

Mr. GREGG. At the time of the purchase of the Dempsey lease, which was very close in point of time to the final discovery on the other lease, there had been two wells brought in?

Mr. FAY. On the Dempsey lease?

Mr. GREGG. Yes.

Mr. FAY. Yes.

Mr. GREGG. One of those wells was a 160-barrel well?

Mr. FAY. Yes.

Mr. GREGG. And the other a 2,200-barrel well?

Mr. FAY. Two thousand two hundred and fifty barrels.

Mr. GREGG. What was the capacity of the well which was brought in on the lease in question?

Mr. FAY. Five thousand—about double.

Mr. GREGG. Yes.

Mr. FAY. Now, another point that the taxpayer has been liberal with himself on is the matter of discount.

DISCOUNT RATES

As to the discount of earnings, the accompanying table shows the present worth of this anticipated net income, using the discount factors of 5 per cent, 10 per cent mid-year, as used by the Revenue Bureau, and 10 per cent regular, and 15 per cent regular discount as applied at the end of each year, in conjunction with the taxpayer's recovery ratio. On the basis of a 15 per cent discount, it would leave the prospective purchaser a possible 15.78 per cent profit on his investment, yet without the assurance of any of the possibilities mentioned below reducing his income. It certainly can not be said that the valuation placed upon this lease can in any way be considered as what would be determined as between a willing seller and a willing buyer, when, in order to consummate the deal the willing buyer would have to part with $8,000,000 and receive in return a possible profit of $28,933. This amount would not much more than cover the attorneys' fees for drawing up papers in connection with such a transaction.

The records show that 130,954 barrels of oil was the actual production during the first 30 days of well No. 1. This amount of oil was produced when oil was selling at $1.70 per barrel, or 20 cents per barrel under the price used for valuation purposes. This amount of oil at 20 cents per barrel would give $26,190.80 for a reduction in receipts on actual prices and practically off-sets the company's discount for present worth of $28,993.

In addition to the above discount rates, as has been mentioned previously, the valuation is already more than $1,000,000 excessive, by reason of the use of an anticipated market price of oil, which materialized one day after the 30-day limit for discovery valuation had passed.

The following table copied from the taxpayer's returns shows his method of arriving at a composite discount factor to reduce the net income to present worth:

Rate of recovery of oil on the basis of decline curve for discovery well No. 1, with 5 per cent discount applied to bring to present worth

Year	Recoverable oil	Rate of recovery	Present worth
	Barrels	*Per cent*	
First	751,250	95.419	$0.95419
Second	31,390	3.987	.03705
Third	4,040	.513	.00454
Fourth	640	.081	.00068
Total	787,320	100.000	.99646
Discount (per cent)			.0354

Rate of recovery of oil on the basis of decline curve for discovery well No. 2

Year	Recoverable oil	Rate of recovery	Present worth
	Barrels	*Per cent*	
First	151,940	94.773	$0.94775
Second	7,040	4.392	.04081
Third	1,340	.835	.00704
Total	160,320	100.000	.99558
Discount (per cent)			.0442

The taxpayer's basis for determining the discount factor may be made clearer in the following setup:

Year	Ratio of recovery	Present worth factor	Present worth
	Per cent		
First	95.419	1.0000	$0.95419
Second	3.987	.9293	.03705
Third	.513	.8850	.00454
Fourth	.081	.8395	.00068
	100.000		
Total present worth of $1 invested in this oil lease			.99646
Discount			.00354
			1.00000

The 5 per cent discount factor used by the taxpayer as noted above applies only to the production after the first year. The first year's income is not discounted in determining present worth. I apparently is considered as so much money in the bank subject to draft. However, in determining the discount factor finally used, the taxpayer combines this undiscounted income for the first year with the discounted income of the second, third, and fourth years, and in this way determines a composite present worth of the $1 invested in this specific oil lease, which amounts to $0.99646, while the discount on this amounts to 0.00354 and converted into percentage becomes 0.354 per cent, which is then applied to the total anticipated net income.

As a further refinement in determining this present worth, the taxpayer, for the second and future years, does not use the 5 per cent factor at the end of the year which is the common practice when using discount tables. He discounts each year's returns in the middle of the year which further increases the present worth of the $1 and at the same time, decreases the so-called composite discount rate. Had he applied the 5 per cent present worth factor at the end of the second, third, and fourth years, the composite discount would be 0.455 instead of 0.354 per cent as used.

Net income $8,190,392 anticipated from discovery No. 1

	Present worth	Total discount	Per cent profit for purchaser
Taxpayers' set up based on 5 per cent composite discount, 0.354 per cent	$8,161,398	$28,933	0.355
Straight discount in accordance with standard tables:			
5 per cent regular	7,780,339	410,053	5.27
10 per cent (mid-year)	7,967,294	223,098	2.80
10 per cent regular	7,409,968	780,424	10.53
15 per cent regular	7,073,632	1,116,760	15.78

Mr. FAY. He determines the percentage of oil that will be recoverable each year from his discovery well and assumes that each dollar invested will be returned in the same proportion, which is proper. In the present case, he determines that 95.419 per cent of the oil will be recovered during the first year. This percentage is carried over into the present worth column, assuming that the return of that portion of the dollar during that first year need not be discounted. The remaining percentages of recovery by years are then multiplied by 5 per cent discount factors, and these products by years are totaled, as shown in table, giving the present worth of $1 invested in this particular property as $0.99645, all of which would be returned within a period of four years. This present worth deducted from 100 gives the composite discount factor of 0.354 per cent. This then applied to the net income from the property gives a total discount on $8,190,392 of $28,933, and on this basis the percentage of profit that a prospective purchaser could expect on an investment of more than $8,000,000 would be 0.355 of 1 per cent. Furthermore, the investor has no assurance during this 30-day period that there will be as much oil as has been estimated; he has no assurance that there will be no dry holes; he has no assurance that water will not encroach upon the oil reserves; he has no assurance that the price of oil will not drop, and yet, in the face of all of these factors, the taxpayer has set up a valuation for depletion purposes which is absurd in the extreme.

Mr. GREGG. May I ask one question there? Was there any allowance in any other way, either in respect to dry holes, or reduction of the recoverable units, or any such allowance made for risk?

Mr. FAY. The only risk that was considered was this: The initial production of the first well was considered as unity, and all of the other wells that came in on this lease were considered as 75 per cent of this particular well. The Carter Co., in setting up their valuations, has used 50 per cent as the anticipated production of future wells.

Mr. GREGG. What about the dry holes? Was there any allowance for dry holes?

Mr. FAY. I know of no allowance for dry holes in either case.

Mr. GREGG. Has that been checked?

Mr. FAY. I could not say that there has been a positive check on it, but from all the information that I can find in the returns there is no mention of dry hole hazard.

Mr. GREGG. What allowance would you say should have been made for dry holes?

Mr. FAY. Not less than 15 per cent. That was the record for that county. There were 15 per cent that produced nothing, while 5 per cent produced gas, and gas at that time was not marketed, as I understand it, but was used largely as fuel for the drilling of additional wells.

As a further refinement in determining this present worth, the taxpayer, for the second and future years, does not use the 5 per cent factor at the end of the year, which is the common practice when using discount tables. He discounts each year's returns in the middle of the year, which further increases the present worth of the $1 and at the same time decreases the so-called composite discount rate. Had he applied the 5 per cent present worth factor at the end of the second, third, and fourth years, the composite discount would be 0.455 per cent instead of 0.354 per cent, as used.

Now, as a summary showing the total discount that was allowed, and what should have been allowed had other percentages of discount been used, I will give you these figures, which are of interest.

The taxpayer's set-up based on 5 per cent composite discount, at 0.354 per cent, gives a total discount of $28,993.

The straight discount in accordance with standard tables, applying 5 per cent at the end of the first year, at the end of the second year, and at the end of the third year for the amount of money that has come back in that period would amount to $410,053, which would give the prospective purchaser a possible 5.27 per cent profit.

Using 10 per cent mid-year discount, which, as I understand, is being used largely by the oil and gas section at the present time, would have given a discount of $223,098, or a percentage of profit to the prospective purchaser of 2.80. Using the 10 per cent regular discount, applied at the end of each year, would have given a discount of $780,424, or a 10.53 per cent of possible profit.

Using the 15 per cent regular discount would give a total discount of $1,116,760, or 15.78 per cent possible profit.

I have some notes here on the revision of reserves, all of which the taxpayer is entitled to under the regulations, but the revision of reserves has an effect on his income, and, for that purpose, I should like to make this comment, because, in writing regulations I think it should be taken into consideration.

When the taxpayer made his valuations as of 1917, late in 1920, and which were submitted to the Department in November, 1920,

his estimate for gross reserves for the entire 160 acres was (let me say that he had three other discovery values on this 160 acres; that he took 40 acres of each section, and the other three-fourths were not as high valuations as this one, but the total amount of oil recovered is apparently reflected from later information, so I am going to make this statement) his estimate for gross reserves for the entire 160 acres was 7,813,592 barrels. The actual gross production from date of discovery to the close of 1920 was 7,819,745 barrels. In computing the discount factor for this property, the taxpayer considered only four years as the life of the well, when the experience showed, in the adjoining fields, 8 to 12 years as the expected life. On January 1, 1920, when the estimated net reserves had been reduced to 220,520 barrels, a revised estimate was made and the life of the property extended to 1926, resulting in adding to the reserves 325,797 barrels. The capital sum or discovery valuation, of course, was not changed, and this new estimate of reserves gave a new depletion unit of 57.55 cents. This, however, is a composite for the entire 160 acres. At the close of 1920, 42 wells were still producing.

Now, the different depletion units for these four quarters are as follows: For well No. 1, which we have just been discussing, it was $1.528; for well No. 2, $1.364; for well No. 10, $1.194; and for well No. 33, $0.461. The composite unit for the entire 160 acres would be $1.466.

When they reduced this to a composite depletion unit, I think they were perfectly justified in using that, for the simple reason that in bringing in the oil from so many different wells, one pipe line connected with another, it is impossible to separate the oil from one well from that of another well, or that from one 40 acres from that of another 40 acres. It would not be practicable to do that; so if they will weight properly the total amount of the reserves in each section, and no other wells come in, or change it when additional wells come in, I think they are justified in making a new composite depletion unit. I think that has been the practice of the department in many other cases. I know it was at the time I was in the unit. We did that very frequently.

Four discovery valuations on Shumway lease (160 acres), reserves, value, and depletion units, 1917–1918

Discovery area	Reserves (net)	Value	Depletion unit
	Barrels		
Well No. 1	5,339,014	$8,161,398	$1.528
Well No. 2	897,792	1,224,863	1.364
Well No. 10	489,282	583,439	1.194
Well No. 33	110,806	50,725	.461
Total	6,836,894	10,020,325	1.466

On January 1, 1922, when the revised estimates of January 1, 1920, had been reduced to 166,297 barrels, the taxpayer states:

The original estimate of recoverable oil being obviously too low, a new estimate is herewith made, the same to be applied to depletion schedule as of January 1, 1922.

This revision added to the reserves 270,866 barrels, and extended the life of the property to 1929, or 12 years from date of discovery. This gave a new depletion unit of 21.89 cents per barrel. The company has therefore had the advantage of a high depletion unit in the high tax years, 1917, 1918, and 1919, and when it was anticipated that the capital sum would be liquidated long before the reserves were exhausted, two revisions of the reserves were made which would deplete the remaining capital during the remaining lower tax years.

This revaluation, however, is in accordance with regulations 45 and 62, article 207, which states:

That no valuation of a property whose value as of the basic date had been determined and approved will be allowed during the continuance of the ownership under which the valuation was so determined and approved, except in the case of discovery as defined in articles 219 and 220 * * *.

Article 208, regulations 45 and 62, reads:

If the information subsequently obtained clearly shows the estimate (of reserves) to have been materially erroneous, it may be revised with the approval of the commissioner.

The effect of this short-life estimate was to decrease an already low discount. Had the ultimate reserves been estimated in accordance with the 12-year life of other Eldorado and Augusta wells, and a straight 5 per cent discount applied, the composite discount would have been 7.6 per cent in place of the composite of 0.354 per cent used by the taxpayer. A straight 15 per cent discount would have resulted in a composite discount of 19.6 per cent as compared with 13.6 per cent based on a four-year life.

Depletion claimed and allowed on Shumway lease, Eldorado, Kans.

	Barrels
Original reserves (4-year life)	6,836,894
Addition by revision (12-year life)	596,663
Total reserves (lessee's seven-eighths)	7,433,557

Discovery valuation, $10,020,325.

Depletion by years, 1917–1923

	Production (barrels)	Depletion unit	Depletion
July 15–Oct. 16, 1917	783,418	$1.52863	$1,197,559
Oct. 16–Nov. 3, 1917	372,766	1.50158	559,738
Nov. 3–Dec. 31, 1917	1,271,991	1.47442	1,875,454
Jan. 1–Apr. 12, 1918	2,086,795	1.47442	3,076,812
Apr. 12–Dec. 31, 1918	1,759,659	1.42590	2,509,098
Jan. 1–Dec. 31, 1919	341,745	1.42590	487,294
Jan. 1–Dec. 31, 1920	217,331	.57557	125,089
Jan. 1–Dec. 31, 1921	162,688	.57557	93,638
Jan. 1–Dec. 31, 1922	115,163	.21894	25,214
Jan. 1–Dec. 31, 1923	119,909	.21894	26,253
Total	7,231,465		9,976,149

Reserves Dec. 31, 1923, 202,091 barrels.
Capital sum to be depleted, $44,177.
Remaining life, six years.

The CHAIRMAN. As I understand it, the taxpayer received a credit for the entire return of his capital in the first four years?

Mr. FAY. Not all of it, quite, Senator. He had depleted it down to about $300,000 or $400,000, and the next year's production would have wiped it out.

The CHAIRMAN. Then, he came in and made another claim for more oil and a greater depletion?

Mr. FAY. But the "more oil" applied to this same remaining capital sum, which gave a lower depletion during the following year, so that the capital sum would not be wiped out in one year, but would be distributed as a continual deduction over a period of six or eight years following, so that he would have the advantage of a reduced tax in all of the years in the future, whereas, if he had not added these reserves, the depletable sum would have been wiped out at the end of the third or fourth year.

Mr. MANSON. When was that done?

Mr. FAY. January 1, 1920.

The CHAIRMAN. No; the last change was on January 1, 1922.

Mr. FAY. January 1, 1922.

Mr. MANSON. That is after Congress had amended the statute, providing that the depletion should not exceed the income.

Mr. FAY. Not at that date, it would not.

Mr. MANSON. No; I mean the date that they revised the estimate of reserves so as to reduce the depletion allowance.

Mr. FAY. Yes; the date that they actually did the work.

Mr. GREGG. Is there any evidence in this case to show that the depletion ever exceeded the income?

Mr. FAY. I have not tried to check that up, but the depletion practically equalled the income from this property.

Mr. GREGG. But there is no evidence that that limitation has ever been applicable?

Mr. FAY. Not to this particular lease, not that I find.

Mr. GREGG. I am not sure whether my position with regard to the estimate as to units recoverable has been made clear. Of course, in the original estimate, when the original valuation is made, you have your estimates of units recoverable, and your valuation. The one is divided into the other to get the depletion per unit per barrel. Suppose your valuation is $200,000, and your units recoverable 100,000. On each unit you have a depletion deduction of $2. Suppose, at the end of three years, you have, by that original assumption, say, 10,000 units left, and $20,000 of your capital left. It is then found that your original estimates of units are incorrect, and you have 20,000 units left instead of 10,000. Instead of going back and reopening everything that was done in the prior years, realizing that you can not always accurately estimate the units recoverable, the regulations provide that you shall revise from that date on and take your $20,000 capital that is left and divide it by the 20,000 units which are left, and from then on have a depletion of $1 per unit; but you never get more than your original capital sum, even by those revisions.

Mr. MANSON. I would like to point out another factor of that provision. Of course, it is manifest that an increase in the number of units will reduce the unit of depletion.

Take a case where the depletion unit is so high that the full amount of the depletion allowed can not be recovered under the 1924 act, which limits depletion to 50 per cent of the income from the property. By increasing the number of recoverable units to which depletion is applied, the depletion unit is reduced, and thus the taxpayer can get back the full gross amount of depletion from a well, where, otherwise, he might be cut off by the 50 per cent limit.

Mr. GREGG. That is not clear to me. I do not understand, Mr. Manson.

Take a specific case. Suppose you had a valuation of the whole value of $200,000, and unit estimates of 100,000. That gives you a deduction of $2 per unit. Suppose the gross profit from the sale of the oil is so small that your depletion would wipe it out. You are limited then to 50 per cent.

The CHAIRMAN. That was by a later act, though.

Mr. GREGG. Yes, sir.

The CHAIRMAN. That did not apply at this time.

Mr. GREGG. It had no application whatever to it, but Mr. Manson did bring that up.

Mr. MANSON. What I am pointing out is that since the discovery act has been amended by the 1924 law, which limits the amount of depletion allowable as against income, as the deduction of 50 per cent of income from the property, if a taxpayer has a depletion rate which would make his depletion allowance exceed the 50 per cent of his income, and he would thereby lose a part of his depletion, he can overcome that, if the conditions are right, by increasing the estimate of the recoverable units, so as to decrease the depletion unit. The result is, that while he waits a longer period of time, while it takes him more years to recover back his full capital, yet he recovers it all back, without having a part of it cut off by the 50 per cent limitation.

Mr. GREGG. That is true only if you assume that the 50 per cent limitation would be applicable in the earlier years, but would not be applicable in the later years. For example, assume that a man is to get a profit, computed without depletion, of $10,000 from a well for the rest of its life. I do not care what his depletion unit is, for the first, last, or any other year, in no case can his depletion unit exceed $5,000 a year.

Mr. MANSON. But, wait a minute. This law was not passed until 1924.

Mr. GREGG. Of course, and you were discussing the effect of the 1924 amendment.

Mr. MANSON. Yes.

Mr. GREGG. Which I am discussing.

Mr. MANSON. Yes; but I am going back to a new well on which a discovery value was fixed prior to the enactment of the 1924 law and under which the man has already deducted depletion at a high depletion rate. Now, when he gets down to 1924, when the law cuts him down to 50 per cent of his income, the 50 per cent does not apply to the depletion unit. The 50 per cent applies to the depletion deduction.

Mr. GREGG. No; it applies to neither. It applies to his operating profits, without reference to depletion.

Mr. MANSON. I understand, but the amount of depletion that he is entitled to deduct is regulated by the amount of his income from that property.

Mr. GREGG. Yes.

Mr. MANSON. And if he finds that the amount of his income from that property is such that he is not going to be permitted to have his full depletion deduction, which has already been allowed under a high valuation, he can avoid the effect of the 50 per cent provision of the law by increasing the amount of his estimated reserves, thereby reducing his depletion unit.

Mr. GREGG. Of course, he has to present proof to show that his original estimate was wrong.

Mr. MANSON. Oh, certainly. That is true.

The CHAIRMAN. I think this discussion has gone far afield in this particular case, because these were not estimates that were used in this case at all, but were actual figures, which they knew at the time they made the claim. In other words, I think the reappraisal of the recoverable oil on January 1, 1922, was, in fact, not doubtful, because they knew when they made their claim on January 1, 1920, what the actual results were at that time. They were not estimates based on known facts at the time of discovery at all, but they were claims made on known facts three years after discovery was made.

Mr. GREGG. Mr. Chairman, I must put something in the record right there. Mr. Fay said in answer to my question that although he drew the conclusion that facts disclosed after the date of discovery were considered in the estimate as of the date of discovery, he still said he had no facts which showed that.

The CHAIRMAN. Well, I do not know that he said that.

Mr. FAY. No.

The CHAIRMAN. He said it looked something like that, but he did give the benefit of the doubt to the taxpayer.

Mr. GREGG. He drew the inference.

The CHAIRMAN. Yes; I admit that, but to any reasonable minded person it must be apparent that they used known factors three years after the discovery.

Mr. FAY. I am only setting forth the facts in the case as I have found them.

The CHAIRMAN. Mr. Fay was not put on the stand to draw any inferences. It is left to some of the members of the committee, who hear the testimony, to draw the inferences.

Is that all you have, Mr. Fay?

Mr. FAY. The only thing I have left here is to show the gradual reduction of the depletion unit by these additions and revisions.

The CHAIRMAN. Well, that will go in the record anyway.

Mr. FAY. It will go into the record, but I might say that we started out, and on July 15 the depletion unit on the first discovery was $1.528.

The CHAIRMAN. You have already stated that.

Mr. FAY. Yes.

The CHAIRMAN. That is already in the record.

Mr. FAY. Then, on November 3——

The CHAIRMAN. What year?

Mr. FAY. October 16 to November 3, 1917, they brought in another discovery well, which added more to the reserves, and reduced the depletion unit to $1.50; and then from January 1 to April 12

they brought in another well, with additional reserves, which are thrown into the composite of $1.47 per barrel; and then on April 12 the depletion unit was again changed by a discovery well.

The CHAIRMAN. What year?

Mr. FAY. This is 1918.

The CHAIRMAN. State the year in the record so that we will understand it.

Mr. FAY. Yes; 1918—which gives the depletion unit of $1.42. No other changes are then made until they revise their estimates as of January 1, 1920, when they reduced the $1.42 unit to 57 cents for additional reserves. Then, on January 1, 1922, additional reserves further reduce that unit to 21 cents per barrel; so that at the close of 1923, on these 160 acres, they have received a credit for depletion of $9,976,149, leaving undepleted reserves of 202,091 barrels, and a capital sum of $44,177 and a remaining life of six years.

The CHAIRMAN. Does the record show what the cost of that property was to the taxpayer on which this $9,000,000-plus was allowed as depletion?

Mr. FAY. $2,250, plus operating expenses.

The CHAIRMAN. $2,000?

Mr. FAY. $2,250. I shall read some comparatives here that will answer that question. I have three or four transactions here, one of the Carter Co. and one of the Gypsy. For instance, the Carter lease basis; they paid $126 an acre for one of their leases, and they set up a value of $23,719 per acre on discovery. On another area, at $78.10 per acre (cost), they set up a value of $15,934. On another discovery well, at a cost of $78.10 per acre, they set up a value of $21,801 per acre.

On this Shumway lease the cost to the Gypsy Oil Co. was $15.94 per acre. Their seven-eighths interest on the first 40 acres is set up at $204,039; on the second 40 acres at $30,621, and on the third 40 acres at $13,586 per acre. I did not consider it on the fourth 40 acres, but it is considerably less.

The CHAIRMAN. Have you anything further at this time, Mr. Manson?

Mr. MANSON. No; that is all this morning.

The CHAIRMAN. Senator Jones, do you wish to ask any questions?

Senator JONES. No, Mr. Chairman.

The CHAIRMAN. I think we will adjourn now until 10 o'clock to-morrow morning, if that is agreeable.

Mr. GREGG. Mr. Chairman, I should like to know the plans of the committee, if it is agreeable to you. I would like to know what the committee intends to do for the next week or 10 days, anyway.

The CHAIRMAN. I will take that up with Mr. Manson, and we will telephone you this afternoon.

Mr. GREGG. I do not mean just for to-morrow, but I would like to have some general idea of your plans for the next week or so, as to the type of cases and the steps to be taken.

The CHAIRMAN. Yes; I will take that matter up with Mr. Manson and telephone you. At this time I do not know myself.

Mr. MANSON. I can give you a general idea of it.

The CHAIRMAN. Well, we can talk that over and let them know.

(Whereupon at 11.45 o'clock a. m., the committee adjourned until to-morrow, Tuesday, February 24, 1925, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

TUESDAY, FEBRUARY 24, 1925

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senators Couzens, presiding, and King.

Present also: Mr. L. C. Manson, of counsel for the committee; Mr. George G. Box, chief auditor for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. A. W. Gregg, special assistant to the Secretary of the Treasury; Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; and Mr Nelson T. Hartson Solicitor, Bureau of Internal Revenue.

The CHAIRMAN. Do I understand that you have an audit case to present this morning, Mr. Manson?

Mr. MANSON. Yes. The matter to which I desire to call the committee's attention this morning is the compromise of the tax of the Atlantic, Gulf & West Indies Steamship Co., and its subsidiary companies.

The taxes for 1917, 1918, 1919 and 1920 of this company and its subsidiaries, amounted to $9,913,841.86. This tax was compromised for the sum of $1,280,000, plus the release of a judgment of the Court of Claims against the United States of $1,351,381.81. In other words, the total consideration for the release of this tax claim is approximately $2,600,000.

The CHAIRMAN. What did they do for the Government which enabled them to have a claim against the Government?

Mr. HARTSON. They lost a vessel, Mr. Chairman.

The CHAIRMAN. They lost a vessel?

Mr. HARTSON. Yes; they lost a vessel during the war. It was the company's vessel, being used and operated by the Government at that time, and it was lost in the Government's service. The company therefore had a claim against the Government for the value of the vessel.

The CHAIRMAN. You are familiar with that case then, Mr. Hartson, are you?

Mr. HARTSON. Yes; I am very familiar with it, Mr. Chairman.

Mr. MANSON. On March 5, 1924, Secretary Mellon addressed a letter to Senator McKellar with reference to the compromise of tax claims against the above named company, from which the following is an excerpt:

> Referring to the Atlantic, Gulf & West Indies compromise, from information received by the Bureau of Internal Revenue, it was believed that large additional taxes and penalties were due from this company for past years. Before an

assessment of these taxes had been made it became apparent to the department that the taxpayer was insolvent, and the sole question of determination was not the amount of the tax but the amount the taxpayer could pay. Since almost all the assets of the taxpayer were subject to prior liens and the general credit of the taxpayer was not good, the levying of an assessment and its attempted collection would have served only to throw the taxpayer into bankruptcy and to destroy the Government's chance of collecting anything. The Department made a thorough investigation into the financial condition of the taxpayer and its available cash resources, with the sole idea of obtaining for the United States the largest possible payment. A compromise of the tax liability was then entered into under section 3229 of the Revised Statutes, for $1,280,000, and satisfaction of a judgment against the United States in the Court of Claims for $1,351,381.81 and interest from November, 1919, to December 15, 1923. That the taxpayer was in fact in a perilous financial situation is disclosed by the subsequent receivership of the Ward Line, which was one of the most important and by far the best known of its subsidiaries. (Congressional Record, March 12, 1924, p. 4155.)

The CHAIRMAN. You mean that is where this letter is quoted?

Mr. MANSON. That is where this quotation is taken from.

It is our position that this claim was settled without a proper investigation of the facts and without the investigation of the facts which was recommended by the auditors, who had handled the claim and by the solicitors.

We are not in a position to say that the compromise should not have been made. We believe the indications are that this compromise was away below what the Government should have collected, taking into consideration the fact of the financial condition of this company and its subsidiaries.

The CHAIRMAN. Do I understand that the claim has been irrevocably settled?

Mr. MANSON. Yes, sir; this claim has been compromised.

The CHAIRMAN. I mean, has it been settled beyond any possibility of reopening it?

Mr. MANSON. I think so; yes. My interpretation of the law is that it is irrevocably compromised. You agree with that, do you not, Mr. Hartson?

Mr. HARTSON. I do, in the absence of fraud.

Mr. MANSON. Yes.

Mr. HARTSON. I think fraud would probably vitiate the contract of settlement, under the compromise sections of the act, but in the absence of that I think Mr. Manson is correct in saying that it is irrevocably settled.

The CHAIRMAN. What brought this case to your attention, Mr. Manson?

Mr. MANSON. I had a recollection of this letter written to Senator McKellar—it was published in the newspapers—and I asked one of the staff of the committee to look it up to see what the condition of the company was—that is, prima facie—not to make an extended investigation. He reported to me that the company had met the interest on its bonds, and that both its common and preferred stock had, not a par value, but a substantial value; and on the basis of that, knowing something of the size of the company's assets and operations, I referred it to Mr. Box for investigation, and I am now presenting Mr. Box's report.

The CHAIRMAN. What is the date of that letter that Mr. Mellon sent to Senator McKellar?

Mr. MANSON. March 5, 1924. The settlement was made in January, 1924.

The CHAIRMAN. Mr. Mellon, in his letter, refers to the prior liens. I assume he meant that these outstanding bonds were secured by a mortgage on the property—is that right?

Mr. MANSON. That is right.

The CHAIRMAN. Do such liens take precedence over a Government lien?

Mr. MANSON. Mortgage claims as against the fleet—that is, as against the ships—would be prior to the Government lien.

We have presented data showing the amount of the outstanding bonds, and we will also show that there was a large sum of liquid assets which are not covered by the bonds. In other words, while the bondholders would have a claim against them, the Government lien would take precedence over the bondholders' general claim for any deficiency.

The CHAIRMAN. But, of course, there would not be any deficiency if there is anything left for the Government on the mortgaged property. I mean, if the bondholders, under foreclosure on the mortgage, did not get all of their money, there would not be anything left for the Government, would there?

Mr. MANSON. As we will show, there is a very substantial amount of liquid assets. For instance, there was one asset consisting of a claim of $1,600,000 against the Shipping Board, as well as a large amount of cash, several million dollars of cash.

The CHAIRMAN. Proceed. I just wanted to clear up the question of the prior lease that was mentioned.

Mr. MANSON. Yes.

Attention is invited to the sentence included in the above quoted excerpt from Secretary Mellon's letter as follows:

> The department made a thorough investigation into the financial condition of the taxpayer and its available cash resources, with the sole idea of obtaining for the United States the largest possible payment.

The record of the case shows that during April, 1923, the Deputy Commissioner of Internal Revenue advised the taxpayer that the additional tax liability for the years 1917 to 1920, inclusive, and penalty for the year 1920, was as follows:

1917, additional tax	$1,482,289.98
1918, additional tax	4,437,282.73
1919, additional tax	1,501,844.82
1920, additional tax	1,661,616.22
1920, penalty	830,808.11
Total additional tax and penalty	9,913,841.86

Under date of May 1, 1923, the president of the Atlantic, Gulf & West Indies Steamship Lines submitted an offer in compromise of any and all additional income, excess profits and war taxes of itself and its subsidiaries for the years 1917 to 1920, inclusive, and any and all penalties in connection therewith in the sum of $1,250,000.

Under date of May 9, 1923, S. Alexander, head special audit division; E. C. Lewis, auditor; and J. W. Carter, chief special adjustment section, held an informal conference with Mr. Cannon in the solicitor's office on the taxpayer's offer in compromise above mentioned, at which it was decided "that an analysis of the financial

statement as at December 31, 1922, showing the condition of the various companies, should be made, before giving further consideration to the taxpayer's offer in compromise."

Under date of June 7, 1923, Mr. E. C. Lewis, one of the conferees above mentioned, submitted a report to Mr. Alexander, head special audit division, on his investigation of the financial condition of the "various companies." (See Exhibit A.)

Under date of July 12, 1923, the taxpayer submitted another offer in compromise in the sum of $1,500,000, to cover all additional income, excess profits, war taxes and penalties for the years from 1917 to 1921. (The former offer covers the years from 1917 to 1920 only.)

As a result of this offer, the Solicitor of Internal Revenue, under date of July 16, 1923, in referring the letter to Deputy Commissioner Bright, made the following request:

> Will you not therefore have the two revenue agents who made the previous investigation in this case bring their report down to include the year 1921 at the very earliest date possible? I should like to have their recommendation on the proposed compromise in this case as well.

Under date of July 20, 1923, revenue agents Fred T. Macdonald and Sydney L. Burg made a report to the Commissoner of Internal Revenue (see Exhibit B) in which they stated that their report was based on an examination of a financial statement prepared by the company as of January 1, 1923, since no audit of the books and records of the consolidated group from the date where the previous examination left off (namely, 1920) to July 1, 1923, had been made. In this report the agents state that in their opinion the company could pay $2,118,623.93 in cash which would leave current assets in excess of $6,000,000.

The CHAIRMAN. Do you mean that the agents recommended that?

Mr. MANSON. Yes. I will read that report. I think it would be interesting right at this point.

The CHAIRMAN. I can not understand how they would recommend a settlement of $2,000,000 plus, when they had $6,000,000 more of assets.

Mr. MANSON. I would call the attention of the Chairman to the fact that this $6,000,000 more assets, as will appear, are liquid assets, that is, not representing total assets.

The CHAIRMAN. Not the property covered by the mortgage.

Mr. MANSON. Not the property covered by the mortgage.

This report to which I have just referred is as follows, dated July 20, 1923, and addressed to Hon. D. H. Blair, Commissioner of Internal Revenue:

> After further deliberation the undersigned agents have agreed as to the amount this corporation could without great difficulty and embarrssment offer in compromise and state their opinions herewith and the method used in arriving at such figure.
>
> FACTS
>
> To determine their exact financial standing at the present time would require a detailed audit of all books and records of the consolidated group from the date where previous examination left off to July 1, 1923.
>
> Since no such audit has been made, it became necessary for the agents to use a financial statement prepared by this company as of January 1, 1923, together with such other statements furnished by them as are of current date.

ANALYSIS OF FINANCIAL CONDITION

In determining the amount of cash this corporation could spare at once, consideration has been given to various factors such as working capital the company must retain to be solvent and its borrowing capacity at the present time, giving further consideration to the fact that the banks have knowledge of the large tax liability standing against this corporation.

An examination of the balance sheet of January 1, 1923, discloses current or liquid assets made up as follows:

Cash in bank	2,686,434.96
Cash coupons	551,775.00
Cash with agents	1,618,623.93
Marketable securities	127,395.00
Notes receivable	337,624.31
Accounts receivable, general	841,224.83
Insurance claims	1,650,849.49
Shipping Board claims	1,661,363.25
Materials and supplies	234,137.00
Total	9,709,407.77

And I would call the chairman's attention to the fact that none of those assets are covered by the mortgage securing the bonds.

To this amount the agents find there should be added $200,000 which represents interest accrued and due on bonds of Atlantic Gulf Oil Co. which this corporation owns, but failed to show on balance sheet, and which are first mortgages on the property of Atlantic Gulf Oil Co. and on which the corporation can get a note and have same discounted at the bank. This makes total current assets $9,909,427.77. Against these are current liabilities which required immediate payment of $1,991,641.49 leaving a balance of net current assets of $7,917,786.28 out of which to pay the Government any taxes due. Taking as a basis the contention of the agents that this corporation can pay $4,000,000 to pay this the corporation would have to convert their current assets into cash and following is shown how this can be accomplished and verifies the fact that same can be done without great disturbance.

Our examination shows the current liabilities average per month about $1,500,000. Therefore, this corporation should have on hand this much in bank, but does not require more. The statement shows $2,636,434.96 cash on hand. Therefore, conservatively $500,000 of this can be paid to Government, leaving $2,186,434.96 in bank for working capital. There is another $1,618,623.93 of cash in the hands of agents due in 60 days this sum also to Government and in addition, if claim against Shipping Board is good this amount to Government making $3,779,987.18. After these payments there would still remain with corporation the following current assets:

Cash	$2,186,434.96
Cash coupons	551,775.00
Account receivable, 30 days	841,224.83
Due from oil company	200,000.00
Due from insurance company	1,650,849.49
Marketable securities	127,395.00
Notes receivable	337,624.31
Materials and supplies	234,137.00
Total	6,129,440.59

This amount has therefore been arrived at without resort to borrowings. As to this corporation's ability to borrow, consideration must be given to the fact that in addition to assets already mentioned, this corporation has investments in bonds of $5,009,375, which could be placed up as collateral without any other notes or personal guarantees, and has in addition a tanker unmortgaged, present market value $385,000.

A word as to bondholders of corporation. They are all secured by mortgage on the marine equipment book, value about $77,000,000. But under no conditions could these bondholders levy against any of the current assets or would there be any occasion to.

If to avoid payment a sort of receivership is gone through, the Government by taking immediate action could apply liens against sufficient assets to protect their claims for any amount.

FRED T. MACDONALD,
Internal Revenue Agent.
SYDNEY L. BURG,
Internal Revenue Agent.

The CHAIRMAN. That is not the report, though, that recommended that compromise, is it? I did not hear any reference to that in that report.

Mr. MANSON. I would say this, that this report sets up what this company can do without greatly inconveniencing itself.

The CHAIRMAN. Yes; but I mean in your statement, prior to the reading of that report, if I recall correctly, you said that the agents recommended a settlement of $2,000,000 plus, and I did not hear any reference to that in that report.

Mr. MANSON. By totaling those figures they pointed out that the company can pay that amount of money without inconvenience.

The CHAIRMAN. But they do not recommend a settlement on that basis?

Mr. MANSON. No; they do not in that report.

The CHAIRMAN. Yet in your prior statement you said they recommended a settlement to that effect.

Mr. MANSON. In their report the agents state that in their opinion the company could pay $2,118,623.93 in cash, which would leave current assets in excess of $6,000,000.

The CHAIRMAN. Then the agents did not really make any recommendation?

Mr. MANSON. No.

The CHAIRMAN. I see.

Mr. MANSON. Under date of January 7, 1924, the Solicitor of Internal Revenue advised the taxpayer that the Commissioner of Internal Revenue had considered the proposition submitted on December 17, 1923, through the Director of Internal Revenue for the second district of New York and had decided with the advice and consent of the Secretary of the Treasury to close the case by accepting $1,280,000 in lieu of all and any liabilities or obligations, etc., for the years from 1917 to 1920, inclusive, the New York & Porto Rico Co. of Maine having released to the United States the judgment of the Court of Claims in its favor against the United States in the sum of approximately $1,351,000. (See Exhibit C.)

I might state that the New York & Porto Rico Co. was one of the subsidiaries of the Atlantic, Gulf & West Indies Co.

The CHAIRMAN. Do you know whether, after that, the Shipping Board paid this claim to this corporation?

Mr. MANSON. I do not know whether the Shipping Board has yet paid that claim, or whether it is still carried as an asset of this company.

The CHAIRMAN. Do you know, Mr. Hartson?

Mr. HARTSON. Yes, Mr. Chairman. The Shipping Board did not pay the claim. The Shipping Board satisfied the judgment that was of record against the United States at the time this compromise was made.

Mr. MANSON. I am talking about another claim now.

Mr. HARTSON. I do not know about that other claim.

The CHAIRMAN. I understood that outside of this claim for a lost vessel this corporation had a claim against the Shipping Board.

Mr. MANSON. Of $1,600,000.

The CHAIRMAN. Yes. Does anybody here know what became of that?

Mr. HARTSON. No; but we can find out and tell you to-morrow.

The CHAIRMAN. I would like to ascertain if the Government paid that claim to the corporation after that settlement.

Mr. MANSON. I will say this in that connection: After the compromise of tax was made, if that claim was not released as a part of this compromise, if the Government was liable on that claim, it would have to pay it, notwithstanding the fact——

The CHAIRMAN. I think that is probably true legally.

Mr. MANSON. Yes.

The CHAIRMAN. But I would like to have the agents of the committee find out what became of that claim against the Shipping Board.

Mr. MANSON. We will look that up.

The record shows that an examination of the taxpayer's books and records in connection with its 1917 tax returns took two agents 148 days and the examination for the years 1918 to 1920, inclusive, took four agents 125 days. From May 1, 1923, the date of the first compromise offer made by the taxpayer to January 7, 1924, the date of the compromise offer was accepted, sufficient time elapsed for a detailed audit of taxpayer's books and records for the years 1921 and 1922, by the revenue agents in the field, yet regardless of the report made by Mr. Lewis on June 7, 1923, to the effect that the true financial condition of the taxpayer could not be determined without a complete audit; the request of the solicitor of July 16, 1923, that the two revenue agents who made the previous examination bring their report down to include the year 1921 at the very earliest date possible; and the statement in the agent's report of July 20, 1923, that to determine the exact financial standing of the taxpayer would require a detailed audit of the books and records of the consolidated group from 1921 to July 1, 1923, no audit or detailed examination of the books for the years 1921 and 1922 had been made up to the time the compromise was accepted. Although it is not disclosed by the records, it appears Mr. Lewis based his report of June 7, 1923, upon his examination of the company's financial statements, which consisted principally of verifying the company's bank accounts and looking over a few ships and tankers in the vicinity of New York City, which examination consumed about 10 days' time. Both he and revenue agents Burg and Macdonald refer in their reports to the financial statements issued by the company as the basis of their findings.

Mr. Lewis, in his report of June 7, 1923, refers four times to the fact that the companies have been making extremely heavy maintenance and depreciation charges. This was, undoubtedly, done for the purpose of converting any profits which might have accrued in those years into losses. The reports of the agents for the years from 1917 to 1920 show that this policy was a continuation of the same policy for those years, and resulted in the writing down of the capital assets of the company beyond any fair figure. In view of these facts, it is hard to understand why any credibility would be

given to the financial statements issued by the company, and a compromise effected when these statements were the only basis on which to determine the taxpayer's ability to pay tax, and why a detailed audit of the books and records of the company was not made by revenue agents for the years 1921 and 1922 prior to deciding the amount of compromise.

In order to bring out fully the reason why, in this particular case, it was important that the fullest investigation should be made, we have deemed it proper to bring to the attention of the committee efforts that had been made by the company up to the time this compromise was effected, to conceal their assets and avoid the payment of taxes.

The CHAIRMAN. Who are the officers of this company? I would like to have something more than the abstract name of the corporation in the record here.

Mr. BOX. A man by the name of Nicol was president at this time. Mr. MacBain was Treasurer.

Mr. MANSON. A. R. Nicol was president of the corporation.

Mr. BOX. Mr. MacBain is treasurer and Mr. Stone is chairman of the board.

The CHAIRMAN. Give the initials, so that we will have a complete record of it. To what Stone do you refer?

Mr. BOX. I do not believe I have the full names of the officers here.

Mr. HARTSON. I do not know Mr. Stone's initials, Mr. Chairman, but he was a member of the firm of Hayden & Stone, bond house in New York.

The CHAIRMAN. Is he connected with any particular group of interests?

Mr. MANSON. The Atlantic, Gulf & West Indies Steamship Co. owns some property of its own. It owns or operates the Clyde Steamship Co., Mallory Steamship Co., New York & Cuba Mail Steamship Co. (Ward Line), New York & Porto Rico Steamship Co. of Maine, New York & Porto Rico Steamship Co. of New York, United States & Porto Rico Steamship Co., Southern Steamship Co., International Steamship Co., Jacksonville Lighterage Co., the Tampa Towing & Lighterage Co., Clyde Steamship Terminal Co., Carolina Terminal Co., San Antonio Co., San Antonio Docking Co., and Wilmington Terminal Co.

The CHAIRMAN. Then, it was mostly a holding company?

Mr. MANSON. I think the Atlantic, Gulf & West Indies Co. is very largely a holding company.

Mr. BOX. It operated about eight ships of its own.

Mr. MANSON. It operated about eight ships of its own?

Mr. BOX. Yes.

Mr. MANSON. The consolidated balance sheet shows the assets for 1921 as being $118,013,223.64; 1922, $113,815,624.79; and 1923, $108,498,814.45. Of those assets, the fleet of vessels owned by the company and its subsidiaries is carried on the books at $75,606,087.31 in 1921, $73,470,700.83 in 1922, and $70,425,466.83 in 1923.

The CHAIRMAN. What were the outstanding bonds that Mr. Mellon referred to as being a prior lien on the property?

Mr. MANSON. The funded debt in the balance sheet of 1921 is $35,205,000; in the balance sheet of 1922, it is $34,572,000; and in the balance sheet of 1923 it is $33,244,000.

The CHAIRMAN. So, in effect, they were reducing the bonded indebtedness right along?

Mr. MANSON. Yes. They were carrying as reserves in 1921, for replacement of marine equipment, depreciation of property and miscellaneous, $20,656,271.03, and had a surplus in 1921 of $19,483,036.71

In 1922 the balance sheet—that is, as of December 31, 1922—shows reserves for the purposes stated of $24,770,458.96 and a surplus of $14,210,173.39.

As of December 31, 1923, the reserves are $22,668,436.21, and the surplus is $16,931,854.01.

In that connection, I would call the committee's attention to the fact that those reserves and the surplus are in addition to the outstanding capital, which amounts to $28,706,300 in 1921, $26,706,300 in 1922, and $28,706,300 in 1923.

Senator KING. Was that increase in capital stock due to stock issued, or was it a sale of stock for more capital?

Mr. BOX. There is no record to show that.

Mr. MANSON. It drops $2,000,000 from 1921 to 1922 and then goes back that same amount in 1923.

The CHAIRMAN. When you were checking up this case was there any information secured as to the market value of the stock at the time that this settlement was made?

Mr. MANSON. No; I have no information on that point.

The CHAIRMAN. I would like to suggest that the agents of the committee look that up and find out.

Mr. HARTSON. The stock was ranging from $8 to $13 a share at the time that this compromise was under consideration, as I recollect it.

The CHAIRMAN. How many shares were outstanding?

Mr. MANSON. I do not know the par value.

Senator KING. How many shares were outstanding, the Senator asked, not the par value.

Mr. MANSON. I do not know the par value of the stock.

The CHAIRMAN. I did not ask for the par value. I asked for the number of shares outstanding.

Mr. MANSON. I do not know. The total par value of the stock outstanding was approximately $28,000,000. How many shares that represents I do not know.

The CHAIRMAN. I know, but, in view of what Mr. Hartson has just said, the price ran from $8 to $13 a share, and if we knew the number of shares, we could get the value of the outstanding stock.

Mr. MANSON. We can get that in a few minutes for you.

The CHAIRMAN. Never mind. Go ahead, and we will get that later.

Mr. MANSON. In order to accentuate the unreliability of the statements issued by this company, some of the conditions reported by the agents as a result of their examination for the years 1917 to 1920, are herewith set out.

As I stated before, in view of their former attempts to conceal their assets for the purpose of showing that, in accepting the statement of the company as to its condition for the purpose of effecting a compromise, the department should have made the most careful examination.

The CHAIRMAN. I would like to ask at this point of Mr. Nash and Mr. Hartson if they know to what extent this policy of compromising Government taxes is practiced?

Mr. HARTSON. I think I can answer the Senator's question better than Mr. Nash, possibly, for this reason, that the only duty that the law places specifically on the Solicitor of Internal Revenue is to make his recommendations in writing to the commissioner, with regard to all offers in compromise, so that all of these compromise offers go through the office of the Solicitor of Internal Revenue.

I think, in answering specifically the Senator's question, the procedure of compromising taxes is rather frequently followed. Of course, the law places a limitation around the authority of the commissioner and the Secretary to compromise and only permits it in cases where the taxpayer is insolvent, or where the assessment and collection of the full amount of the tax due would create a condition of insolvency. As a result of that, a great many tax liabilities are compromised, by reason of the fact that the taxpayers are or would be insolvent as a result of enforcing the collection of the tax.

The CHAIRMAN. You would compromise, then, only where the tax, in itself, would make the company insolvent; is that right?

Mr. HARTSON. We would be without authority, I believe, to compromise the tax liability, when the Government's liability, together with other liabilities of the company, would not create a condition of insolvency.

The CHAIRMAN. In this particular case so far—and I do not want to anticipate anything, and I do not know anything about the case—it appears from the evidence that the stockholders and bond holders were left in the possession of the property and that a great deal of assets were left, and yet I am reminded that in the case of the Lincoln Motor Car Co.—and I want to say that I had no interest in it financially or otherwise—the taxpayer was not only put into bankruptcy, but it was sold out, and the proceeds of the sale were practically all applied to the Government. I mention that because there seems to have been such a strange contrast between the method of dealing with the Lincoln Motor Car Co. and with the taxpayer under discussion.

Mr. HARTSON. Well, I know nothing about the Lincoln Motor Car case, Mr. Chairman. I was not here at the time that was settled and closed by compromise, but I was, of course, present and participated in the settlement that was made in the case of the Atlantic, Gulf & West Indies Co.

The CHAIRMAN. I would like to ask Mr. Nash if there is any record in the bureau of the amount of taxes lost by the Government by these compromise settlements?

Mr. NASH. There is a record in the solicitor's office of every case that has been compromised, the amount of the tax that was involved, and the amount that has been accepted as a compromise.

The CHAIRMAN. Has any abstract of the result of those compromises ever been made?

Mr. NASH. I do not know that any have ever been compiled, Mr. Chairman.

Mr. HARTSON. I believe, Mr. Chairman, that the statutes which outline the authority of the Secretary and the commissioner to compromise taxes may well be improved. I think there is a field there for constructive legislation which would be helpful to the Department, and which would make more uniform the practice of compromising liabilities of taxpayers. The statute which Mr. Manson has

referred to covering this subject is found in one paragraph, Section 3229, of the Revised Statutes. The language used in that section is sufficiently broad, in my judgment, to permit of the commissioner and the Secretary to compromise any liability for any sum that, in their discretion, might seem proper.

Senator KING. Would that be a liability which is contingent, or one which is liquidated, fully determined and agreed upon between the parties as a liability?

Mr. HARTSON. I believe, Senator King, that the language is sufficiently broad to include the authority to compromise either contingent or specific cases. Except for opinions of the Attorney General, Mr. Chairman, which interpret this section 3229, the Secretary and the commissioner could, I believe, compromise even a solvent taxpayer's liability upon the payment of money.

The CHAIRMAN. That is what actually happened in this case, is it not?

Mr. HARTSON. No; I am not prepared to concede that; no sir. This company, in my judgment, was insolvent. It was insolvent to the point where—and I do not wish to anticipate what is going to be our showing here—the collection or extraction of any additional money from this company would have put it in the hands of a receiver, which we were consciously attempting to prevent.

Senator KING. Why?

Mr. HARTSON. Because we thought it was of greater advantage to the Government of the United States to keep this largest American-owned shipping company afloat financially than to throw it into the hands of a receiver and close it up as a going business concern.

Senator KING. I do not know of any state that permits compromise.

Mr. HARTSON. I do not, either.

Senator KING. I cannot conceive of the fact that Congress has passed a law as broad as you state, but I would follow your interpretation of it.

Mr. HARTSON. It is very broad.

Senator KING. And if I may be pardoned, I should be very glad, and I hope the chairman will take that view of it, to have such concrete suggestions from the department, and from you who are so familiar with it, and from Mr. Gregg and Mr. Nash.

The CHAIRMAN. I should like to ask Mr. Nash, if it is not too much trouble or too much expense to the bureau, to take off an abstract of the amount of tax compromises.

Mr. NASH. How far back do you want to go on that, Mr. Chairman?

The CHAIRMAN. How long have you been doing it?

Mr. NASH. This statute has been in existence, I presume, for nearly a hundred years.

Mr. HARTSON. I would like to clarify the situation a little more, Mr. Chairman, by saying that this section, 3229, like a great many other internal revenue statutes, was conceived at a time when income taxes were unknown, and yet an income tax is an internal revenue tax. The language of section 3229 is that the commissioner and the Secretary may compromise any internal revenue tax.

The CHAIRMAN. And all of this time since the income tax law has been enacted, no statute has been passed by Congress to change that old statute, and no recommendation has been made by the bureau

which would make better understood the question of compromising these taxes. Is that right?

Mr. HARTSON. To my knowledge there have been no changes made in this provision of law since the income tax acts were passed.

The CHAIRMAN. In answer to Mr. Nash's question, I should say that we ought to have it from 1916 on.

Mr. NASH. Very well.

Senator KING. You use the word "compromise" there, do you, Mr. Solicitor, as applicable only to those cases where the tax has been agreed upon; that is to say, there is no contest as to the amount of the tax?

Mr. MANSON. Where it has been assessed. Which is right, Mr. Hartson?

Mr. HARTSON. I believe the language of section 3229 of the Revised Statutes is not so limited as to prevent the commissioner and the Secretary from compromising a liability which is not definite in terms but which the taxpayer and the officials of the Government can agree exists in some amount, but which can not be determined definitely.

Senator KING. Would you call this a compromise: The Government levies a tax against A's property, say $10,000, and that goes onto the books. A contests it in a friendly way, saying that they have not taken into account this factor or that factor, or have not allowed enough for obsolescense, depreciation, and what not, and a reexamination shows that perhaps part of his claim is right and they reduce it. The Government says, "Well, we will take off $2,000, if that is agreeable." That is agreeable and it is compromised and paid. Would that pass through the Solicitor's office?

Mr. HARTSON. That is not a compromise as we understand it, Senator King, because in such a case the assessment would be changed either by abating and reducing a larger assessment that may theretofore have been made, or a new assessment may have been made in that amount, and that assessment would be completely paid and settled and satisfied.

Senator KING. I think I understand, then, what you mean by the word "compromise." If there has been a change in assessment, if more is allowed for obsolescence or depletion or what not, and a reassessment is made with respect to that, or a revaluation made, and then after all those facts are taken into consideration you make a final settlement, you would not consider that a compromise.

Mr. HARTSON. That is correct. We would not consider that a compromise as provided for in section 3229.

Senator KING. And yet the compromise spirit may enter into the matter of those settlements, perhaps thousands of them.

Mr. HARTSON. Yes; and no doubt you have heard the suggestion made by the witnesses or counsel to the effect that these are compromise adjustments. Well, that is not a compromise as we understand it, according to the provisions of this section 3229.

The CHAIRMAN. But that is not the kind of a case that we have before us now, Senator.

Senator KING. No; I know that. I appreciate that, but I just wanted to bring that out so that when we get those figures from Mr. Nash, if they show a much smaller amount than might be anticipated, we will know just what cases are embraced, because I can comprehend that there may be thousands of cases where assessments were made

and afterwards reductions made and revaluations made, and the amount of the tax collected, perhaps not more than 50 per cent to 80 per cent of the first assessment, and yet those would not be called compromise cases.

Mr. NASH. Senator Couzens, do you wish the compromises on income tax, or do you want compromises on all of our taxes, excise taxes, etc.?

The CHAIRMAN. Yes; those covered by the Income Tax Unit, whether excess profits taxes or——

Mr. NASH. Of course the excess profits and the income taxes go together, but we have so many other kinds of taxes.

The CHAIRMAN. No; I mean just those which were settled on an alleged compromise, on account of bankruptcy, etc.

Senator KING. With respect to those others, the excise and admissions, etc., do they run into a great number, and is the amount involved very great?

Mr. NASH. During the war, Senator King, when the admissions taxes were a new thing, and when the taxpayers were not familiar with the existence of the law, we had to compromise a great many cases. For instance, a man would be running a picture show in a small town and he may never have heard of an admission tax. He is required to collect that tax from the people who purchase admissions to his theater. When our inspectors come around, they find that he has not collected the tax for, maybe, a year, and by checking up from the serial numbers on the tickets that he has used, and from other information they arrive at the approximate amount of tax that appears to be due. No one can swear that it is the correct amount due; there is no way of checking it up definitely, and we accept such an amount as a compromise of his tax liability up to that date.

Senator KING. But there are no large amounts involved in those taxes, going up into the hundreds of thousands and millions of dollars.

Mr. NASH. They run into a great volume in the number of cases.

Senator KING. Oh, yes; but I mean in any one case.

Mr. NASH. I would not say that any one of them runs into large amounts. On income taxes, also, we have a great many compromises for penalty and interest. I was just wondering whether you wanted such cases included with the compromises of income tax liability?

The CHAIRMAN. In this particular case, where there was an $800,000 penalty, that was compromised because of the alleged bankruptcy or insolvency that would be involved.

Mr. NASH. We have a great many compromises for the old 50 per cent penalty for delinquency. In the old internal revenue law we had a 50 per cent penalty if the taxpayer was even two days late in filing his return. In many instances there was a very good reason for failing to file at the proper time. There was probably a delay in the mails or something of that sort, and the commissioner has compromised, with the approval of the Secretary, such penalties. The old statute also carried 1 per cent a month interest, and then section 250 (c) of the 1921 act permitted the compromising of that interest at 6 per cent a year. There have been a great many compromises of that sort on income taxes. But if we can confine this request to compromises of tax liabilities only, and to such penalties as accrue in those cases, it will not be a very difficult job.

The CHAIRMAN. Then, let us have that.

I want to correct something that I said in the record a while ago concerning the Lincoln Motor Car Co. I think I was confused in my statement in that connection. The settlement that I referred to was the settlement of a war fraud case, and not a settlement of income tax. I want to make that statement.

Mr. MANSON. I would like to make clear again that we are not taking the position in this case that this company was solvent. We do not know. We say that, prima facie, from such evidence as appeared in the record in the Income Tax Unit, it was solvent, and was able to pay this tax. Our criticism is that no proper investigation was made to determine the ability of the Government to recover this tax, and that criticism is both a general criticism to the effect that, in any case, regardless of the previous history of the taxpayer, a proper determination of the ability of the taxpayer to pay a tax of the size of this should be made before so great a reduction in the tax has been made as has been made in this case; but, in addition to that, the previous history of this taxpayer is such that the acceptance of the taxpayer's statements as to its liability, or as to its financial condition, was practically tantamount to negligence.

In this connection, I also wish to make it clear that no criticism is made of the conduct of the solicitor in this case. The solicitor indicated and requested a proper examination.

Mr. HARTSON. Now, Mr. Manson, before you proceed, in view of what you have just said, I think it proper and appropriate for me to say that I was personally present at all of the conferences that took place when this tax liability was settled. I had several hearings in my own office, before the matter was referred to Mr. Blair, and then Mr. Blair held several conferences with the representatives of the taxpayer and the representatives of the Government.

The matter went from Mr. Blair to Secretary Mellon, and Mr. Mellon held several conferences, and I participated in those.

In view of what you have said, I want to assume my full responsibility in the adjustment that was made, and I want to say that I did not request or suggest to the Secretary or to the commissioner that any additional or further examination should be made beyond what was made in this case.

The letter which was written, and which Mr. Manson has read into this record, does suggest that a complete audit be made. I remember very distinctly the circumstances under which that letter was written, that it would have been highly desirable to conduct a complete examination and audit of all of the books of the subsidiaries of this company, but in view of the conditions, which seemed to us to warrant, not hurried action, but action which brought results within the immediate future, rather than to continue it over an indefinite period, we consulted with everybody that knew anything about it, and we made as complete an examination as we thought was necessary under the circumstances, and then compromised on that basis.

Now, as to a complete audit and examination, which would be highly desirable—and nobody questioned the advisability of doing that—this was a company tremendous in size, and it would have taken an interminable time to complete an audit, bringing these facts from

1920, down to January, 1924. We did have the company's financial statement, prepared by reputable people. We did have that checked, not by Mr. Lewis alone, who was sent from Washington to New York, and spent some 10 days or 2 weeks up there going over the books and checking the balance sheet, but also by two internal revenue agents, who examined the company's books in New York, and who thereafter were called to Washington by the commissioner himself to confer with the commissioner and advise with him in the settlement and final closing of this case.

I appreciate the statement that counsel has made, so far as I am personally concerned, but I am here to take as much of the responsibility in the settlement of this case as anyone else, and I do not want the record to show that I advised something in the interest of the protection of the Government which Mr. Blair and Mr. Mellon did not feel justified in following.

The CHAIRMAN. Is there any record, Mr. Hartson, of those various conferences that you had?

Mr. HARTSON. I do not believe there is a record of each conference that was held. I think there is not.

The CHAIRMAN. I should like to ask in that connection, then, inasmuch as you have been so magnanimous in accepting full responsibility for the settlement of this case——

Senator KING. His full share of the responsibility.

Mr. HARTSON. Yes; that is a better way to put it, Senator King.

The CHAIRMAN. Yes. I would like to ask, then, if consistent with his conscience, he can tell the committee whether he proposed any higher assessment during any of these conferences?

Mr. HARTSON. You mean a higher compromise settlement?

The CHAIRMAN. Yes.

Mr. HARTSON. A higher amount?

The CHAIRMAN. That is right.

Mr. HARTSON. Before this matter was called to the commissioner's attention, Mr. Chairman, I thought in my own mind and made the suggestion orally to the commissioner that a compromise by the payment of $1,500,000 in cash would, in my judgment, meet the full ability of the company to pay, and yet not embarrass it financially to the point of destroying it. The commissoner, after my recommendation was forwarded to him, conducted conferences, which I attended, and, as a result of those conferences, he became convinced that they could pay more than the $1,500,000, the amount that I suggested, and it was the commissioner who exacted from the company the satisfaction of the Shipping Board judgment, and thereby made a net payment of substantially in excess of $1,500,000, which, as I say, I would have recommended the acceptance of.

The CHAIRMAN. I think you might proceed, Mr. Manson, to complete your statement for the record.

Mr. MANSON. I do not care to repeat, but in view of Mr. Hartson's statements, I want to call attention to the fact that I have read into the record a written communication of both Mr. Hartson and the revenue agents who made the previous examination of the company's books, that to determine the financial condition of the company, it was necessary that an audit be made.

To proceed now to show the exceptional circumstances here, and the exceptional necessity for a most careful examination, I would call the committee's attention to the following conditions:

The examination disclosed that the taxpayer's income had been understated and the payment of taxes evaded by the failure to report profits on sale of ships, reserves set up out of income, the failure to capitalize permanent improvements, instead of which they were charged as expenses, excessive depreciation charges and the failure to report as income the profit resulting from liquidating dividends paid by the Mexican Navigation Co. As a result of the latter transaction the agents recommended that a penalty for fraud be assessed against the taxpayer. Their report shows that on May 21, 1919, the Mexican Navigation Co., a Mexican corporation 75 per cent owned and controlled by the Atlantic, Gulf and West Indies Steamship Co., went into dissolution, it having ceased doing business on April 25, 1918. On May 24, 1919, liquidators of this company, A. R. Nicol, Albert Gilbert Smith and Gonzalo Abauno, the first two of whom were president and director of the Atlantic, Gulf & West Indies, respectively, declared a dividend of $1,000 a share on the 4,500 shares of the capital stock of the company.

That was a dissolution dividend, a liquidating dividend

On March 15, 1920, a final dividend of $156,123 a share was declared. On May 24, 1919, the Atlantic Gulf & West Indies and its subsidiary, the New York & Cuba Steamship Line (Ward Line) owned 3,409 shares of the Mexican Navigation Co. stock, costing as follows:

Atlantic Gulf & West Indies, 2,409 shares	$1,561,863.48
Ward Line, 1,000 shares	325,000.00

Had these two companies surrendered their stock, they would have received the sum of $3,941,223.31 as liquidating dividend on their 3,409 shares of stock, resulting in a profit of $2,054,359.83, which should have been reported as income. The records show that the Atlantic Gulf & West Indies Co. received $3,941,223.31, the amount of the liquidating dividend, during the month of March, 1920, however, in order to secrete the profit and avoid the payment of income tax thereon, it issued to the Mexican Navigation Co. three noninterest bearing demand notes in the amounts of $3,941,223.31—that is the exact amount of that liquidating dividend—$20,410.84, and $38,365.85 making a total of $4,000,000.

The CHAIRMAN. Was there any evidence in connection with those notes that they were for value received?

Mr. MANSON. They were just straight promissory notes, but the point is that the liquidators of a dissolved corporation had no authority to loan this money. Their purpose is to liquidate the corporation and distribute the assets among its stockholders.

Senator KING. Well, did they not distribute money?

Mr. MANSON. They did distribute money.

Senator KING. So those notes are mere fictions?

Mr. MANSON. As to the amount of the liquidating dividend, they were merely fictions.

Senator KING. Has the statute of limitations run against that transaction?

Mr. MANSON. It was all uncovered. The taxes were assessed and are a part of the taxes which have been compromised.

Senator KING. But I am asking if there was such a penal statute violated by this concealment, has the statute run against that? If the transaction would constitute an offense, as I understand it, the settlement of the tax would not relieve the taxpayer from prosecution for a crime, if he committed a crime.

Mr. MANSON. Well, I think the penalties which were imposed amounted to $830,000.

Senator KING. If they were merely civil penalties, of course they are wiped out, but I was wondering if there was any violation of the criminal statute in this concealment.

Mr. MANSON. I have not considered that feature of it.

Senator KING. All right.

Mr. MANSON. These notes were issued in 1921 and antedated March 15, 1920. The action of the treasurer of issuing these notes was approved by the directors of the Atlantic, Gulf & West Indies at its meeting in January, 1921. The transaction at this time shows on the books of the company as a liability in the form of notes payable in the sum of $4,000,000 and assets in the form of an investment in Mexican Navigation Co. in the sum of $1,561,863.48.

Under date of June 15, 1920, three months subsequent to the date of the payment of the liquidating dividends above mentioned, the Cuban American Terminal Co. was incorporated under the laws of Cuba with Alfred G. Smith, president (president New York & Cuba Mail Steamship Co.); Alexander R. Nicol, first vice president (president Atlantic, Gulf & West Indies Co.); and Robert E. McBain, treasurer (treasurer Atlantic, Gulf & West Indies Co.).

On September 23, 1920, the Cuban American Terminal Co., which was organized in part with a view to transferring in due course the assets of the Mexican Navigation Co., to a Cuban corporation without a change of interest, authorized the proper officers to issue and transfer to the Atlantic, Gulf & West Indies Co. 2,409 shares and to the New York & Cuba Mail Steamship Co. 1,000 shares of its stock in exchange for a like number of shares of Mexican Navigation Co.'s stock owned by these companies, the president of the Atlantic, Gulf & West Indies and New York & Cuba Mail Steamship Co. having by letters dated September 21, 1920, offered to the Cuban American Terminal Co. this exchange.

The situation at this time is this: The taxpayer and its subsidiaries owned the stock of this dissolved corporation, had received their liquidating dividend, and had given back a note. Then this new company is organized, and the assets of the old company are transferred to the new company in exchange for this stock.

On February 9, 1921, the action of the treasurer of the Cuban American Terminal Co., in turning in the 3,409 shares of Mexican Navigation Co. to the liquidators of the latter corporation for cancellation and accepting the demand note of the Atlantic, Gulf & West Indies Co., dated March 15, 1920, for $3,941,223.31, was approved by the board of directors.

The income statement of the Atlantic, Gulf & West Indies Co., dated December 31, 1923, indicates the receipt of dividends from the Cuban American Terminal Co. of $3,941,223.31, which is the exact amount, under the heading of exempt income (nontaxable). This

is the amount of the liquidating dividend for the Mexican Navigation Co.'s stock formerly owned by the Atlantic, Gulf & West Indies Co.

The revenue agents who made the report for the years 1918 to 1920 stated as follows:

It is desired to draw attention to the fact that the three corporations which were used in the above transaction are all one in that they are owned and controlled entirely by the Atlantic, Gulf & West Indies Steamship Co. The agents were thorough and impartial in their investigation to ascertain the truth.

The writer of the anonymous communication was traced with the aid of the Intelligence Unit, and while carrying a grudge yet found to be a man of intelligence who had held a high official position with the Atlantic, Gulf & West Indies Co. and was the man who had made some of the original book entries. From his statements we became convinced that this scheme originated with the president, A. R. Nicol, and Mr. MacBain.

It never was a true transaction but was obviously concocted with the purpose of evading tax. The completing of the scheme took almost two years, after many discussions at board of directors meetings, where some of the directors hesitated in being connected with the scheme and expressed fear of committing crime against the Government and suffering necessary penalty.

Senator KING. Whose statement is this?

Mr. MANSON. This is the statement of the agents who made the examination:

Mr. Fano, treasurer of the Ward Line, when examined by the agents, stated it was a subterfuge to cover the real facts and the agents were right to tax same, and that Mr. A. R. Nicol, president, was responsible for it.

In conclusion the agents desire to state that in their experience covering a number of years assigned to fraud investigations, they have not found evidence that could show more conclusively the brazen attempt to defraud the Government. Therefore the penalties have been applied to the tax and this case is strongly recommended to the Solicitor of Internal Revenue for prosecution.

It is believed by the agents that an attempt will be made by representatives of the taxpayer (prior to receipt of this report in Washington) to make a full confession of the facts, accompanied by a claim that same was a voluntary confession, and therefore taxpayers are not subject to any action by the legal division.

It is also suggested that the agents be present at any conference held at which representatives of the taxpayer may appear to discuss the basis for the additional tax and penalty recommended herein.

Another method of concealing income and therein evading the payment of tax by this company was effected by writing off depreciation on its marine equipment at the rate of 10 per cent per year, whereas prior to the year 1917, it had written off depreciation at the rate of 3 or 4 per cent.

Another instance of the effect of this taxpayer to conceal income was in the matter of the replacement fund created in connection with the loss of the steamship *Massa Pequa*, owned by the New York & Porto Rico Steamship Co.; 100 per cent of the stock of the latter company was owned by the Atlantic, Gulf & West Indies Steamship Co.

This steamship, which has been chartered to the Republic of France, was sunk by a submarine on July 7, 1917. On September 13, 1917, the owner of the vessel received compensation in the sum of $940,000—that is, this subsidiary of the taxpayer. The depreciated value of the vessel at the date it was sunk was $187,528.80. The taxpayer applied to the Commissioner of Internal Revenue for authority to create a replacement fund for the excess of the amount received over the value of the vessel at the date it was sunk, and the Commissioner of Internal Revenue granted the request under authority of articles 49 and 50 of regulations 45. The commissioner

authorized the company to make the replacement any time prior to September 22, 1920.

Under date of April 22, 1920, the New York & Porto Rico Steamship Co. passed a resolution authorizing the purchase from the Atlantic, Gulf & West Indies Steamship Co. of certain steamers in order to release the cash and Liberty bonds held by the treasurer of this replacement fund.

It will be borne in mind that this New York & Porto Rico Co. is one of the subsidiaries, and the taxpayer owns 100 per cent of its stock, and that this purchase is made from the taxpayer.

The company then claimed that the Massa Pequa was replaced by steamers purchased from the Atlantic, Gulf & West Indies Steamship lines. However, no replacement was effected, as the steamers were merely transferred from one unit to another, and no additional steamers were received by the consolidated group. The effect of this transaction was that the New York & Porto Rico Steamship Co. realized a profit of $752,471.20, which it attempted to conceal as such and evade the payment of tax thereon. Upon discovery by the bureau of this transaction the company requested an extension to 1922, which was approved.

In the matter of depreciation, according to the revenue agents' report, the taxpayer claimed excessive depreciation, which was disallowed by the agents as follows:

1917	$955,647.40
1918	5,004,276.48
1919	2,853,978.69
1920	3,124,685.29

In Secretary Mellon's letter, above referred to, reference is made to the fact that "almost all the assets of the taxpayer were subject to prior liens." It is assumed the prior liens refer to the funded debt of the different companies which, according to the consolidated balance sheet of December 31, 1922, was $34,572,000. In this connection attention is invited to the statement of the taxpayer for the year ended December 31, 1923 (Exhibit D), which provides for the amortization of bond discount for the year. This statement shows that bonds of the par value of $1,951,500 were sold during the first four months of 1921 for the sum of $981,763.50, slightly more than 50 per cent of their face value. Whether or not other sales of bonds were made at a large discount can not be determined without an examination of the taxpayer's books for 1921 and 1922. It would be possible to distribute earnings of the corporation by selling bond issues in large amounts to the officers and other stockholders of the corporation at large discounts.

The consolidated balance sheets as at December 31, 1922 (Exhibit E), and as at December 31, 1923 (Exhibit F), are attached hereto.

The field audit for the years from 1918 to 1920, inclusive, was made as the result of an anonymous communication received by the Bureau of Internal Revenue which was subsequently found to have been written by a former officer of the Atlantic, Gulf & West Indies Steamship Co.

It is our position, to summarize the whole situation, that in view of the fact that former audits had disclosed all of these attempts of the taxpayer to evade taxes in enormous amounts, when it came to the compromise of the taxes which were assessed as the result of

the disclosures that the bureau made, the most of diligence should have been used to ascertain the facts before accepting the company's statements as to its financial condition.

Senator KING. One question: Did you pursue the matter sufficiently to determine whether any of that funded indebtedness, aside, possibly, from the point you last made, that they may have issued these bonds for dividends, or what not, was incurred in the purchase of property at grossly exaggerated values?

Mr. MANSON. We do not know anything about that.

Senator KING. I have known of many cases where property was taken over at two or three or four hundred per cent in excess of its real value, and bonds issued for the purchase of the same. Of course, I do not know anything about this case, and I venture no opinion, but I would be very glad if the investigators would take the time to pursue that matter a little further.

Mr. MANSON. Inquiry was made as to the value of the stock. Mr. Hartson stated that the stock was quoted at from $8 to $13 at about the time this settlement was made. We have ascertained that the stock has a par value of $100, which, at $8 a share, would give the stock a value of $2,296,504, and at $13 a share would give it a value of $3,731,819.

The CHAIRMAN. Do you know whether the stock went lower than that at any time, or higher than that at any time?

Mr. MANSON. It is my impression that the stock is worth more than that now, but I am not sure about that.

Mr. HARTSON. I do not know, Mr. Chairman. I just have a faint recollection that that was the range of quotations about that time. I remember that at the time the representatives were here, the value of the stock and the figure that it was being traded in at the exchange was around the figures I have given. I am just using my recollection, however.

The CHAIRMAN. Will the investigators please find out what the trend of that stock has been since this settlement?

Mr. MANSON. We will find out what it has been.

The CHAIRMAN. All right.

Mr. MANSON. I desire to call the attention of the committee to the fact that the whole theory of this settlement has been: How much can this company pay without embarrassment—not how much can the Government collect if it enforces its rights. I do not care to make any criticism of that policy. It strikes me that it is a proper matter for Congress to determine whether or not that should be the policy of the Government.

The CHAIRMAN. I think it is the most astounding case that I can possibly conceive of, that after all of these attempts at fraud that were made by the taxpayer, as disclosed by the records in the final settlement, they got advantage of their attempts at fraud which were made, and that no criminal prosecution, at least of record before this committee, has been had.

I would like to ask Mr. Hartson if he knows any reason why criminal prosecution was not started, in view of the recommendations of the agents?

Mr. HARTSON. I am unable to say definitely, Mr. Chairman. I am inclined to think that the statute had run against at least one or two of the criminal charges which might have been brought against

them. I do not want to say that definitely, but my recollection is that the statute of limitations had run. Of course, the fraudulent attempts made by this taxpayer to evade taxes were, as Mr. Manson pointed out, well known to us. We all knew it to be a fraud case, a case where they had, in our judgment, deliberately attempted to evade a tax. That, however, when it came to closing the tax liability, was a thing, while materially important to put us on notice that the representations of this company could not be relied upon to the fullest extent, nevertheless, the proposition before us at the time, was how much money we could get, and we thought we got all that could be secured without throwing the company into bankruptcy. The stock was widely held; it was a big company, that had extensive interests in this country, and, as I indicated a few moments ago, it was the largest American-owned shipping company, and that was brought home to us very strongly.

Counsel who appeared for the taxpayer in this case was the firm of Root, Clark, Buckner & Howland, than whom no more reputable men practice before the department, and so far as the showing is concerned that was made by counsel at the time this matter was compromised, I am confident in my own mind now, and was at the time, that it was made in good faith, and there was a full disclosure made by the then representatives of the company when this matter was settled.

I want to say one thing further, and in doing so I use my recollection, because I have not gone through the files for a year or more. Mr. Nicol, who was president of the company, and who, as was brought out here, was doubtless responsible for the fraud which was perpetrated by the company, was not in control of the company at the time this matter was settled or compromised, but a Mr. Mooney had succeeded to the presidency; a new element was in control of the company at the time it was before us for settlement.

The CHAIRMAN. I would like to ask Mr. Hartson, Mr. Nash, or Mr. Gregg if they can tell us of, or can recall any other cases, where the stockholders were practically held harmless as the result of the Government making a settlement of this kind, and where an effort to prevent a receivership was made.

Mr. HARTSON. I recall no other case, but I must say that I believe there are other cases. I believe that a corporation that has been guilty of fraud, and a flagrant fraud, and when it is discovered at some later time, the effort is to convict, of course, and punish the guilty. On the other hand, what is a separate thing from an attempt to collect the full amount of tax and the civil penalties. When we come to settle the taxes and penalties, it may be that the financial condition of the company is such that it is not only desirable, but it is our duty, as we conceive it at least, to get as much from that company as we can, and still maintain it as a future taxpayer to the Government. We feel that we will get more money in the long run than if we exact the last penny from the company, which might throw it into the hands of a receiver. Of course, one of its subsidiries, the best known one, if not the largest and most important, did go into the hands of a receiver, almost immediately after this compromise was effected, and it was charged—and I know nothing of the inside workings of the company—that the reason why that was done was because of the cash that was raised to settle this compromise and

close the tax for the entire affiliated group, that there was such an amount taken from this company, this subsidiary, as to not permit it to continue business as a going concern.

Mr. MANSON. I might also say that I have here a clipping—I do not know what paper this is from—stating that an action was brought by the receiver of the Ward Line against the parent company, upon the ground that they claimed that the taxpayer had unlawfully taken $20,000,000 of the assets of the Ward Line while it was in control of it.

This clipping is as follows:

WARD LINE SUES ATLANTIC, GULF & WEST INDIES ASKING $20,000,000

New York, July 23—

Senator KING. What year?

Mr. MANSON. This is last July, 1924.

Suit was filed in Federal court to-day by Francis G. Caffey, as receiver of the New York & Cuba Mail Steamship Co., operators of the Ward Line, against the Atlantic, Gulf & West Indies Steamship lines and others, seeking restoration of approximately $20,000,000, which the receiver alleges the Atlantic, Gulf & West Indies directors obtained unlawfully from the Ward Line.

The complaint charged that the Atlantic, Gulf & West Indies lines and their directors controlled the votes of the directors of the New York & Cuba Co., and through this control wrecked the latter line by taking large sums of money from its stockholders, bondholders, and creditors, which, if not diverted, would have enabled it to continue as a prosperous steamship line.

The complaint alleges that in 1915, 1916, and 1917 the New York & Cuba Co. declared and paid dividends amounting to $10,200,000, of which the Atlantic, Gulf & West Indies lines received more than 99 per cent.

The CHAIRMAN. I would like to ask Mr. Hartson if he contends that it is the Government's responsibility to hold $28,000,000 of stock, or some value at least, in preference to collecting the Government's tax, because, in this instance, the stock was not wiped out, and I do not understand that the shipping would have been affected had there been a reorganization and the stock and the equities of the bondholders retained.

Mr. HARTSON. Our attempt has been, Mr. Chairman, to collect the full amou t of the taxes, penalties, and interest. There are cases, and they are exceptional cases, but by reason of the great number of cases that have come before the board they are large in number, too, where the full amount of taxes and interest, and in some cases penalties, can not be collected. The money is not there. We then try to get as nearly the full amount assessed as can be secured.

Now, the point at which you have gotten the last nickel that can be secured is difficult to ascertain in many cases. I must say, in frankness here, that the most trying responsibility I have had as solicitor of internal revenue has been to find out, to my own satisfaction, how much a company could pay, or how much an individual could pay, in these compromise offers, because in most of the cases it is my own responsibility to settle those cases. I make the recommendation, and in these large cases, such as this one, they go to the commissioner, and he personally goes into them, and the secretary in some cases goes into them; but in the great run of cases they come through my office, and the lawyers, after a field investigation has been made, make their recommendation, and I hold conferences in some cases, and in others the men in my office do it for me. It is frequently impossible to determine just the largest amount of money that you can obtain. I

do not know at times where that point is. I use my own judgment: I use the judgment of those who are assisting me in it, and it is not our desire to let anybody off; but, on the other hand, it is our effort, and our conscious effort—we do it purposely—to try to keep a going business as a going business. We try to keep it on its feet.

The CHAIRMAN. Do you contend that in this case, in view of the prior liens, if you had collected the full liability of the Government, these ships would have stopped, that the shipping would have been affected?

Mr. HARTSON. I believe, as a going concern, if any more cash was taken out of the business this company would have been forced to the wall. That is what I believe. I believe a big receivership would have resulted.

At the time that these nogotiations were in progress there was an element in the Atlantic, Gulf & West Indies stock ownership which was attempting to use the tax liability and the claim of the Government against the company as a means of throwing it to the wall and putting it in the hands of a receiver.

We felt that our settlement was good business. Now, we might have gotten, Mr. Chairman, another $50,000; we might have gotten another $100,000. I do not know, but we thought we got all we could get. I am not sure that it would have been money in the Government's pocket, in the long run, to have gotten another $500,000, assuming that that could not have been raised except by exhausting the assets of the company to the point where its financial condition might have forced it to the wall.

The CHAIRMAN. Well, I understand that, but I also know that there are many reorganizations where the capital is wiped out, where the corporations mave been made successful after they have been written down to a basis where they could make a return. I still do not understand that it is the business of the Government to waive taxes for the purpose of preventing receiverships. I do not understand that there is anything in the statute or that it is implied in any statute that we must waive taxes so as to prevent receiverships.

Mr. HARTSON. I think you will find nothing in the statutes. As I have pointed out, Mr. Chairman, I think it is a question of administrative policy. In view of the wide discretionary power which the statute placed in the hands of the commissioner and the Secretary it then becomes a matter of policy for them to determine, to be generally used in the settlement of all cases, as to how far they should go in getting money from taxpayers on these compromise settlements. The money end of it, the point of view of getting all the money that can be secured, is behind this policy that I suggested has been followed—of keeping the company a solvent and going concern.

We have had this come up, Mr. Chairman, and it shows you the ramifications of this question.

Assume, for instance, that we will not compromise except on the payment of a sum of money which will and does throw the company into a receivership.

There may be thousands or millions of dollars that that company owes to its creditors, other business concerns in the country. If it does go into a receivership or bankruptcy, some of those claims are lost to these creditors, these other taxpayers.

The CHAIRMAN. That is also true if a bondholder forecloses on his bonds, or a mortgagor forecloses on his mortgage, and I do not see why we should place ourselves in a more insecure position than a bondholder or a holder of a mortgage on a piece of property.

Mr. HARTSON. Mr. Chairman, my point is this: If we keep a company going there is nothing written off the bondholder's books, no deduction of a loss on his return, and on account of the claims of one character or another that they have against this company they write nothing off of their income tax returns because of losses having been suffered through this taxpayer going to financial ruin. I have seen cases—I do not recall the names now—but I have seen cases where, if the company whose taxes were before us for adjustment and settlement was not continued as a going concern, the loss that the Government would suffer by reason of other companies writing off their losses because of the insolvency proceedings would more than make up any additional amount that we might be able to collect against this taxpayer.

Mr. MANSON. Just as a pure matter of mathematics, I can not quite see the point.

For instance, we will assume that you have a dozen corporations who are creditors of a corporation with whom a compromise is effected. They are all paying taxes on their net income at the rate of 12½ per cent. Suppose you fail to collect from the debtor corporation. You lose 100 per cent, in what you fail to collect. If you had collected it that amount might be written off as a loss by other corporations, in which event you would lose 12½ per cent.

Mr. HARTSON. The explanation lies there, Mr. Manson, that it is entirely conceivable that the liabilities of a corporation are very great, so that if those liabilities are written off even at the rate of 12½ per cent, you have a sum substantially in excess of the difference between what they offer to pay you in compromise and the small sum in addition thereto that you insist on getting.

We have cases like this: A company offers $100,000. It is insolvent. The liabilities, let us say, are $500,000. We think we can get $150,000, and that they ought to pay that. But they will not pay it, because they insist that they can not.

Now, the hypothetical case that I am taking is this, that if we get the additional $50,000, which is an amount that we will compromise for, because we believe the company can pay that sum, and should pay it—if we get that, or insist on getting it, and it goes into bankruptcy, then the other deductions for losses, even at the rate of 12½ per cent, will much more than make up that $50,000.

There are cases of that kind, as I say.

Now, it is not a matter that a single word of explanation will entirely satisfy. There are a great many different elements that must be considered, and there are no two companies just the same in these compromise cases. There are different circumstances in connection with each case.

Mr. MANSON. I wish to formally introduce as a part of the record the exhibits which accompany my statement.

(The exhibits submitted by Mr. Manson are as follows:)

EXHIBIT A

In re: Atlantic, Gulf & West Indies, Steamship lines and subsidiary companies, 25 Broadway, New York, N. Y.

Mr. S. ALEXANDER,
Head, Special Audit Division, Income Tax Unit,
Washington, D. C. JUNE 7, 1923.

Pursuant to a decision at an informal conference held in the solicitor's office on May 9, 1923, on the taxpayer's offer in compromise of additional income and profits taxes for the years 1917 to 1920, inclusive, and penalty for the year 1920, an investigation has been made of the financial condition of the various companies.

The annual reports for the years 1921 and 1922 show the following net income for the years 1920 to 1921, inclusive:

1920, net income	$148, 231. 01
1921, net income	1, 781, 337. 19
1922, net loss	3, 582, 736. 44

The adjusted net income for the year 1920 as determined by the bureau and shown in revised letter, is $7,648,824.54, as compared with $148,231.01 shown in the annual report for 1921.

From monthly statements of the principal companies the net income and net loss from operations during the month of March, 1922, and March, 1923, were as follows:

	March	
	1922	1923
New York & Cuba Mail Steamship Co	($97, 246. 56)	($196, 356. 00)
New York & Porto Rico Steamship Co	(45, 417. 55)	(33, 923. 61)
Southern Steamship Co	30, 679. 42	2, 599. 04
Mallory Steamship Co	50, 763. 24	19, 746. 67
Clyde Steamship Co	134, 696. 23	201, 519. 55
International Shipping Corporation	5, 763. 50	17, 392. 41
San Antonio Co	250. 00	250. 00
Net profit	79, 488. 28	11, 228. 06

Net decrease in income $68,260.22.

The income from operations of the various principal companies for the first quarter ending March 31, 1922 and March 31, 1923, is as follows:

	March	
	1922	1923
New York & Cuba Mail Steamship Co	($297, 086. 21)	($368, 132. 44)
New York & Porto Rico Steamship Co	(41, 715. 12)	(178, 194. 99)
Southern Steamship Co	34, 458. 14	12, 264. 88
Mallory Steamship Co	(165, 453. 14)	(32, 064. 08)
Clyde Steamship Co	239, 096. 95	445, 143. 94
International shipping Corporation	16, 042. 70	37, 699. 98
San Antonio Co	750. 00	750. 00
Net loss	(313, 906. 68)	(82, 532. 71)

Net decrease in loss, $231,373.97.

A comparative consolidated income account for the years 1921 and 1922 is shown as follows:

	1922	1921	Increase or decrease
Operating revenue	$31,947,882.72	$40,717,774.93	($8,769,892.21)
Maintenance and depreciation	8,150,785.58	6,290,608.45	1,860,177.13
Total expenses (operating)	32,570,979.49	35,650,446.22	(3,079,466.73)
Net income	3,582,736.44	1,781,337.19	5,364,073.63
Loss on sale of vessels	2,055,522.52		
Total loss for 1922	(5,638,258.96)		

A comparative balance sheet for the years 1921 and 1922 is as follows:

	Dec. 31, 1922	Dec. 31, 1921	Increase or decrease
Cash on hand and in bank	$2,686,434.96	$2,047,118.76	639,316.20
Expenditure on account of unfinished voyages and business	2,704,414.01	2,506,563.79	107,850.22
Total assets	95,652,017.56	103,484,575.39	(7,328,557.83)
Bonded debt (total)	34,572,000.00	35,205,000.00	(633,000.00)
Receipts on account of unfinished voyages and business	2,219,448.62	1,824,355.05	395,093.57
Notes payable	919,236.01	1,308,135.45	(388,899.44)
Accounts payable:			
General	4,061,222.81	5,943,846.43	(1,882,623.62)
Agents	238,941.06	204,412.45	(34,528.61)
Interest accrued on bonded debtedness and notes	254,995.22	281,757.04	(26,761.82)
Coupons payable	551,775.00	532,375.00	19,400.00
Reserves:			
Ship replacement	4,992,468.14	5,077,346.04	(84,877.90)
Miscellaneous reserves	1,480,812.79	1,733,508.03	(252,695.24)
Surplus	17,353,551.18	22,301,182.41	(4,947,631.23)

The cash balance as shown by daily statements prepared by the various affiliated companies is as follows (see Exhibit A):

May 19, 1923	$1,761,329.32
May 21, 1923	1,988,536.26
May 31, 1923	2,030,750.81

A verification of the cash in banks of the principal companies was made as at May 31, 1923, and the amounts were approximately the same with one exception. (See Exhibit A.)

The companies have been making extremely heavy maintenance and depreciation charges thereby writing down its tonnage rather rapidly. A statement is made in the annual reports for 1921 and 1922, that considerable improvement and progress has been made toward placing the company in a better financial condition. During the year 1921 mortgages were arranged to cover the tanker obligations, and during the year 1922 additional trust certificates of $1,800,000 were issued in connection with the payment for two tankers built by the Newport News Shipbuilding & Dry Dock Co. which constituted the only increase in the bonded indebtedness on the tankers. Through the operation of the sinking funds the original bank loan of $6,000,000 had been reduced to $1,020,000 by the sale of Liberty bonds of $2,000,000 and by the application of earnings from the tankers. The total outstanding indebtedness on the oil tankers at the close of 1922 is $9,022,000, in addition to which there is the Atlantic, Gulf & West Indies Steamship lines, 50-year 5 per cent collateral trust gold bonds of $13,000,000. The interest on the tanker indebtedness of $9,022,000 is $603,340 and on the company's $13,000,000 collateral trust bonds, $650,000. There are also outstanding $12,550,000, first mortgage 5 per cent gold bonds of subsidiary companies, the interest on which amounts to $627,500, thereby resulting in a total interest indebtedness for the year of $1,880,840.

The profits from the operation of the tankers for the month of March, 1923, are shown in the statement of the Atlantic, Gulf & West Indies Steamship lines under Exhibit C.

It should be noted that the company reduced the bank loan of $4,000,000 to $1,020,000 by applying the earnings from the tankers, but shows in the monthly statement of the Atlantic, Gulf & West Indies Steamship lines a net loss of $3,422.93 for March, 1923, and a net loss of $85,345.14 for March, 1922. It seems to be the practice of all the companies to offset any profit from operations by excessive maintenance and depreciation charges.

Balance sheets and income account of the Atlantic, Gulf Oil Corporation and Atlantic, Gulf & West Indies Petroleum Corporation, which companies are not affiliated but controlled by the Atlantic, Gulf & West Indies Steamship lines, are attached to this report and marked "Exhibits D and E." It is noted that the Atlantic Gulf Oil Corporation has deducted depreciation and depletion of $3,526,355.20 from gross earnings $5,502,594.58, thereby reporting gross earnings of $1,976,239.38.

From the annual reports it is shown that the companies have been operating at a loss since the year 1921. However, due consideration must be given to the fact that excessive depreciation and maintenance charges have been made and any profits that may have been realized converted into losses.

Attention is also invited to the large outstanding insurance claims and agent's balances. A detailed statement of these accounts are shown in the attached Exhibits F and G, respectively. The agent's balances are usually convertible into cash from 60 to 90 days. There are also outstanding general claims of $969,763.89 and United States Government claims of $1,873,901.10.

It is contended by the taxpayer that the company is not in a position and could not possibly pay the amount offered in compromise and would only be able to do so through the personal indorsement of some of the stockholders. It is requested by the taxpayer that a conference be arranged, in event the offer in compromise is not favorably entertained. In order that all the facts and details pertaining to the financial condition of the various companies may be presented.

It is the opinion that while some of the companies are operating at a substantial loss yet the fact must not be overlooked that excessive depreciation and maintenance charges have been made resulting in large deficits from operations, in addition to which there are large outstanding claims.

It is shown in the March statement of the New York & Cuba Mail Steamship Co. (Ward line) that the loss from operation for the month of March, 1923, was $196,356 in addition to which there is an operating deficit of $2,534,558.34 as at March 31, 1923. It is, therefore, apparent that this company has been sustaining very substantial losses from operations and will not be able to continue in business unless some improvement is noted.

The March statement of the Clyde Steamship Co. reports a net profit for the month of $201,519.55, together with a surplus of $795,025.85.

A consolidated profit and loss statement as at March 31, 1923, for the principal companies only is as follows:

	Profit	Loss
Atlantic Gulf & West Indies Steamship Lines	$19,552,823.67	
New York & Cuba Mail Steamship Co		$2,902,890.78
New York & Porto Rico Steamship Co		565,604.50
Southern Steamship Co		152,617.41
Mallory Steamship Co		2,668,845.80
Clyde Steamship Co	1,240,169.79	
International Steamship Co	131,415.56	
San Antonio Co	750.00	
	20,925,159.02	6,289,758.49
Profit and loss Mar. 31, 1923		14,635,400.53
Profit and loss Dec. 31, 1922 (all companies)		17,353,551.18

It will, therefore, be seen that the various principal companies as at March 31, 1923, were not as financially strong as at December 31, 1922, and that the condition of the consolidated group as at March 31, 1923, does not probably present as good a showing as at the close of the year 1922.

An examination of the consolidated balance sheet as at December 31, 1922, submitted in connection with the offer in compromise shows that the assets and liabilities were valued in accordance with the consolidated balance sheet as at December 31, 1922, shown in the annual report to stockholders. It was decided that

an extensive investigation as to the correctness of the value of the assets and liabilities as at that date would be unnecessary in view of the fact that the trial balance of several of the companies showed that they were valued with the amounts as shown by the books and that they agreed with the values shown in the annual report to the stockholders.

An analysis of the consolidated balance sheet as at December 31, 1922, shows that on the total book value of fixed assets of $73,778,681.53 there is a total bonded indebtedness of $34,572,000 which would receive prior lien over Federal income taxes if it is decided to liquidate the company.

The investment in the Atlantic Gulf Oil Corporation, which is capitalized for $20,000,000, consists of $4,500,000 first mortgage bonds, $1,000,000 second mortgage bonds, and $1,000 qualifying shares, while the investment in the Columbia Syndicate is $1,920,000. Neither of the above investments are claimed to be very profitable and the balance sheet as at December 31, 1922 of the Atlantic Gulf Oil shows a deficit of $826,131.01. A balance Atlantic, Gulf & West Indies Petroleum Corporation as at September 30, 1922, shows accrued liabilities of £116,821 2s. 4d. with total assets of £1,120,071 2s. 4d. No balance sheet of the Columbia Syndicate or Cia Maritima Cubana were obtainable.

It is my opinion and belief that the Atlantic Gulf & West Indies Steamship lines and subsidiary companies are in financial difficulties and according to a statement of one of the officers of the company may be able, through the practice of strict economy to avoid bankruptcy. The true financial condition of the consolidated group can not, however, be determined without a complete detailed audit. According to a statement of Mr. Mooney, the president, it has only been able to continue in business through the loans obtained on the tankers from several shipbuilding corporations, no provision has been made, however, for setting up a sinking fund. While it may be possible to realize nearly the amount of taxes and penalties due through liquidation it is not believed that it would be advisable, owing to the state of the shipping industry and the large number of ships idle on the market.

E. C. LEWIS,
Internal Revenue Accountant.

NOTE.—Exhibits mentioned in this report are not with the file.

EXHIBIT B

JULY 20, 1923.

Re: Atlantic Gulf & West Indies:
Hon. D. H. BLAIR,
Commissioner of Internal Revenue:

After further deliberation the undersigned agents have agreed as to the amount this corporation could without great difficulty and embarrassment offer in compromise and state their opinions herewith and the method used in arriving at such figure.

FACTS

To determine their exact financial standing at the present time would require a detailed audit of all books and records of the consolidated group from the date where previous examination left off to July 1, 1923.

Since no such audit has been made, it became necessary for the agents to use a financial statement prepared by this company as of January 1, 1923, together with such other statements furnished by them as are of current date.

ANALYSIS OF FINANCIAL CONDITION

In determining the amount of cash this corporation could spare at once, consideration has been given to various factors such as working capital the company must retain to be solvent and its borrowing capacity at the present time, giving further consideration to the fact that the banks have knowledge of the large tax liability standing against this corporation.

An examination of the balance sheet of January 1, 1923, discloses current or liquid assets made up as follows:

Cash in bank	$2,686,434.96
Cash coupons	551,775.00
Cash with agents	1,618,623.93
Marketable securities	127,395.00
Notes receivable	337,624.31
Accounts receivable, general	841,224.83
Insurance claims	1,650,849.49
Shipping Board claims	1,661,363.25
Materials and supplies	234,137.00
Total	9,709,407.77

To this amount the agents find there should be added $200,000, which represents interest accrued and due on bonds of Atlantic Gulf Oil Co. which this corporation owns, but failed to show on balance sheet, and which are first mortgages on the property of Atlantic Gulf Oil Co. and on which the corporation can get a note and have same discounted at the bank. This makes total current assets $9,909,427.77. Against these are current liabilities which required immediate payment of $1,991,641.49, leaving a balance of net current assets of $7,917,786.28 out of which to pay the government any taxes due. Taking as a basis the contention of the agents that this corporation can pay $4,000,000 to pay this the corporation would have to convert there current assets into cash and following is shown how this can be accomplished and verifies the fact that same can be done without great disturbance.

Our examination shows the current liabilities average per month about $1,500,000. Therefore, this corporation should have on hand this much in bank, but does not require more. The statement shows $2,636,434.96 cash on hand. Therefore, conservatively $500,000 of this can be paid to Government, leaving $2,186,434.96 in bank for working capital. There is another $1,618,623.93 of cash in the hands of agents due in 60 days, this sum also to Government and in addition, if claim against Shipping Board is good this amount to Government making $3,779,987.18. After these payments there would still remain with corporation the following current assets:

Cash	$2,186,434.96
Cash coupons	551,775.00
Accounts receivable, 30 days	841,224.83
Due from oil company	200,000.00
Due from insurance company	1,650,849.49
Marketable securities	127,395.00
Notes receivable	337,624.31
Materials and supplies	234,137.00
Total	6,129,440.59

This amount has therefore been arrived at without resort to borrowings. As to this corporation's ability to borrow, consideration must be given to the fact that in addition to assets already mentioned this corporation has investments in bonds of $5,009,375, which could be placed up as collateral without any other notes or personal guarantees, and has in addition a tanker unmortgaged, present market value $583,000.

A word as to bondholders of corporation. They are all secured by mortgage on the marine equipment book, value about $77,000,000. But under no conditions could these bondholders levy against any of the current assets or would there be any occasion to.

If to avoid payment a sort of receivership is gone through, the Government by taking immediate action could apply liens against sufficient assets to protect their claims for any amount.

SYDNEY L. BURG,
Internal Revenue Agent.
FRED T. MACDONALD,
Internal Revenue Agent.

EXHIBIT C

JANUARY 7, 1924.

ATLANTIC, GULF & WEST INDIES STEAMSHIP LINES,
New York City.

Attention of Mr. Franklin D. Mooney, president.

SIR: The Commissioner of Internal Revenue has considered the proposition submitted on December 17, 1923, through the collector of internal revenue for the second district of New York by the Atlantic, Gulf & West Indies Steamship Lines and it subsidiary companies, viz, Clyde Steamship Co., Mallory Steamship Co., New York & Cuba Mail Steamship Co., New York & Porto Rico Steamship Co. (of Maine), United States & Porto Rico Navigation Co., The New York & Porto Rico Steamship Co., (of New York), Southern Steamship Co., International Shipping Corporation, Jacksonville Lighterage Co., the Tampa Towing & Lighterage Co., Clyde Steamship Terminal Co., Carolina Terminal Co., San Antonio Docking Co., San Antonio Co., Wilmington Terminal Co., as a compromise of their taxes, penalties and other obligations arising out of or connected with returns for and payments of income, war profits and excess profits taxes for the years 1917 to 1920 inclusive, and has decided with the advice and consent of the Secretary of the Treasury to close the case by the acceptance of the following terms, viz, $1,280,000 in lieu of any and all liabilities or obligations, whether for tax, penalty, or of any other nature, arising out of or in connection with the obligation to file returns for, and to make payments of, any income, war income, excess profits and or war profits taxes for the years 1917 to 1920 inclusive, or arising out of or in connection with any acts, events, transactions, omissions, or replacement funds or other undertakings, relating to the receipt or accrual during those years of any income, gains, profits, or amounts or the accounting therefor in any manner whatsoever, the New York & Porto Rico Steamship Co. (of Maine), one of the subsidiary companies named, having released to the United States the judgment of the Court of Claims in its favor against the United States on account of the loss of the steamship *Carolina* amounting, with interest, to approximately $1,351,000 and having released all other claims of any nature whatsoever growing out of the loss of said steamship *Carolina*.

Respectfully,

NELSON T. HARTSON,
Solicitor of Internal Revenue.

EXHIBIT D

Atlantic, Gulf & West Indies Steamship Lines and subsidiary companies—memorandum of bond discount, year ended December 31, 1923

(Discount on 195,500 par Atlantic, Gulf & West Indies Steamship Lines 5 per cent collateral trust gold bonds, due January 1, 1959)

Date sold	Par	Amount received	Discount
1921			
Jan. 25	$13,000.00	$7,650.50	$5,349.50
Jan. 26	14,000.00	8,309.00	5,691.00
Feb. 1	10,000.00	5,985.00	4,015.00
Feb. 17	10,000.00	5,885.00	4,115.00
Feb. 18	19,000.00	11,184.00	7,816.00
Apr. 30	1,885,500.00	942,750.00	942,750.00
Total	1,951,500.00	981,763.50	969,736.50

Life period of bonds, May 1, 1921, to January 1, 1959 (37 years 8 months = 452 months).

Discount per month	$2,145.435
Discount absorbed 1921 return (8 months)	17,163.48
Discount absorbed 1922 return (12 months)	25,745.22
Discount absorbed 1923 return (12 months)	25,745.22

EXHIBIT E

Atlantic, Gulf & West Indies Steamship Lines and subsidiary companies, exclusive of foreign and controlled companies—comparative consolidated balance sheet, December 31, 1921, and 1922

	1921		1922	
ASSETS				
Capital assets:				
Fleet in commission	$75,606,087.31		$73,470,700.83	
Shore properties	4,358,510.99		4,071,155.63	
Good will and franchises	12,254,320.37		12,504,320.37	
		$92,218,918.67		$90,046,176.83
Investment in foreign subsidiaries		2,124,874.62		2,374,274.62
Investments in associated companies (Compania Cubana de Navegacion, net investment for 1921, inclusive)		11,405,286.05		8,408,090.04
Cash in hands of trustees		178,618.86		45,013.56
Expenditures for accounts of unfinished voyages		2,502,932.85		2,695,882.52
Current assets:				
Supplies and repair parts	502,180.52		431,444.85	
Accounts and notes receivable	6,446,853.55		6,597,718.73	
Marketable securities	155,969.32		144,871.57	
Cash on hand and in banks	1,945,211.20		2,519,168.07	
Cash for coupons payable	532,375.00		551,775.00	
		9,582,592.59		10,244,978.22
		118,013,223.64		113,815,624.79
LIABILITIES				
Capital liabilities:				
Capital stock—				
Common stock, authorized and issued	20,000,000.00		20,000,000.00	
Less: In treasury	5,036,600.00		5,036,600.00	
	14,963,400.00		14,963,400.00	
Preferred stock, authorized and issued	20,000,000.00		20,000,000.00	
Less: In treasury	6,257,100.00		6,257,100.00	
	13,742,900.00		13,742,900.00	
		[1] 28,706,300.00		[1] 26,706,300.00
Minority stockholder's interest in subsidiaries		91,671.12		85,283.24
Funded debt, per exhibit		35,205,000.00		34,572,000.00
Receipts on account of unfinished voyages		1,824,355.05		2,219,148.62
Current liabilities:				
Notes and accounts payable	7,353,012.80		5,033,885.13	
Accrued interest on bonds, etc	281,757.04		254,905.22	
Coupons payable	532,375.00		551,775.00	
		8,167,144.84		5,840,655.35
Intercompany balance (net)		3,879,444.89		3,411,305.23
Reserves:				
Replacement of marine equipment	5,077,346.04		1,992,468.14	
Depreciation of properties and equipment	13,846,261.80		18,346,416.14	
Miscellaneous	1,732,663.19		1,431,574.68	
		20,656,271.03		24,770,458.96
Surplus		19,483,036.71		14,210,173.39
		118,013,223.64		113,815,624.79

[1] 287,063 shares.

EXHIBIT F

Atlantic, Gulf & West Indies steamship lines and subsidiary companies, exclusive of foreign and controlled companies—comparative consolidated balance sheet as at Dec. 31, 1923

ASSETS	1923	
Capital assets:		
Fleet in commission	$70,425,466.83	
Shore properties	4,104,398.89	
Goodwill and franchises	12,503,977.37	
		$87,033,843.09
Investment in foreign subsidiaries (Exhibit 2)		2,371,274.62
Investments in associated companies (Exhibit 2)		6,121,000.00
Cash in hands of trustees		221,033.09
Expenditures for account of unfinished voyages, etc		2,816,066.70

Current assets:		
Supplies and repair parts	$347,960.33	
Accounts and notes receivable	6,254,053.89	
Marketable securities	122,676.57	
Cash on hand and in banks	2,001,379.14	
Cash for coupons payable	409,912.50	
		$9,198,981.43
Intercompany balances (net)		933,615.52
		108,498,814.45
LIABILITIES		
Capital stock:		
Common, authorized and issued	20,000,000.00	
Less: In treasury	5,036,600.00	
	14,963,400.00	
Preferred, authorized and issued	20,000,000.00	
Less: In treasury	6,257,100.00	
	13,742,900.00	
		[1] 28,706,300.60
Minority stockholders' interest in subsidiaries		82,164.05
Bonded debt		33,244,000.00
Receipts on account of unfinished voyages, etc		1,996,273.44
Current liabilities:		
Notes and accounts payable	4,060,284.70	
Accrued interest on bonds, etc	360,589.54	
Coupons payable	409,912.50	
Intercompany balances (net)		4,869,786.74
Reserves:		
Depreciation of properties	21,147,087.82	
Replacement of marine equipment	1,520,748.39	
		22,668,436.21
Miscellaneous		10,931,854.01
Surplus		108,498,814.45

[1] 287,063 shares.

EXHIBIT 2

Atlantic, Gulf & West Indies steamship lines and subsidiary companies - Investments in foreign subsidiary and controlled companies left out of consolidation for year ending Dec. 31, 1923

	Par value	Excess of carrying value over par value	Carrying value
The Santiago Terminal Co	$46,200.00	$70,457.67	$116,657.67
The Santiago Warehouse Co	32,500.00	40,753.47	73,253.47
Atlantic, Gulf & West Indies Trading Corporation	25,000.00		25,000.00
Compania Cubana de Navegacion	272,500.00		272,500.00
Cuban-American Terminal Co	877,250.00	1,009,613.48	1,886,863.48
	1,253,450.00	1,120,824.62	2,374,274.62

Investments in associated companies

Atlantic Gulf Oil Corporation, bonds	$1,200,000.00
Atlantic Gulf Oil Corporation, stock	1,000.00
Compania Maritima, stock	100,000.00
Advances in cash to Colombia Syndicate for development of oil properties	1,820,000.00
Total	6,121,000.00

The CHAIRMAN. We will adjourn now, and will let you know later in the day as to whether we will want you to-morrow. We do not know as yet whether we will go on with the prohibition cases to-morrow or with the income-tax features.

(Whereupon, at 12 o'clock meridian, the committee adjourned until to-morrow, Wednesday, February 25, 1925, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

THURSDAY, FEBRUARY 26, 1925

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senator Couzens, presiding.

Present also: Mr. L. C. Manson, of counsel for the committee; Mr. L. H. Parker, chief engineer for the committee; and Mr. Edward T. Wright, investigating engineer, for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. A. W. Gregg, special assistant to the Secretary of the Treasury; Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, solicitor, Bureau of Internal Revenue; Mr. James M. Williamson, attorney, office of solicitor, Bureau of Internal Revenue; Mr. S. M. Greenidge, head engineering divisions, Bureau of Internal Revenue; and Mr. John Alden Grimes, chief metals valuation section, Bureau of Internal Revenue.

The CHAIRMAN. You may proceed, Mr. Manson.

Mr. MANSON. When we were considering the copper revaluations, the statement was made that the valuations as fixed by Mr. Graton were afterwards checked, and many of the discrepancies eliminated before they were applied to the determination of the tax.

In that connection, I desire to call attention to the various valuations placed on the property of two companies, the Anaconda and the Inspiration.

In the case of the Anaconda Co., the valuation claimed by the company in its return was $184,152,965. The valuation of the property by Mr. Graton was $132,125,101. According to the office revision of Mr. Graton's valuation, the valuation was $188,713,192, and the revaluation by Mr. Grimes is $54,865,822.

In the case of the Inspiration Co.

The CHAIRMAN. Just at this point let me ask you what basis the tax was settled on.

Mr. MANSON. The tax was settled on the basis of the office revision which is about $4,500,000 in excess of the amount claimed.

The CHAIRMAN. In other words, they ignored Mr. Grimes's valuation?

Mr. MANSON. Mr. Grimes's valuation is the revaluation that has been ordered to apply to the 1919 and subsequent years' taxes.

The CHAIRMAN. So far as the revision is concerned, that being the one made by Mr. Grimes, it has been made to apply in the year 1919 and subsequent years?

Mr. MANSON. Yes.

The CHAIRMAN. But that is ignored, so far as 1917 and 1918 are concerned?

Mr. MANSON. Yes. In the case of the Inspiration, the value as claimed by the taxpayer was $62,214,806. The Graton valuation was $91,654,000. The office revision was $92,134,730, and Mr. Grimes's revaluation was $17,292,074.

The CHAIRMAN. The same situation applies in this case as applies in the Anaconda case?

Mr. MANSON. Yes.

The CHAIRMAN. Is there any information in the records as to why the office revision was so high?

Mr. MANSON. Not that I know of. Do you know about that, Mr. Wright?

Mr. WRIGHT. No; I do not recall that it was. I think in that memorandum the Chile Copper Co. was also mentioned.

Mr. MANSON. Yes.

Mr. WRIGHT. And the office revision on all three of them was very much less. They are now all Anaconda interests. Then, Mr. Grimes's revision is still very greatly less. There is a difference of over $100,000,000 I think.

The CHAIRMAN. The engineers, in checking these figures, must have found something there to indicate on what basis, at least, the bureau did revise those figures.

Mr. MANSON. It will be recalled at the time Mr. Graton was on the stand he testified that hearings had not been granted taxpayers at the time he made his valuations, and that subsequently hearings were granted the taxpayers. I assume that the office revisions were based on the results of those hearings.

The CHAIRMAN. And there was no stenographic report of what took place in those hearings?

Mr. WRIGHT. Mr. Chairman, these cases have been gone into in aggregate figures, rather than in detail. The Anaconda case will be taken up separately as a case in the near future, but we have not gone into it in detail as yet, on the individual cases.

The CHAIRMAN. When the taxpayer made his return, he set certain valuations, which counsel has just referred to. Did he later submit a brief changing those valuations to the valuations set by the bureau, Mr. Wright, do you know?

Mr. WRIGHT. I can not tell you, Mr. Chairman.

Mr. MANSON. We will report on the Anaconda case as an individual case.

The CHAIRMAN. All right; you may proceed.

Mr. MANSON. The matter I wish to present this morning refers to the revaluation of silver mines. Before going into the engineer's report, I will state that the only difference between the original valuation and the basis of valuation upon which the metals valuation section now stands, which is characteristic of all the valuations with respect to silver, is a difference of price. The price fixed as the basis for the original valuations was 65 cents an ounce, while the price accepted by the metals valuation section is 57.78 cents per ounce.

Both in the case of silver and copper, the difference in price makes an entirely disproportionate difference in the depletion allowance.

For instance, in the case of copper, the difference in price between that accepted by the bureau as its basis of revaluation, of 15 cents a pound, and the price used by Mr. Graton, of 17.41 cents, makes a vastly greater difference in the value of the metal in the ground than the proportionate difference in the price, for this reason, that the entire cost of the plant is deducted from the total expected profit, and the operating expenses are deducted from the total expected aggregate returns for the ore. Thus, the entire difference in the price is reflected in the valuation of the ore in the ground.

The situation with respect to the silver mines is set forth clearly in the report of Mr. Wright, the committee's engineer, from which I shall now read:

The history of the original valuations of silver mines dates back to 1919, and is identical with that of copper mines, as outlined in office memorandum No. 8, dated January 6, 1925.

Mr. J. C. Dick, entered the natural resources subdivision as a valuation engineer in July, 1919, and was placed in charge of the valuations of lead and silver properties. Most of the early valuation reports bear his signature.

In December, 1919, Mr. Dick was appointed chief of the metals valuation section, and in March he was appointed head of the natural resources subdivision.

One or two only of the original silver valuations were marked "provisional," although the same valuation methods were used as were applied by Mr. Graton in the copper mine valuations.

Hearings were conducted early in 1920 in some of the more important cases, and the original valuations became the basis for the determination of taxes for the year 1917 and subsequent years.

The protest by the St. Louis Lead Co. and the Doe Run Lead Co. in July, 1921, caused the metals valuation section to start an investigation of the original valuations, particularly as to the prices of silver. It was found that, as in the case of copper, silver had been favored as to the expected average price as compared with the zinc and lead prices used in the early valuations.

A price of 65 cents per ounce was used in the original valuations, while it was determined by the metals valuation section that such average price should have been 57.78 cents per ounce.

I might depart from this report at this point to state that there will be offered as an exhibit a statement showing the prices of silver over a 10-year period, and that the price of 65 cents used as the expected price at which the product of these mines would be sold is a higher price than had been obtained for silver since the month of September, 1907.

The CHAIRMAN. That did not include, of course, the price that the Government paid under the Pittman Act, did it? As I understand it, the Government paid as high as a dollar for some silver under the Pittman Act.

Mr. MANSON. Yes; but these valuations were made as of March 1, 1913.

The CHAIRMAN. Oh, I see.

Mr. MANSON. And as was brought out in a hearing the other day, the only factors which could be considered were the conditions existing up to that date; and I am calling attention now to the fact that the price used as the expected price for the purpose of figuring the value of these properties was higher than the silver had brought at at any time subsequent to September, 1907.

It is also shown by chart which will be introduced as a part of this report that the trend of silver prices from 1893 or 1894 was a constant decline.

The CHAIRMAN. Have you the average price convenient of the silver from 1906 up to 1913?

Mr. MANSON. I have the average price for silver for 10 years.

The CHAIRMAN. What is that?

Mr. MANSON. Prior to March 1, 1913, 57.78 cents, which is the price used by the bureau under the present administration of the metals valuation section as the basis for revaluing these mines.

The CHAIRMAN. Do you consider that a fair basis?

Mr. MANSON. I do. If there is anything wrong with that basis it is in favor of the taxpayer, for the reason that the chart attached to this report shows the trend of silver prices to be downward from about 1893 to and after March 1, 1913, and with the natural trend being downward to use the arithmetical average price for the preceding 10 years certainly gives the taxpayer all the advantages that he is entitled to.

Mr. HARTSON. Do you know, as a matter of fact, that the price since March 1, 1913, has been downward?

Mr. MANSON. Basing my answer to that question on the graph, I would say the trend has been downward.

Mr. HARTSON. I do not know.

Mr. MANSON. That is, when you take into consideration commodity prices to get at the actual value of the silver, the trend has been downward right up to 1922 or 1923. There have been some irregularities, of course, owing to the purchase of silver, under the Pittman Act.

I will now continue with this report:

The expected average price for lead of 4.35 cents per pound, St. Louis, was used in the original valuations, while it was determined that 4.469 cents should have been used. The ratio of the expected average price for silver of 65 cents per ounce to the 10-year average price of silver, 57.78 cents per ounce, is 112.5 per cent.

The St. Louis Lead Co., having asked for a revision of their valuations based on the price of 5 cents per pound, on the basis that copper and silver had received preferential treatment as to price, were informed that errors might have been made in the determination of copper and silver prices, but such an argument would not have been permitted to be the foundation for other errors.

The same errors were found on investigation in the silver valuations as occurred in the copper valuations, although not to such a marked degree, the principal error being in the expected average price of silver.

The metals valuation section, as a result of their investigation of the original valuations, concluded that the copper and silver industries were receiving preferential treatment, and that a large amount of taxes was being lost by the Government. It was developed also that uniform procedure should be adopted for the analytical valuations of mining property.

On January 7, 1922, a memorandum (see Exhibit D of Copper Mines Valuation, pp. 1635, 1637 of pt. 10 of the record of hearings), was prepared by Mr. John A. Grimes, chief of the metals valuation section, and forwarded by the head of the natural resources division, Mr. Fay, to the commissioner, which included certain recommendations for his consideration. Subsequently, other memoranda were written to him and various charts and tables submitted, which placed the entire subject in comprehensive shape before the commissioner.

During the summer of 1922 a hearing was held before the Commissioner of Internal Revenue with representatives of the large copper producers. It appears, however, that the silver producers were not invited to this hearing, nor were they given an opportunity of expressing their views in connection with the subject of revaluation of their properties.

On December 11, 1922, the Commissioner of Internal Revenue, D. H. Blair, with the approval of the Secretary of the Treasury, A. W. Mellon, authorized (Exhibit B) the revaluation of copper and silver mines, for the purpose of determining their tax liability for 1919 and subsequent years, in accordance with the recommendations of the metals valuation section.

The order for this revaluation was included in the record in connection with the copper revaluations.

Pursuant to the above order, the metals valuation section proceeded immediately with the revaluation of copper mines.

In connection with the silver properties, however, revaluations were delayed until after the more important copper properties had been completed. An examination has been made of the files pertaining to silver properties, the results of which are incorporated in the accompanying tabulation. From the recapitulation of sheet 3 thereof—

This tabulation that I refer to is Exhibit C, which I will offer—

it will be noticed that from the records of the metals valuation section there are 180 silver producers, of which 85 do not appear to have had tax cases before the Income Tax Unit, leaving 95 silver producers whose cases are concerned in the valuation section. Of this number, 54 only are subject to revaluations, and of which 11 have been completed.

The following summary is shown for the 54 cases subject to revision:

Of the 11 valuations completed, the original valuations, according to the Dick valuations, are $37,517,093. The revised valuations made by the metals valuation section are $23,867,624, a difference of $13,649,469, or a difference of 157.19 per cent.

The property of the remaining 43 companies was valued at $100,431,047. Applying the same percentage of difference to those companies, the revised valuations would be $63,894,232 a difference of $36,536,815. In other words, if that same percentage of difference is applied to all 54 companies, that is, to the remaining 43 companies, the original valuations of $137,948,140, would be revised to $87,761,856, or a difference of $50,186,284.

In order to get at a total figure for reduction in valuations and in additional tax reflected thereby, it has been necessary to compute and estimate such reduction, using the same ratio for the 43 cases yet to be revised as is shown in the 11 cases completed.

Assuming that the estimated revised values for 54 cases, amounting to $44,563,976, will be increased 15 per cent in conference, the corrected totals for estimated revaluations of depletion for the 54 cases is as follows:

Original valuation	$92, 265, 344
Revaluations	51, 248, 572
Reduction in values	41, 016, 772

With a tax rate of 12½ per cent on the reduction in valuation deductions, a tax of $5,127,096 is indicated for 1919 and subsequent years. In some cases, it has been found necessary to revise the invested capital valuations, but it is not possible to give an estimate of such reductions in total.

It will be noted at this point that that difference in tax is indicated for 1919 and subsequent years only, and does not include any excess profit taxes, or war profit taxes, which would amount to a great deal more than those figures, if these valuations were made to apply for 1918.

The CHAIRMAN. And 1917, too?

Mr. MANSON. Yes.

The CHAIRMAN. Have you taken any specific case and figured what it would have been in a specific case?

Mr. MANSON. We have not as yet.

The CHAIRMAN. You will do that, will you?

Mr. MANSON. We will do that. We will present at least one specific case.

As noted above, 11 out of 54 silver properties had been revalued. When, on April 11, 1924, the commissioner, with the approval of the Secretary of the Treasury, rescinded his order of December 11, 1922, as relating to silver mining companies (Exhibit D).

TREASURY DEPARTMENT,
Washington, April 11, 1924.

Memorandum for Mr. Bright:
Attention Mr. Greenidge.

Under date of December 11, 1922, the Secretary of the Treasury approved an order of the commissioner to revalue copper mining companies for the purpose of determining their tax liability for 1919 and subsequent years. In said order

silver mining companies were inadvertently mentioned. In view of the fact that numerous hearings were granted to copper mining companies and the silver mining companies were not notified of such hearings and had no hearing and that silver mining was not discussed in the various meetings and it was the intention at the time to revalue only copper mining companies, you will, therefore, ignore all reference to silver mining companies to said order.

D. H. BLAIR, *Commissioner.*

Approved:

A. W. MELLON,
Secretary of the Treasury.

The metals valuation section has made a careful study and investigation of selling prices of metal, and have adopted the arithmetical average price method for the 10 years preceding the basic date, except in the cases of metals for which such an average price is not available, or for which the price trend during the 10-year period is strongly and conclusively up or down. Exhibit E, herewith, shows the computations in arriving at the future selling price of silver at 57.78 cents per ounce.

When the commissioner's memorandum of April 11, 1924, which is the memorandum rescinding the order for the revaluation of the silver mines——

The CHAIRMAN. That order of April 11, 1924, must have been changed subsequently, if you had some revaluations, must it not?

Mr. MANSON. These valuations were made in the interim. The order for the revaluation of both copper and silver mines was made, as will be recalled, in December, 1922.

The CHAIRMAN. Yes; I understand that, but do you understand that only these 11 companies are being revalued now?

Mr. MANSON. Only those 11 companies have been revalued.

The CHAIRMAN. Are the other companies being revalued, or are they not being revalued?

Mr. MANSON. As I understand, and as I will show here, the work has been ordered stopped.

It appears that when the commissioner's memorandum of April 11, 1924, was received by the metals valuation section, there was considerable uncertainty as to whether, in fact, this memorandum constituted the direct order to stop the work of revising the silver mine revaluations.

I might say in that connection that that difference of opinion arose in this way:

It was understood by the metals valuation section that no valuation must be put into effect for the purpose of determining tax until the taxpayer had had a hearing, but it was not understood by the metals valuation section that the work of revaluing these properties for the purpose of determining whether or not a revaluation should be put into effect had been stopped. By reason of that doubt, an effort was made to go ahead with these revaluations for the purpose of determining the difference between the valuations as previously fixed and the valuations as fixed on a proper basis.

A large number of silver mines cases were in the department for action and it was necessary either to forward these cases to the audit for the determination of 1919 taxes on the basis of the original valuations or to proceed with the revision of such valuations. The chief of the metals valuation section was unwilling to take the responsibility of approving the original valuations for tax computa-

tions and referred the matter to Mr. Greenidge, head of the engineering division. Mr. Grimes, chief, Mr. Donahoe, assistant chief, and Mr. Graigue, valuation engineer, had a conference with Mr. Greenidge shortly after the receipt of the commissioner's letter of April 11, 1924. These gentlemen took the position that the commissioner's letter was indefinite and that the section should receive positive instructions in the matter of definitely stopping the revaluation of silver mines. As a result of this conference, Mr. Greenidge addressed a memorandum dated April 17, 1924, to the metals valuation section as follows (Exhibit F):

INCOME TAX UNIT,
ENGINEERING DIVISION,
April 17, 1924.

Memorandum to Mr. Grimes, chief, metals valuation section, in re revaluation of silver mining companies and commissioner's memorandum, dated April 11, 1924.

The last sentence of the commissioner's memorandum, noted above, states among other things:

"It was the intention at the time to revalue only copper mining companies."

This, I take it, is insufficient instruction for this division not to revalue any metal producing companies other than copper unless, of course, fraud or gross error can be clearly demonstrated.

You are therefore directed not to revalue silver mining companies.

S. M. GREENIDGE,
Head of Division.

This memorandum was taken as a definite order and the work of revaluing silver mines was abandoned. Subsequently and on June 18, 1924, Mr. Grimes addressed a memorandum to the commissioner (Exhibit G) on the subject of silver revaluations. The matter of silver revaluations was again presented, but in a more specific and detailed manner, for the consideration of the commissioner. Reasons were presented for such revaluation in order to equalize the treatment of taxpayers in the same industry as also between industries. Many exhibits were attached to this memorandum in proof of the position taken by the metals valuation section. The commissioner was again requested to consider the matter and, if possible, to restate his order as pertaining to silver mines covered by his memorandum of December 11, 1922. It would appear that this memorandum has never reached the commissioner, inasmuch as a reply to same has never been received by the metals valuation section. A matter of such importance would certainly have been given consideration by the commissioner if the memorandum of June 18, 1924, had been received. It is learned on inquiry that the commissioner does not recall ever having received this memorandum, but a search having been made, discloses that the memorandum is now in his files, but lacks the receiving stamp of the office so that it is impossible to say when or how it got there.

At this point I desire to call attention——

The CHAIRMAN. Just a minute. How long is that letter of Mr. Grimes which is directed to the commissioner? Is it a long one? I see you offer it as an exhibit.

Mr. MANSON. It is four pages long.

The CHAIRMAN. We will let it go in as an exhibit, then.

Mr. MANSON. It was my intention at this point to call attention to this letter, Exhibit G, and to call special attention to the fact that this letter is dated June 18, 1924.

We are unofficially advised that although the commissioner has not revoked his letter of April 11, 1924, he has verbally approved and ordered the metals valuation section to proceed with a revision of the silver mine valuations.

The CHAIRMAN. You say you are "unofficially advised?"

Mr. MANSON. We were unofficially advised about 10 days ago that the commissioner verbally instructed the metals valuation section to proceed with the revaluations.

Mr. Grimes is present here, and if the chairman desires to examine him as to that he may do so.

The CHAIRM. N. I would like to ask Mr. Grimes if he has been officially notified to revalue the silver mines.

Mr. GRIMES. I called on the commissioner in person about, I should say, three or four weeks ago, the time getting pretty short in which we could revalue for 1919, and the commissioner assured me at that time that we would be given permission to revalue.

I prepared a letter to taxpayers in the mining industry asking for waivers for 1919, informing them that if waivers were not received it would be necessary to put a jeopardy assessment on in the tax interest of the Government, and that letter was forwarded to the commissioner's office and returned, approved by him, with slight revision, and has now been sent out to all of the taxpayers in the silver mining industry.

The CHAIRMAN. So that you interpret that as an instruction to proceed with the revaluations?

Mr. GRIMES. The commissioner informed me at the time that he would give us written instructions.

Tue CHAIRMAN. But he has not done that up to date?

Mr. GRIMES. No; we have not received them to date.

The CHAIRMAN. Well, are you proceeding, or are you remaining in status quo?

Mr. GRIMES. No; we are proceeding.

The CHAIRMAN. Under the oral instructions?

Mr. GRIMES. Yes, sir.

Mr. HARTSON. So that nothing further, or nothing in addition, could be done had the instructions been in writing?

Mr. GRIMES. No.

Mr. HARTSON. To what has been done under the oral instructions?

Mr. GRIMES. No.

Mr. GREGG. One more question, if I may be permitted, Mr. Chairman:

Did not this letter which you prepared and sent to the different silver mining companies contain a statement that a revaluation of their properties was contemplated?

Mr. GRIMES. Yes; under the order of December 11, 1922.

Mr. GREGG. In other words, this letter was recently approved by the commissioner, about 10 days ago, asking for waivers for 1919, and stating that the revaluation of their properties was under consideration?

Mr. GRIMES. It stated that it had been ordered on December 11, 1922.

Mr. GREGG. Was the approval of that by the commissioner sufficient to justify you in going ahead with the revaluations as you have been?

Mr. GRIMES. Yes; we have been going right ahead with them. There has been no delay on that point.

The CHAIRMAN. Well, what happened between June, 1924, and the time three or four weeks ago that you mentioned? Did you continue the revaluations during that period?

Mr. GRIMES. No, sir.

The CHAIRMAN. I think that is what Mr. Gregg is wrong on. Mr. Gregg gave me the impression that there was no let-up.

Mr. GREGG. I did not mean that.

The CHAIRMAN. Between the time of that letter to the commissioner in the matter of the revaluations——

Mr. GREGG. I did not mean to give that impression. Perhaps I did not make myself clear.

The point I wanted to bring out was that this letter of some two or three weeks ago, which was approved by the commissioner, asking the silver companies for waivers, stated that a revaluation of the silver companies for waivers, stated that a revaluation of the silver industry was contemplated, and was sufficient to justify Mr. Grimes in doing what he has done since that date in revaluing the silver properties.

The CHAIRMAN. Do you know, Mr. Gregg, what happened between June, 1924, and this recent date, concerning the revaluation of the silver mines?

Mr. GREGG. No, sir; except what Mr. Grimes has just said, that nothing was done. He held it in abeyance pending action by the commissioner.

The CHAIRMAN. Do you know what became of your letter, Mr. Grimes, that was written in June, 1924?

Mr. GRIMES. I know nothing about it from the time it left my hands. I took some time in preparing that letter, something like six weeks, or maybe two months, after we got the commissioner's letter of April 11, 1924, and as soon as I could get the letter prepared, with the exhibits to go with it, I took it to Mr. Greenidge's office to deliver it to him. I had his assurance that it would be forwarded to his superior officer. Mr. Greenidge was not in his office at the time. I left the letter with Mr. Greenidge's assistant. I was leaving on field work either that day or the next, I believe, or, at any rate, within two or three days. I left it with Mr. Griggs in Mr. Greenidge's office. That was the last I ever heard of it.

The CHAIRMAN. Is it the custom or the rule that communications addressed to the commissioner should pass through your chief first?

Mr. GRIMES. Yes, sir.

The CHAIRMAN. Is Mr. Greenidge here?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. Do you know what became of that letter, Mr Greenidge, that was left in your office in June, 1924?

Mr. GREENIDGE. I took it personally to Mr. Bright's office. We discussed it, and Mr. Bright and I personally took it to the commissoner's office, and we discussed it there.

The CHAIRMAN. About what time was that, would you say?

Mr. GREENIDGE. A matter of a few days only after that.

The CHAIRMAN. Does that account for the fact that there is no receiving stamp on the letter in the files?

Mr. GREENIDGE. Undoubtedly, because the letter, and I think the copies, was returned by the commissioner to Mr. Bright and myself, along with a number of other communications on the silver-revaluation subject.

The CHAIRMAN. When were they returned?

Mr. GREENIDGE. I think at the time we discussed it with the commissioner. If not at that meeting, it was at a subsequent meeting.

The CHAIRMAN. How do you account for the time that has elapsed between then and the more recent date that Mr. Grimes has referred to?

Mr. GREENIDGE. That is accounted for, Mr. Chairman, by the fact that during the discussion of the silver-revaluation matter, I prepared a proposed order for the commissioner's signature deferring the revaluation of silver-mining companies, I think, until the end of the year 1921—and I am speaking from memory now, but I think that was the year—and the proposed letter I had prepared for the commissioner's signature received Mr. Grimes's approval, and when Mr. Bright and I talked it over with the commissioner, as I recall it now, the decision arrived at at that time was that if the revaluation of the silver mines was not necessary for immediate taxes, we would defer it until we could get some of the work which was piled up on us behind us, and give the matter such consideration as it merited at a later date. I have a distinct recollection of having discussed it with Mr. Bright, and an equally distinct one of having communicated that to Mr. Grimes, but he seems to have no recollection on that, as he stated.

The CHAIRMAN. So that we are to understand that along in June, 1924, there was a tentative agreement to revalue the silver properties, and that the matter was allowed to remain in status quo from June, 1924, to February, 1925, because of the volume of other work which you had to do. Is that a correct understanding?

Mr. GREENIDGE. No; not entirely on account of the volume of other work, Mr. Chairman, but largely on account of the fact that the revaluations to commence at a later date had received Mr. Grimes's approval.

The CHAIRMAN. In other words, then, you were to leave out the years 1919 and 1920, and start with 1901 and take in the subsequent years; is that the idea?

Mr. GREENIDGE. I think it was, sir. That memorandum is in the file, and we can definitely fix that date. My memory is that it was at the end of the year 1921.

The CHAIRMAN. Just why did you reach the conclusion in the copper cases to reach 1919 and subsequent years, and in the silver cases to use 1922 and subsequent years?

Mr. GREENIDGE. As regards the copper end of it, sir, I do not think I can answer you, but as regards the silver end of it, I can. Because there were a number of elements in connection with the silver revaluation that did not necessarily appear in the copper. The principal one, and I think the one on which the whole question turns, is the amount of assessable tax because of the silver revaluation and because of the amount of refunds that will result from the raising of the lead price, which practically counterbalance each other. I believe I am correct in that, am I not, Mr. Grimes?

Mr. GRIMES. I think so.

The CHAIRMAN. Do I understand from that, then, that the same corporate interests own the lead and the silver?

Mr. GREENIDGE. No, sir; they do not. The lead mines of Missouri, Kansas, and Oklahoma produce very little silver, but some of the silver-producing mines do carry lead, of course, such as the Coeur d'Alene and some in Utah.

The CHAIRMAN. Then, as I understand it, when you referred to the lead and the silver counterbalancing each other, the result of that would be that the lead people would be penalized, and the silver mines would receive considerable of an advantage?

Mr. GREENIDGE. No, sir. The lead producers would receive refunds, as I understand it.

The CHAIRMAN. But you were not proceeding, as I understand it, with the lead companies on the refund feature.

Mr. GREENIDGE. No; I do not know that I would place that construction on it exactly. It would be a counterbalancing feature on the part of the Government, and a very large portion of this money which would be refunded would also be assessable and the penalizing of it, if any did come, would come to those companies that did not produce any silver; but with a revaluation of them all, there would be no penalizing.

The CHAIRMAN. But a peculiar situation, as it appears to the chairman, is that you should counterbalance, from the Government's point of view, one industry with another industry, regardless of the merits in the situation as applied to either industry.

Mr. GREENIDGE. When you come to look at it in a large way, Mr. Chairman, you may take this view, I think, that the revaluation of all the silver producing mines, and the resetting up of their books on this new basis is not a small task. It will be an expensive one. A very considerable sum of money will be expended, and energy, and in addition to that, there will be little assessable tax as a result thereof.

The CHAIRMAN. Well, I understand that, but I am still in a quandary to know why you held up the lead industry's refunds, to which you say they would be entitled if a proper basis of valuation was used?

Mr. GREENIDGE. That is the same basis of valuation?

The CHAIRMAN. Yes; because of the fact that you did not want to tackle the revaluation of the silver mines, on account of its being so large a task.

Mr. GREENIDGE. Well, it is not a small task, Mr. Chairman.

Mr. HARTSON. Mr. Greenidge—if I may interrupt, Mr. Chairman—are you stating your personal views as to this, or are you attempting to outline the views of the commissioner, when you speak about the offsetting of the silver tax against the lead tax?

Mr. GREENIDGE. No; I am not either expressing my personal views or the ideas of the commissioner on the matter. I am simply transferring to you gentlemen the various points that were discussed at those meetings that we had concerning the silver revaluation.

The CHAIRMAN. So you did discuss this at those hearings or conferences; that is, the question of offsetting the lead refunds with additional assessments to silver?

Mr. GREENIDGE. Oh, yes, sir. That has been, at least as far as I can remember, before us all the time.

Mr. HARTSON. Conceding that it was discussed, Mr. Greenidge, you do not mean to say—and I want to get this squarely before the chairman and the committee—you do not mean to say that it was on such a proposition that the commissioner delayed revaluing the silver properties, and that that was his reason for withholding action during the period from April, 1924, until February, 1925?

Mr. GREENIDGE. No; I do not say that was the only reason.

Mr. MANSON. What was your recommendation to the commissioner, Mr. Greenidge, with respect to taking the action recommended by Mr. Grimes?

Mr. GREENIDGE. My recommendation was that the revaluations take effect as of the date that has been agreed on by Mr. Grimes, I think, as I said before, the 1st of January, 1922.

Mr. MANSON. Mr. Grimes had refrained from approving these valuations for taxes for 1919, had he not?

Mr. GREENIDGE. No; I do not think so.

Mr. MANSON. Wasn't that what brought this matter to a head?

Mr. GREENIDGE. His refraining from approving them for 1919?

Mr. MANSON. Yes.

The CHAIRMAN. Mr. Grimes is here, and I think he can answer for himself.

Mr. GREENIDGE. He could answer that. I could not.

Mr. GREGG. May I throw a little additional light on that? I have been trying to think when I discussed with the commissioner this matter of the revaluation of silver. It was never done at any formal conference. It was done in the most casual manner. I had a great deal to do with the original order revaluing the copper, and I suppose that is the reason that he brought it up with me. These points were brought out and this may be responsible for the delay in that period.

In the silver industry a great deal of silver is produced—probably my terminology is not correct—as a by-product. The mines are not primarily silver mines. The question arose as to the extent to which we should go in revaluing the silver, in view of those conditions. It seemed rather obvious that we should not go to the work of revaluing of the silver when it was just a by-product of very minor importance, and some definite rule or policy had to be laid down as to the question of revaluation. The original order made the revaluation apply to the years 1919 and subsequent years, as it did in the case of copper. I never discussed with the commissioner the matter of the years to which it should be applied, but in my own mind it was the same years, 1919 and subsequent years; but there was this question of the extent to which we should go, and I think it did really deserve careful consideration. We never came to any conclusion on it, and nothing was ever done, although we discussed it. Since it was not a pressing matter, we did not take any definite action with reference to the silver industry, though, of course, as you know, action was taken to get in 1919 prior to the running of the statute.

The CHAIRMAN. You may proceed, Mr. Manson.

Mr. MANSON. I would like to ask Mr. Grimes this question: In making the revaluation of copper mines, where silver was a by-product of a copper mine, what price did you use?

Mr. GRIMES. 57.78 cents.

Mr. MANSON. In other words, in connection with the copper-mine valuations, you valued silver deposits on the basis of the revaluation that you proposed to make for the silver mines?

Mr. GRIMES. Yes.

Mr. MANSON. So that if the original valuations were permitted to stand for 1919 and subsequent years, the copper producers would receive a valuation for silver on the basis of 57.78 cents, and the other silver producers would receive a valuation on the basis of 65 cents.

Mr. GRIMES. Yes, sir.

Mr. GREGG. May I make the point there, Mr. Chairman, that the bureau has taken no action limiting the revaluation of silver to 1921 and subsequent years. As a matter of fact, the indication is, from the letter of Mr. Grimes, approved by Mr. Blair, that the revaluation, if applied, will go back to 1919, because it was with reference to 1919 that Mr. Grimes's letter applied. Is not that correct, Mr. Grimes?

Mr. GRIMES. The original instructions of the commissioner, of December 11, 1922, have never been changed with respect to copper revaluations.

Mr. GREGG. I was speaking of silver. If I said copper, I meant silver.

Mr. GRIMES. The silver revaluation is being applied for 1919 and subsequent years.

Mr. GREGG. I just wanted to bring that out.

The CHAIRMAN. All right, Mr. Manson.

Mr. MANSON. Did you ever agree to the proposition that that silver revaluation should only be applied to 1921 and subsequent years?

Mr. GRIMES. I had no objection to the commissioner fixing any year for the revaluation that he thought was proper. The silver production is, we will say, 25 or 30 per cent as a by-product from copper ores, and about the same proportion as a by-product from lead production. The balance is somewhat in the same proportion as the silver produced with gold. Sometimes the silver predominates and sometimes the gold, and neither of them could be mined separately. Those industries, the gold-silver, the lead-silver, and the copper-silver industries, comprise probably 90 per cent of the total production, the other 10 per cent being about equally divided as between the by-product of zinc-ore production and the production of silver only, where the silver value in the ore would yield a profit without any other metals being present. About 30 per cent of the silver was revalued with the copper. About another 30 per cent is produced with lead, and the same rule of time and the 10-year average price for lead and silver would nearly balance in that 30 per cent. Of course, what was taken away from the price of the silver would be made up in the price of the lead; so that the silver revaluation instructions of April 11, 1924, only applied to about 40 per cent of the silver production.

The CHAIRMAN. Let me ask you this: What suggested the idea of revaluing the silver mines from the end of 1921, as Mr. Greenidge has stated, and subsequent years, instead of going back and using 1919, as you did in the copper cases?

Mr. GRIMES. I think a number of silver producers made very strenuous protest that they had not been granted a hearing. There was considerable doubt as to the legality of the commissioner's order to revise the silver-mine valuations unless the silver producers had been given a hearing.

The CHAIRMAN. Oh, yes; I understand that, but what I mean is as to the change of the dates. I understand the doubt on that question, but I do not understand why in one case it was suggested that you take the end of 1921 in the silver cases when you had adopted as far back as 1919 for the copper cases.

Mr. GRIMES. I think that was mainly on the ground that the people who were protesting most strongly would agree to the revaluation if they did not have to change their books and the distribution of dividends to stockholders. You see, the depletion dividends are tax-free deductions to taxpayers. That would involve the audit not only of the silver mining companies alone, but a reaudit of the personal returns of stockholders on the tax-free deductions that had been distributed in depletion dividends.

The CHAIRMAN. Then, the principal reason for that consideration was the protest of the taxpayer?

Mr. GRIMES. Yes.

The CHAIRMAN. Go ahead, Mr. Manson.

Mr. GRIMES. I think the order should be put into effect with as little disturbance as possible. You have, perhaps, 60 or 70 copper companies having 100,000 or 150,000 stockholders, and there was a distribution of depletion dividends made on the basis of a prior settlement of the valuation questions with the Government, or an apparent settlement, and to disturb that would disturb not only those 60 or 70 copper companies, or the 60 or 70 silver companies, but a very large number of individual returns.

The CHAIRMAN. I understand. You may proceed, Mr. Manson.

Mr. MANSON. There is one other thing that I would like to be clear on. That is that if the revaluation of copper mines already ordered is carried into effect in determining the tax of the copper companies for 1919 and subsequent years, about 30 per cent of the silver production will be taxed on the basis of the new valuation for silver, while the balance of it will not. Is that correct?

Mr. GRIMES. Yes, sir; 30 per cent would probably make very little difference.

Mr. HARTSON. That is assuming, Mr. Manson—and I think your question did not make that assumption—that no subsequent revaluation was made of the balance of the silver properties.

Mr. MANSON. Yes.

The CHAIRMAN. Yes; I understand that.

Mr. HARTSON. Yes. I knew Mr. Manson intended to convey that idea, but his question did not include that.

Mr. MANSON. Yes.

The CHAIRMAN. All right, Mr. Manson.

Mr. MANSON. That is all I care to present in connection with that.

The CHAIRMAN. Have you covered the silver situation completely?

Mr. MANSON. Yes; I have.

Mr. GREGG. We have one matter that we would like to state in the record, Mr. Chairman.

You asked the bureau whether it intended to revalue copper mines for 1917 and 1918, or just for 1919 and subsequent years, when the copper situation was under consideration by the committee.

The CHAIRMAN. Yes; but I thought I got an answer in the hearing before the Finance Committee.

Mr. GREGG. Yes, sir; but I wanted it in this record, too.

The CHAIRMAN. All right; you may proceed.

Mr. GREGG. Before answering it I shall again review a little of the history of the copper valuations.

As you know, in 1919 the copper companies' returns had never been audited. The taxes had been paid on the basis of the valuations determined by the copper companies and shown on their returns. At that time it was thought that a great deal of additional tax was due from the copper companies, and as a necessary step in making the audit to get that additional tax—and the Government was badly in need of revenue at that time—Mr. Graton was brought in to value the copper mines. His experience in copper matters was brought out in his testimony before the committee. He was secured because it was thought that he was the most competent person to value the copper properties that we could get.

He made his valuations, as he pointed out, on the basis of the data which he found had been submitted by the taxpayers. He did not call the taxpayers in for hearings or consult with them in making his valuations. He valued the majority of the copper industry and marked his valuations "provisional."

Subsequently he resigned, and those who took over his duties held these conferences with the taxpayers, and final valuations were made on the copper properties. The taxpayers were notified that they were final, and they were agreed upon between the representatives of the taxpayers and the representatives of the Government.

Subsequently, in 1922, Mr. Grimes called attention to what he considered errors in those valuations. The matter was then put up to the commissioner as to whether he wanted to revalue the properties of the different copper companies. Before making any decision he had his assistant commissioner, who at that time was Mr. C. P. Smith, hold conferences at which representatives of the copper companies stated their views and their position and Mr. Grimes stated his.

The CHAIRMAN. Mr. Grimes has appeared to be a very valuable agent of the Government, has he not?

Mr. GREGG. Yes, sir; he certainly has.

After those hearings it was concluded that the valuations that had been placed originally upon the copper companies were excessive. The situation, however, was this: Those valuations had been made by competent mining engineers and had been approved by the assistant commissioner at the time they were made, Mr. Callan, and by the commissioner, Mr. Roper. The differences which were subsequently developed between Mr. Grimes and Mr. Graton, with reference to those valuations, were primarily differences of judgment.

At the time that this matter came up for decision——

The CHAIRMAN. Just a minute there. Do you mind my interrupting you?

Mr. GREGG. No, sir.

The CHAIRMAN. You say the valuations were differences in judgment?

Mr. GREGG. I said they were primarily differences in judgment.

The CHAIRMAN. It is fortunate that there is always something subsequent to a prima facie case, isn't it?

Mr. GREGG. I think the big differences were differences in judgment. I think Mr. Graton brought that out, and think Mr. Grimes will agree with that.

The CHAIRMAN. If that is true, how do you account for the great variation between the copper companies' own valuations, the bureau's valuations, as arrived at by Mr. Graton, and the subsequent valuations as arrived at by Mr. Grimes?

Mr. GREGG. There were big differences in all three of the valuations. There were three differences in judgment, the difference between the judgment of Mr. Graton, the judgment of the engineers for the companies, and the judgment of Mr. Grimes.

The CHAIRMAN. You do not want the chairman to understand, though, that these judgments were not biased by motives?

Mr. GREGG. Oh, I think the copper companies, probably in some cases, but not in all, put a fairly high value on their properties.

The situation, as it was presented to the commissioner, was this: The taxpayers' cases for 1917 had been finally closed, and in a great many instances they had been finally closed for 1918. They had been closed by competent men, men who were fully advised as to the facts, and honestly, and I think intelligently decided.

The CHAIRMAN. Are we to understand that you think that Mr. Graton's valuations were intelligent valuations?

Mr. GREGG. I think Mr. Graton is a very intelligent mining engineer, and very familiar with the copper industry.

The CHAIRMAN. I am not disputing that; but I asked you if you thought the copper valuations are intelligent valuations?

Mr. GREGG. Yes, sir. I do not think it was a correct valuation. I considered the question personally when it was up, and I thought we should revalue, after going into it myself personally, but I do not mean to say that Mr. Graton's valuations were mathematically wrong. I just thought that he had made mistakes in judgment.

The copper industry at the time that this question arose was in a bad position. We all know what the copper industry went through in 1920 and 1921. They made very strong representations that the assessment of these big additional taxes for prior years would put a great many of them into bankruptcy. It certainly would have financially embarrassed a large number of them.

So we had a situation where we differed, in a matter of judgment, from honest, intelligent predecessors, who had considered the same question.

The CHAIRMAN. You will remember that, at the hearing before the finance committee, I made the statement that the great power in the hands of the commissioner made it possible for him to break industries, and Senator Smoot asked me in what respect the commissioner could break an industry or a concern. I did not have the details of this Atlantic, Gulf & West Indies case and these other cases in mind at the time, but the developments here since the hearing before the finance committee do indicate the great power of the commissioner to break or make an industry, do they not?

Mr. GREGG. I think probably Senator Smoot, in questioning that, did not have in mind the excess profits tax. He was probably thinking of the income tax on corporations. He knew about the excess profits tax. There is no question but what the commissioner has tremendous power. He could, in many instances, break an individual concern, and in some instances even an industry, by taking arbitrary and unjustifiable action.

As I say, these valuations have been made by competent, intelligent, honest predecessors, and the taxpayers had been advised that they were final for 1917, and in a good many cases for 1918.

The copper industry was in a bad financial position. The assessment of this large additional tax for prior years would have crippled the industry badly; so what the commissioner decided to do, and his action was approved by the secretary, was to leave the valuations for the years which had been closed in whole or in part, 1917 and 1918, closed, and to revalue for 1919 and subsequent years.

That assured a fair excess profits tax from the copper companies, because they paid a fair excess profits tax, even on the excessive valuations for 1917 and 1918, and would also get an excess profits tax for 1919 and 1920, and if any of them were liable, for 1921, and would insure a fair tax in the future from the industry. But it was decided not to go back and reopen 1917 and 1918.

The bureau intends to adhere to that position, taken in the order of the commissioner of December, 1922.

Mr. MANSON. Mr. Chairman, I would like to make a statement in that connection.

The CHAIRMAN. Yes, Mr. Manson.

Mr. MANSON. I would like to call the committee's attention to several factors, as to whether or not the differences in these valuations are matters of judgment or the competence of the men who made them.

It will be recalled, in response to questions of mine, Mr. Graton testified that prior to making these valuations he had had no experience as a valuation engineer. He also testified that he had had no experience as an operating mining engineer. I question the competence of a man as an expert to value these copper mines, who had had no experience, either as an operating or as an appraisal engineer.

As to the matter of judgment, it will be recalled that the basic price adopted by Mr. Graton was in excess of the basic price claimed by the companies.

Mr. GREGG. May I interrupt?

Mr. MANSON. That might be a matter of judgment.

It will be recalled that Mr. Graton admitted that if the life of a mine exceeded the life of its equipment, the additional plant required to operate the mine to the end of its anticipated life should be deducted from the anticipated profits of the property. That might be a question of judgment; but there was no difference of judgment between Mr. Graton and Mr. Grimes upon that point. Therefore, there is no difference in judgment.

It has been shown in the record that Mr. Graton made errors in his valuation, in some instances by estimating the life of mines at a number of years which would exceed the estimated life of the equipment, and he made no provision for the additional equipment necessary to run the mine to the end of its estimated life. It will be remembered that Mr. Grimes conceded that in many instances, and, as a rule, the further you go into a mine, the lower will be the grade of the ore, and that fact must be taken into consideration in making a valuation.

Therefore, there was no difference of judgment as between Mr. Graton and Mr. Grimes upon that question.

It has been shown, however, in the record, that in some instances Mr. Graton overlooked what he admitted in the record here it was his judgment should have been considered. In other instances, Mr. Grimes admitted that where it was anticipated that a higher percentage of recovery of ore would be made that the past experience had been shown, that an additional expense element and equipment element was necessary to be considered in order to take care of that higher percentage of recovery.

It has been shown in the record that, while there is no difference of judgment between Mr. Graton and Mr. Grimes as to the necessity of providing for that additional element of expense, in the case of some of these valuations Mr. Graton has absolutely overlooked it.

What Mr. Graton said was this: On the one hand, he testified that he had added about one cent to the anticipated operating expenses to take care of the higher operating expenses in the future. He afterwards stated that he had added something to the price of the copper over and above what the companies had claimed, and in response to a question of mine he admitted that the addition to the price of copper was the same addition that he had made as being the anticipated increase in operating expenses.

So that while he provided a factor of safety to take care of anticipated additional operating expenses, he then took it way, he nullified it, in the shape of an addition to the price of copper. Therefore, the result is that if he was right in anticipating an increase in operating expenses—a thing which he undoubtedly should have done—the increase in the price of copper over what the companies claimed was an actual increase in profit to them.

The CHAIRMAN. I do not think the committee will have any difficulty in arriving at the truth on the question of the comparative intelligence used in the two methods used in the appraisal or the results obtained.

Mr. GREGG. May I ask just one question?

The CHAIRMAN. Yes.

Mr. GREGG. Do you think that because the taxpayer claimed, for example, a future value of copper of 16 cents, if, in the bureau's judgment, the future value should be 17 cents, we should not increase the value?

Mr. MANSON. I assume that the copper industry, as a whole would be most competent to determine what they could naturally expect, and I assume that they would ask for all that they felt they were entitled to.

Mr. GREGG. Well, that is an assumption. There is no use of our having a joint debate here over the merits of Mr. Graton and Mr. Grimes, Mr. Chairman. I have said that I, myself, took part in the conferences, where it was decided to reopen for 1919 and subsequent years.

The CHAIRMAN. In doing that, in substance, at least, you agreed that Mr. Grimes' method was more sound than that of Mr. Graton?

Mr. GREGG. I agreed that Mr. Grimes' valuations were more nearly correct than Mr. Graton's, yes, sir.

The CHAIRMAN. Yes.

Mr. GREGG. Yes; but I think Mr. Grimes will admit that he has had the benefit of many years of experience on the part of the Bureau on these questions.

There are a couple of points that Mr. Manson made, and I want to bring it out. In the first place he said it was the difference in judgment, possibly——

The CHAIRMAN. Oh, I understood him to say that there was no difference in judgment.

Mr. GREGG. He said there might possibly be a difference in judgment in the fact that in some cases Mr. Graton increased the valuation placed by the copper companies on their own properties.

Mr. MANSON. No; I did not make that statement.

Mr. GREGG. That was the first statement you made. May I ask the reporter to read Mr. Manson's statement, so that I will be clear as to what he did say?

Mr. MANSON. Well, I can add that statement now so that we will not have any dispute about it.

The CHAIRMAN. Let us see what the record says about it.

Mr. GREGG. Will you read that statement of Mr. Manson's.

(The reporter read as follows:)

Mr. MANSON. I would like to call the committee's attention to several factors, as to whether or not the differences in these valuations are matters of judgment of the competence of the men who made them.

It will be recalled, in response to questions of mine, Mr. Graton testified that prior to making these valuations he had had no experience as a valuation engineer. He also testified that he had had no experience as an operating mining engineer. I question the competence of a man as an expert to value these copper mines, who had no experience either as an operating or as an appraisal engineer.

As to the matter of judgment, it will be recalled that the basic price adopted by Mr. Graton was in excess of the basic price claimed by the companies. That might be a matter of judgment.

Mr. GREGG. That will be sufficient.

Do you mean by price the price of copper, Mr. Manson?

Mr. MANSON. Yes, certainly; the basic price of copper.

Mr. GREGG. You added later, when you came to it, that although he added 1¾ cents to the expense, Mr. Graton testified, to the anticipated cost of production, he then took that off by adding it to the price of copper.

Mr. MANSON. By adding it to the price of copper.

Mr. GREGG. I remember very distinctly what that was, and I think what Mr. Graton made very clear was this, that he added 1¾ cents to the expense of production to take care of any future rise. He said he thought that was very high. Then, in speaking of the price of copper, he did not state that he had put 1¾ cents onto the price of copper, higher than what he thought was right, to counterbalance that item. He said that even if his price was in excess of the price set by the industry itself, the difference was more than offset by what he had added to the cost of the production. He set the price of copper, and he so stated, at what he thought the average price should be, but he did not state that he determined what he thought the price in the future of copper would be, and then added 1¾ cents to it.

But, as I say, I do not think there is any need of our entering into a joint debate as to that. I admit that I do not know enough about it.

However, as to one point, as to Mr. Graton's competence, I have spoken to Doctor Adams, since Mr. Graton testified, about the conditions under which Mr. Graton was employed. Doctor Adams was in the bureau and held a very high position at the time. He was con-

sulted, and they went over the people available, the people they thought they might possibly secure, to come down here and make these valuations. They knew that there were mining engineers more familiar with copper valuations than Mr. Graton was, that there were mining engineers that were better known nationally, who had greater reputations, but they decided that the best man they had any chance of securing to come down here, considering what they had to offer as inducement, was Mr. Graton. That was the reason he was employed.

There is no use in debating it any further. I have made a statement of our position on the copper revaluations, and I think the points really narrow down to a difference in judgment.

The CHAIRMAN. The committee has a right to assume from the testimony today that due diligence has been exercised to revalue the silver mines?

Mr. GREEG. Absolutely; yes, sir.

Mr. MANSON. I wish to formally introduce as a part of this record the exhibits accompanying the report of Mr. Wright, the investigating engineer for the committee.

(The exhibits submitted by Mr. Manson are as follows:)

EXHIBIT A

FEBRUARY 24, 1925.

Mr. L. C. Manson, counsel, Senate Committee for Investigating Bureau of Internal Revenue.
Office Report No. 20.
Subject: Silver mines revaluations.

INTRODUCTION

The history of the original valuations of silver mines dates back to 1919 and is identical with that of the copper mines as outlined in office memorandum No. 8, dated January 6, 1925. Mr. J. C. Dick entered the natural resources subdivision as a valuation engineer in July, 1919, and was placed in charge of the valuation of lead and silver properties. Most of the early valuation reports bear his signature. In December, 1919, Mr. Dick was appointed chief of the metals valuation section and in March he was appointed head of the natural resources subdivision. One or two only of the original silver valuations were marked "provisional" although the same valuation methods were used as were employed by Mr. Graton in the copper mine valuations. Hearings were conducted early in 1920 in some of the more important cases, and the original valuations became the basis for the determination of taxes for the year 1917 and subsequent years.

PROTEST BY LEAD INDUSTRY

The protest by the St. Louis Lead Co. and the Doe Run Lead Co. in July, 1921, caused the metals valuation section to start an investigation of the original valuations, particularly as to the prices of silver. It was found that, as in the case of copper, silver had been favored as to the expected average price as compared with the zinc and lead prices used in the early valuations.

A price of 65 cents per ounce was used in the original valuations, while it was determined by the metals valuation sections that such average price should have been 57.78 cents per ounce. The expected average price for lead of 4.35 cents per pound St. Louis was used in the original valuations while it was determined that 4.469 cents should have been used. The ratio of the expected average price for silver of 65 cents per ounce to the 10-year average price of silver, 58.78 cents per ounce, is 112.50 per cent. Applying this percentage of 112.50 per cent for silver to the 10 year average price for lead of 4.469 cents per pound would give an expected average price of 5.028 cents per pound.

The St. Joseph Lead Co. having asked for a revision of their valuations based on a price of 5 cents per pound, on the basis that copper and silver had received preferential treatment as to price were informed that errors might have been made in the determination of copper and silver prices, but such an argument would not have been permitted to be the foundation for other errors.

ERRORS IN VALUATION

The same errors were found on investigation in the silver valuations as occurred in the copper valuations, although not to such a marked degree, the principal error being in the expected average price of silver.

RECOMMENDATION TO THE COMMISSIONER

Metals valuation section, as a result of their investigation of the original valuations, concluded that the copper and silver industries were receiving preferential treatment and that a large amount of tax was being lost by the Government. It was developed also that uniform procedure should be adopted for the analytical valuations of mining property.

On January 7, 1922, a memorandum (see Exhibit D of copper mines valuation, pp. 1635–1637 of No. 10 of the record of hearings) was prepared by Mr. J. A. Grimes, chief of the metals valuation section, and forwarded by the head of the natural resources division, Mr. Fay, to the commissioner, which included certain recommendations for his consideration; subsequently other memoranda were written to him and various charts and tables submitted which placed the entire subject in comprehensive shape before the commissioner. During the summer of 1922 a hearing was held before the Commissioner of Internal Revenue with representatives of the large copper producers. It appears, however, that the silver producers were not invited to this hearing, nor were they given an opportunity of expressing their views in connection with the subject of revaluation of their properties.

COMMISSIONER'S REVALUATION ORDER

On December 11, 1922, the Commissioner of Internal Revenue, D. H. Blair with the approval of the Secretary of the Treasury, A. W. Mellon, authorized (Exhibit B) the revaluation of copper and silver mines for the purpose of determining their tax liability for 1919 and subsequent years in accordance with the recommendations of the metals valuation section.

DECEMBER 11, 1922.

Memorandum for Deputy Commissioner Batson

(Attention Mr. Fay, head natural resources division.)

Reference is made to the memorandum prepared by Mr. Grimes to the commissioner, dated January 7, to Mr. Fay's memorandum to you, dated February 7, to your memorandum to Mr. Fay, dated February 16, and to the various memoranda regarding the tax liability of copper companies for 1917 and subsequent years.

Full consideration has been given to the question, and it is concluded that for 1919 and subsequent years the valuation of the ore bodies of copper mines should be revised. The price of approximately 15 cents a pound, recommended by the natural resources division, and the 10 per cent interest rate, are approved for the purpose of discounting to the present worth. The Income Tax Unit is authorized and instructed immediately to proceed to the revaluation of the copper and silver mining companies for the purpose of determining their tax liability for 1919 and subsequent years in accordance with the recommendation heretofore made by it.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved:

A. W. MELLON,
Secretary of the Treasury.

SILVER MINES REVALUATION

Pursuant to the above order, the metals valuation section proceeded immediately with the revaluation of copper mines. In connection with the silver properties, however, revaluations were delayed until after the more important copper properties had been completed. An examination has been made of the files pertaining to silver properties, the results of which are incorporated into the accompanying tabulation (Exhibit C). From recapitulation of sheet 3 thereof, it will be noted that from the records of the Metals Valuation Section there are 180 silver producers of which 85 do not appear to have had tax cases before the Income Tax Unit, leaving 95 silver producers whose cases are concerned in the valuation section. Of this number, 54 only are subject to revaluations, and of which 11 have been completed. The following summary is shown for the 54 cases subject to revision.

Silver mine revaluations

VALUATIONS FOR DEPLETION AS OF MARCH 1, 1913

	Number of companies	Original	Revised	Difference	Per cent original to revised
Completed	11	$37,517,093	$23,867,624	$13,649,469	
To be revised, estimated	43	100,431,047	63,894,232	36,536,815	
Total	54	137,948,140	87,761,856	50,186,284	157 19

VALUATIONS FOR DEPLETION AS OF JANUARY 1, 1919

Completed	11	$21,240,621	$10,259,035	$10,981,586	
To be revised, estimated	43	71,024,723	34,304,941	36,719,782	
Total	54	92,265,344	44,563,976	47,701,368	207.04
Add 15 per cent, for increases, in conference			6,684,596		
Corrected total	54	92,265,344	51,248,572	41,016,772	
Additional taxes indicated, $41,016,772 at 12½ per cent				5,127,096	

In order to get at a total figure for reduction in valuations and in additional tax reflected thereby it has been necessary to compute and estimate such reduction using the same ratio for the 43 cases yet to be revised as is shown in the 11 cases completed. Assuming that the estimated revised values for 54 cases amounting to $44,563,976 will be increased 15 per cent in conference, the corrected totals for estimated revaluations of depletion for the 54 cases is as follows:

Original valuation	$92,265,344
Revaluations	51,248,572
Reduction in values	41,016,772

With a tax rate of 12½ per cent on the reduction in valuation deductions, a tax of $5,127,096 is indicated for 1919 and subsequent years. In some cases it has been found necessary to revise the invested capital valuations but it is not possible to give an estimate of such reductions in total.

As noted above, 11 out of 54 silver properties had been revalued. When on April 11, 1924, the commissioner, with the approval of the Secretary of the Treasury, rescinded his order of December 11, 1922, as relating to silver mining companies (Exhibit D).

TREASURY DEPARTMENT,
Washington, April 11, 1924.

Memorandum for Mr. Bright.
(Attention Mr. Greenidge.)

Under date of December 11, 1922, the Secretary of the Treasury approved and order of the commissioner to revalue copper mining companies for the purpose of determining their tax liability for 1919 and subsequent years. In said order silver mining companies were inadvertently mentioned. In view of the fact that numerous hearings were granted to copper mining companies and the silver mining companies were not notified of such hearings and had no hearing and that silver mining was not discussed in the various meetings and it was the intention at the time to revalue only copper mining companies, you will therefore, ignore all reference to silver mining companies to said order.

D. H. BLAIR, *Commissioner.*

Approved:
A. W. MELLON,
Secretary of the Treasury.

LAWS AND REGULATIONS

Since the same laws and regulations are concerned in the silver revaluations as are discussed in the report on the copper revaluations, which has already been presented to the committee, same will not be repeated here.

FUTURE SELLING PRICE OF METALS

Metals valuation section made careful study and investigation of the selling prices of metals and have adopted the artithmetical average price method for the 10 years preceding the basic date, except in the cases of metals for which such an average price is not available or for which the price trend during the 10-year period is strongly and consistently up or down (Exhibit E) herewith shows the computations in arriving at the future selling price of silver 57.78 per cent per pound.

STATUS OF SILVER REVALUATIONS

It appears that when the commissioner's memorandum of April 11, 1924, was received by the metals valuation section, there was considerable uncertainty as to whether, in fact, this memorandum constituted a direct order to stop the work of revising the silver mine revaluations. A large number of silver mine cases were in the department for action and it was necessary either to forward these cases to the audit for the determination of 1919 taxes on the basis of the original valuations or to proceed with the revision of such valuations. The chief of the metals valuation section was unwilling to take the responsibility of approving the original valuations for tax computations and referred the matter to Mr. Greenidge, head of the engineering division. Mr. Grimes, chief; Mr. Donahoe, assistant chief; and Mr. Craigue, valuation engineer, had a conference with Mr. Greenidge shortly after the receipt of the commissioner's letter of April 11, 1921. These gentlemen took the position that the commissioner's letter was indefinite and that the section should receive positive instructions in the matter of definitely stopping the revaluation of silver mine. As a result of this conference, Mr. Greenidge addressed a memorandum dated April 17, 1924, to the metals valuation section as follows (Exhibit F):

INCOME TAX UNIT, ENGINEERING DIVISION,
April 17, 1924.

Memorandum to: Mr. Grimes, chief metals valuation section.
In re: Revaluation of silver mining companies and commissioner's memorandum, dated April 11, 1924.

The last sentence of the commissioner's memorandum, noted above, states among other things:

"It was the intention at the time to revalue only copper mining companies."

This, I take it, is insufficient instruction for this division not to revalue any metal producing companies other than copper unless, of course, fraud or gross error can be clearly demonstrated.

You are, therefore, directed not to revalue silver mining companies.

S. M. GREENIDGE,
Head of Division.

This memorandum was taken as a definite order and the work of revaluing silver mines was abandoned. Subsequently and on June 18, 1924, Mr. Grimes addressed a memorandum to the commissioner (Exhibit G) on the subject of silver revaluations. The matter of silver revaluations was again presented but in a more specific and detailed manner for the consideration of the commissioner. Reasons were presented for such revaluation in order to equalize the treatment of taxpayers in the same industry as also between industries. Many exhibits were attached to this memorandum in proof of the position taken by the metals valuation section. The commissioner was again requested to consider the matter and, if possible, to reinstate his orders as pertaining to silver mines covered by his memorandum of December 11, 1922. It would appear that this memorandum has never reached the commissioner inasmuch as a reply to same has never been received by the metals valuation section. A matter of such importance would certainly have been given consideration by the commissioner if the memorandum of June 18, 1924, had been received. It is learned on inquiry that the commissioner does not recall ever having received this memorandum, but a search having been made, discloses that the memorandum is now in his files, but lacks the receiving stamp of the office so that it is impossible to say when or how it got there.

We are unofficially advised that although the commissioner has not revoked his letter of April 11, 1924, he has verbally approved and ordered the metals section to proceed with a revision of the silver mine revaluations. The metals section has been instructed to call a hearing for the silver producers and to obtain waivers in all cases where necessary. A form letter, as per Exhibit H herewith,

has been sent to all silver producers and in case waivers are not forthcoming jeopardy assessments will be sent out as per section 274 (d) of the revenue act of 1924.

About 25 per cent of the silver is produced from copper ores and price corrections have been made for silver as well as copper in the copper revaluations, covered in office report No. 8.

The balance of the silver produced comes from ores in which it is associated with other metals. Approximately 25 per cent is produced from lead-silver ores, 35 per cent from gold-silver ores, and the balance from complex zinc and straight silver ores. The list of silver mines involved in this report, therefore, concerns approximately 75 per cent of the silver production. In revaluing these silver properties, the revised Ten Year Average Prices for Metals, adopted by the metals valuation section, has been applied to the associated metals also. In the case of the lead-silver mines this results in a substantial revision upward for the lead and downward for the silver values.

CONCLUSION

The question of revising the original valuation of silver properties, and of finally determining their tax liabilities should be considered in its entirety; that is, as to the periods before 1919, and after.

First. As to whether additional tax liability should be determined based on the revaluations, for the years previous to 1919. The commissioner's order does not cover this and doubtless such action would involve somewhat different legal aspects, together with certain moral and economic questions. Nevertheless, the facts remain that the silver companies made large profits during 1917 and 1918 and paid comparatively small taxes. Some $5,000,000 in additional taxes from silver properties is estimated to be involved for the years 1916, 1917, and 1918.

Second. As to whether the additional tax liability for 1919 and subsequent years has, as a matter of fact, been authorized by the commissioner and whether same will be finally determined, assessed, and collected. Additional taxes are involved from the silver industry in the amount of $5,127,096 for the year 1919 and subsequent years, which in all equity should be forthcoming.

Respectfully submitted.

EDWARD T. WRIGHT,
Investigating Engineer.

Approved:
L. H. PARKER,
Chief Engineer.

EXHIBIT B

DECEMBER 11, 1922.

Memorandum for Deputy Commissioner Batson.
(Attention Mr. Fay, head natural resources division).

Reference is made to the memorandum prepared by Mr. Grimes to the commissioner, dated January 7, to Mr. Fay's memorandum to you dated February 7, to your memorandum to Mr. Fay dated February 16, and to the various memoranda regarding the tax liability of copper companies for 1917 and subsequent years.

Full consideration has been given to the question and it is concluded that for 1919 and subsequent years the valuation of the ore bodies of copper mines should be revised. The price of approximately 15 cents a pound, recommended by the natural resources division, and the 10 per cent interest rate, are approved for the purpose of discounting to the present worth. The Income Tax Unit is authorized and instructed immediately to proceed to the revaluation of the copper and silver mining companies for the purpose of determining their tax liability for 1919 and subsequent years in accordance with the recommendations heretofore made by it.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved:
A. W. MELLON,
Secretary of the Treasury.

EXHIBIT C

Silver valuation statistics

CASES VALUED AND REVALUED—WORK COMPLETED

State	Name of company	Invested capital in depletible assets						Risk original	Rate revised
		As of date of acquisition			As of Jan 1, 1919				
		Original	Revised	Difference	Original	Revised	Difference		
								Per cent	*Per cent*
New York	Butte & Superior Mining Co	$2,944,299	$2,944,299			(1)		8	9
Utah	Chief Consolidated Mining Co	553,736	553,736		$1,199,347	$797,888	$401,459	10	10
Illinois	Cusi Mining Co	128,882	128,882		45,153	45,153		15	10
Utah	Dragon Consolidated Mining Co	(1)	320,060			290,902		10	10
Do	Grand Central Mining Co	(1)	(1)					10	10
Idaho	Hercules Mining Co	16,454,820	1,090,396	$15,364,124	4,483,052	297,076	4,185,976	8	8
Colorado	Iron Silver Mining Co	(1)	(1)					8	8
New York	New York, Honduras & Rosario Mining Co	(1)	(1)					10	10
Utah	Rico Wellington Mining Co	(1)	(1)					8	10
Idaho	Tamarack & Custer Consolidated Mining Co	3,078,800	1,770,560	1,308,240	2,629,160	1,511,981	1,117,179	8	8
California	West End Consolidated Mining Co							10	10
	Total	23,160,557	6,807,953	16,672,664	8,356,712	2,943,000	5,704,614		

[1] No change.

Silver valuation statistics—Continued

CASES VALUED AND REVALUED—WORK COMPLETED—Continued

State	Name of company	Values for depletion						Remarks
		As of Mar. 1, 1913			As of Jan. 1, 1919			
		Original	Revised	Difference	Original	Revised	Difference	
New York	Butte & Superior Mining Co	$13,051,000	$7,425,668	$5,625,332	$7,826,702	$3,622,597	$4,204,105	
Utah	Chief Consolidated Mining Co	1,438,967	918,772	520,195	1,826,960	980,489	846,471	Value remaining at Jan. 1, 1919, includes cost of Eureka City property in 1915
Illinois	Cus Mining Co	1,189,000	1,361,300	−172,300	652,687	722,819	−70,132	
Utah	Dragon Consolidated Mining Co	584,060	320,060	264,000	454,425	252,859	201,566	
Do	Grand Central Mining Co	515,571	338,331	177,240	336,218	200,520	135,698	Invested capital determined by special assessment.
Idaho	Hercules Mining Co	12,124,480	8,762,371	3,362,109	4,483,052	1,987,523	2,495,529	
Colorado	Iron Silver Mining Co	444,453	382,043	62,410	75,451	13,041	62,410	Invested capital determined by audit.
New York	New York, Honduras & Rosario Mining Co.	2,422,947	1,628,681	794,266	1,080,345	722,899	357,446	
Utah	Rico Wellington Mining Co	330,158	46,309	283,849	317,298	8,815	308,483	
Idaho	Tamarack & Custer Consolidated Mining Co.	4,618,200	2,120,412	2,497,788	3,947,430	1,630,177	2,317,253	
California	West End Consolidated Mining Co	798,257	563,677	234,580	239,993	117,296	122,697	No data on invested capital.
	Total	37,517,093	23,867,624	13,649,469	21,240,621	10,259,035	10,981,586	

CASES VALUED, BUT NOT REVALUED—TO BE REVALUED

State	Name of company	Invested capital in depletible assets		Values for depletion			Remarks
		Original, as of date of acquisition	Original, as of Jan. 1, 1919	Risk rate	Original, as of Mar. 1, 1913	Original, as of Jan. 1, 1919	
				Per cent			
New York	American Smelting & Refining Co	(1)		10	$15,189,001	$14,004,179	
Massachusetts	Bingham Mines Co	$928,619	$494,683		1,525,293	933,483	
California	Bunker Hill & Sullivan Mining & Concentrating Co	3,576,354	2,917,098		19,396,000	15,900,662	

Montana	Butte Copper & Zinc Co	(1)			1,026,000	745,568	Original value speculative, based on.
Idaho	Caledonia Mining Co	(1)			2,538,000	2,244,856	Anaconda offer in 1915. Includes discovery allowed in 1916. Discovery value as of Dec. 19, 1919.
California	California Rand Silver Co	(1)			1,299,182		
New York	Cinco Mines Co	3,123,435	2,029,448		4,128,614	2,670,746	
Montana	W. A. Clark, jr	(1)		8	1,917,000	1,353,906	
Do	Clark Montana Realty Co	(1)		8	1,917,000	1,353,106	
Colorado	Colorado Superior Mining Co	(1)			15,550	11,951	
New York	Consolidated Interstate Callahan Mining Co	(1)			2,956,376	1,376,951	
Do	Elko Prince Mining Co	42,000	33,763		730,000	321,955	
Do	El Potosi Mining Co	254,956	192,767		7,188,000	4,718,668	
Do	Federal Mining & Smelting Co	10,044,472	1,925,123		6,363,799	3,812,850	
Do	Fresnillo Co	343,217	315,098	10	690,520	690,188	
Idaho	Gold Hunter Mining & Smelting Co	241,788	128,588	8	495,591	275,126	
New York	Guanajuato Consolidated Mining Co	(1)			430,000	387,711	
Idaho	Hecla Mining Co	(1)			6,490,000	3,707,464	
Washington	Idaho Continental Co	(1)			665,000	577,351	
Colorado	Idaho M. R. & T. & T. Co	(1)			88,000	26,909	
Utah	Iron Blossom Consolidated Mining Co	(1)			1,236,000	415,116	
Do	Judge Mining & Smelting Co	(1)			1,579,000	1,304,621	
California	William Kent	(1)		12	209,626		Sold to foreign corporation Jan. 1, 1918.
Illinois	Latest Out Mining & Smelting Co				48,265	36,387	
California	Minas Peirazzini Gold & Silver Mining Co	1,200,000	791,102	15	363,353	345,093	
New Mexico	Mogollon Mines Co	(1)			495,684	293,794	
Nevada	Montana Tonopah Mines Co				306,092	87,342	
Pennsylvania	Nevada Wonder Mining Co	542,998			341,666	52,791	
Utah	Ontario Silver Mining Co	5,103,765			2,321,562	2,049,538	
Do	Ophir Hill Consolidated Mining Co	(1)			677,408	355,342	
Do	Prince Consolidated Mining & Smelting Co			8	1,062,980	766,190	
Do	Silver King Coalition Mines Co	5,479,865	2,848,026	8	3,297,604	2,255,514	
Do	Silver King Consolidated Mining Co	199,929	6,684		278,648	8,539	Invested capital in ores only.
New York	Silver King of Arizona Mining Co	1,236,661	1,230,351		1,236,661	1,230,351	
California	Slate Range Minerals Co	328,279	299,017		328,279	279,047	On cost.
Utah	South Hecla Mines Co	200,000			100,000	87,091	
California	Tecopa Consolidated Mining Co	487,150	413,378		252,601	276,725	
Pennsylvania	Tonopah Belmont Development Co	1,132,000	1,097,276		5,000,000	2,972,000	
New York	Tonopah Extension Mining Co	920,267	1,424,027		1,544,832	423,411	
Pennsylvania	Tonopah Mining Co	410,040	59,041		1,478,482	245,513	
Washington	United Silver Copper Co				240,561	178,705	Invested capital not determined.
Massachusetts	Utah Apex Mining Co				1,695,857	1,380,689	
California	Yellow Pine Mining Co				1,194,860	457,424	
	Total	35,643,906	15,517,323		100,431,047	71,024,723	

[1] Determined by audit.
[2] Incomplete data.
[3] Not computed by metals section.
[4] Computed on par value of stock.
[5] Not determined by section.

Silver valuation statistics

CASES VALUED AND REVALUED—FOR SPECIAL REASONS

State	Name of company	Invested capital in depletible assets						Rate revised
		As of date of acquisition			As of Jan. 1, 1919			
		Original	Revised	Difference	Original	Revised	Difference	
Colorado	Humbolt Mines Co	$256,203	$325,554	−$69,291	$90,052	$196,679	−$106,627	*Per cent*
	CASES REVALUED ONLY							
California	Original Mining & Milling Co	(1)						12

State	Name of company	Values for depletion						Remarks
		As of Mar. 1, 1913			As of Jan. 1, 1919			
		Original	Revised	Difference	Original	Revised	Difference	
Colorado	Humbolt Mines Co	$256,203	$325,554	−$69,291	$90,052	$196,679	−$106,627	Based on revision of cost in July, 1915
	CASES REVALUED ONLY							
California	Original Mining & Milling Co		99,204			70,632		Mostly a gold producer.

(1) No data

CASES VALUED, BUT NOT REVALUED—NONE NECESSARY

State	Name of company	Invested capital in depletible assets—		Risk rate	Values for depletion—		Remarks
		As of date of acquisition	As of Jan. 1, 1919		As of Mar. 1, 1913	As of Jan. 1, 1919	
				Per cent			
New York	Alvarado Mining & Milling Co	(1)			$3,830,137	$3,018,646	Value based on offer to purchase 75 to 100 per cent of stock of company late in 1912.
Pennsylvania	Amparo Mining Co	(1)			2,163,842	1,629,390	Metals section memo July 25, 1922, recommend extensions for 1919 and 1920 on basis of old valuation.

Montana	Angelica Mining & Development Co	$149,728	$139,109		149,728	134,109	Based on cost.
Massachusetts	Bullion Beck & Champion Mining Co	(1)			96,659	17,475	Not analytical appraisal
Colorado	Carbonero Mines & Reduction Co	(2)		8	8,140	5,306	
Utah	Cardiff Mining & Milling Co	(1)			500,000	327,993	
California	Cerro Gordo Mining Co	253,046	103,368		253,046	103,368	Based on cost.
Utah	Colorado Consolidated Mines Co	149,043	(3)		149,043		Based on cost. No operating profits. No depletion figured.
Do	Columbus Rexall Consolidated Mining Co	96,432	60,162		86,462	60,162	No valuation on cost. Depletion claimed on discovery but not allowed.
Do	Daly Mining Co	(1)			300,000	224,222	
Do	Daly West Mining Co	1,378,751	521,088		167,305	127,323	Not based on engineering appraisal.
Do	Deer Trail Mining Co	(1)		12	108,010	98,709	
Colorado	Down Town Mines Co	492,631	382,460		492,634	382,460	Based on cost
Arizona	Duquesne Mining & Reduction Co	(1)			784,431	662,852	Depletion based on cost. Out of business 1919.
New York	Esperanza Mining Co	(1)			698,084	446,163	
California	Eureka Holly Mining Co	(1)			130,000	128,513	Based on cost
Do	Fairview Round Mountain Mines Co	193,695	146,942		100,000	49,989	No revaluation. No depletion claimed.
Colorado	Fanny Rawlings Mining Co	(5)			13,400	11,830	
Do	Leadville Basin Mining Co	98,774	90,983	10		90,983	Based on cost. Bought in 1917
Massachusetts	Liberty Bell Gold Mining Co	(1)			246,505	50,621	
California	MacNamara M. & M. Co	40,239			40,239		Based on cost. Revaluation by C. C. Greggs in field. No record in section.
Utah	Michigan Utah Consolidated Mining Co	300,000	263,558		300,000	263,558	
Colorado	Mountain Top Mining Co	144,438	136,666		144,438	136,666	
Nevada	Nevada Packard Mines Co	155,000	109,739		155,000	109,739	
Do	Nevada United Mines Leasing Co	20,280	16,616			16,616	Organized in 1917. Depletion based on cost.
California	Petrero Mining Co	105,019	121,026		105,019	121,026	Capital additions in 1918 of $30,000
Do	Presidio Mining Co				171,381	146,235	
Washington	Quilp Gold Mining Co	(1)		12	38,836		No depletion claimed or allowed.
Do	Standard Silver Lead Mining Co	(1)			1,359,897	137,682	
Utah	Tintic Mining & Development Co	(1)			152,000	17,667	
Do	Tintic Standard Mining Co	(1)			4,130,603	3,770,094	Discovery in 1917.
Do	Tomboy Gold Mines Co. (Ltd.)	1,963,881	243,438	10	1,241,330	706,868	Based on operating profits.
Colorado	Volunteer Mining Co	(1)		5	25,650	22,750	
Do	Wagner Development Mining Co	(2)		10	298,382		In development stage.
Do	Wellington Mines Co	354,822	71,394		989,084	174,256	
Missouri	Western Mining Co	581,023	298,976	10	64,900	5,824	
Colorado	Wilbert Mining Co	139,367			139,367	0	
Utah	Wyman Mining Co	(1)		9	57,150	21,780	Based on lessor's income.
Ohio	Yak M. M. & T. Co	457,015					Property sold in 1917.
Colorado							
	Total	9,746,435	2,765,525		19,709,522	13,220,259	

[1] Determined by audit.
[2] Not made; not in excess-profits class.
[3] Not computed
[4] No data in section.
[5] Not determined by metals section.
[6] No invested capital

Silver valuation statistics

CASES NOT VALUED OR REVALUED

State	Name of company	Remarks
Utah	Ajax Mining Co	No depletion claimed.
Idaho	Alameda Mining Co	Do.
Utah	Alta Tunnel & Transportation Co.	No returns in metal section.
Montana	Amalgamated Silver Mining Co	No depletion claimed.
Utah	American Fork Exploration Co	Do.
Do	American Mining & Exploration Co.	Do.
Idaho	Armstead Mines (Inc.)	Do.
Colorado	Atlas Mining & Milling Co	Do.
Utah	Bay State Mining & Development Co.	Do.
Washington	Bipont Silver Mining Co	No record in metals section
Utah	Black Mines (Inc.)	No depletion claimed.
Wisconsin	Black Hawk Consolidated Mines Co.	No record in section.
Montana	Boston Montana Corporation	No depletion claimed.
Utah	Bristol Silver Mines Co	No record in section.
Colorado	Brunswick Consolidated Gold Mining Co.	No depletion claimed.
Montana	Cascade Silver Mines & Mills	Claims not substantiated.
Nevada	Cash Boy Consolidated Mining Co.	No record in section.
Washington	Coeur d'Alene Crescent Mining Co.	No depletion claimed.
New York	Consolidated Cortex Silver Mines Co.	Do.
California	Consolidated Virginia Mining Co.	No record in section.
Nevada	Consolidated West Extension Simon Mines Co.	Do.
California	Cucharas Mining Co	Do.
Texas	Cusi Consolidated Mining Co	No depletion claimed.
Massachusetts	Denbigh Mining Corporation	No record in section.
New Mexico	El Centro Mining & Milling Co	Depletion not substantiated.
New York	El Rayo Mines Co	
Do	El Salvador Silver Mines Co	No depletion claimed.
Utah	Emma Silver Mines Co	Do.
Idaho	Enterprise Mining Co	Do.
Colorado	Estella Mining Co	Do.
Do	Evergreen Mines Co	Do.
Utah	Fewern Mining Co	Do.
Missouri	Granite Bi-Metallic Consolidated Mining Co.	
Utah	Knight Investment Co	
Missouri	Lucky Tiger Combination Gold Mining Co.	No depletion claimed. A holding company.
Massachusetts	Majestic Mines Co	No record of case.
Washington	Marsh Mines Consolidated Mines Co.	
Utah	Montana Bingham Consolidated Mining Co.	
New York	Montezuma Silver Mines Co	
Do	Nevada Silverfields Co	No record.
Do	Nicaragua Mining Co	No record. No production.
California	Northern Light Mining Co	A gold mine.
Do	Nuestra Senora Mine	In development stage until 1920.
Pennsylvania	Pittsburgh Idaho Co. (Ltd.)	
Utah	Rainshorn Mines Co	Not incorporated until 1919.
Oregon	Rand & Melzer	No operations until 1919.
California	Rescue Eula Mining Co	No record of case.
New York	Rio Plata Mining Co	No depletion.
Utah	Rocher de Boule Copper Co	No data. No tax involved.
Nevada	Rochester Silver Corporation	Do.
California	Round Mountain Mining Co	Do.
Idaho	Ruby Silver Mines Corporation	
California	Saint Louis Mining Co	No record.
Pennsylvania	San Toy Mining Co	Do.
Utah	Silis Mining Co	
Do	Silver Canyon Mining Co	
Colorado	Silver Gulch Mining Co	
Massachusetts	Smuggler Union Mining Co	
New Mexico	Socorro Mining & Milling Co	Operated at loss 1917, 1918.
New York	South Utah Mines & Smelting Co.	
Nevada	Spruce Monarch Consolidated Mining Co.	
West Virginia	Swastika Silver & Copper Mining Co.	
Utah	Tacoma Consolidated Mining Co.	
Do	Tintic Milling Co	
Do	Tintic Standard Milling Co	
Nevada	Tonopah Divide Mining Co	No depletion. In development stage until 1919.
Do	Tonopah Midway Consolidated Mining Co.	
California	Union Consolidated Mining Co.	

Oklahoma	Guanajuato Reduction & Mines Co.	No depletion allowed.
Utah	Hamburg Mines Co.	No record.
Colorado	Hampton Consolidated Mines Co.	No depletion allowed.
Montana	Hemlock Silver Lead Mining Co.	Do.
Idaho	Horn Silver Mining Co.	Do.
Wyoming	Iron Blossom Mining Co.	
Pennsylvania	Jim Butler Tonopah Mining Co.	
Utah	Utah Metal & Tunnel Co.	
Do	Utah Silver Lead Mines	In development stage.
Montana	Utopia Mining Co.	
Utah	Victor Consolidated Mining Co.	
Do	Vipont Silver Mining Co.	
Arizona	Vulcan Consolidated Mining Co.	
California	West End Opoteca Mines Co.	
Nevada	White Caps Mining Co.	
Massachusetts	Yosemite Mines Co.	No record.
New York	Yukon Gold Co.	Silver in ore negligible.

RECAPITULATION

Number of producers	Summary	Invested capital in depletible assets					
		As of date of acquisition			As of Jan. 1, 1919		
		Original	Revised	Difference	Original	Revised	Difference
11	Cases valued and revalued—Commissioner's orders	$23,160,557	$6,807,953	$16,672,664	$8,356,712	$2,943,000	$5,704,604
43	Cases valued to be revalued	35,643,906			15,517,323		
54	Total						
1	Cases valued and revalued, special reasons	256,263	325,554	−69,291	90,052	196,679	−106,627
1	Cases revalued only	(1)					
39	Cases valued, no revaluation necessary	9,746,435	(1)		2,705,525		
85	Cases not valued or revalued	(1)					
180	Grand total						

[1] No data.

RECAPITULATION—Continued.

Number of producers	Summary	Values for depletion								Remarks
		As of Mar. 1, 1913			Original to revised	As of Jan. 1, 1919			Original to revised	
		Original	Revised	Difference		Original	Revised	Difference		
11	Cases valued and revalued—Commissioner's orders.	$37,517,093	$23,867,624	$13,649,469	*Per cent* 157.19	$21,240,621	$10,259,035	$10,981,586	*Per cent* 207.04	Not complete; some cases determined by audit.
43	Cases valued to be revalued	100,431,047	63,894,232	36,536,815	157.19	71,024,723	34,304,941	36,719,782	207.04	
54	Total	137,948,140	87,761,856	50,186,284	157.19	92,265,344	44,563,976	47,701,368	207.04	
1	Cases valued and revalued, special reasons	256,263	325,554	−69,291	78.72	90,052	196,679	−106,627	45.78	
1	Cases revalued only	99,204	99,204			70,632	70,632			
39	Cases valued, no revaluation necessary	19,709,522	19,709,522			13,220,259	13,220,259			
85	Cases not valued or revalued									
180	Grand total	158,013,129	107,896,136	50,116,993	146.45	105,646,287	58,051,546	47,594,741	181.99	

EXHIBIT D

TREASURY DEPARTMENT,
Washington, April 11, 1924.

Memorandum for Mr. BRIGHT.
(Attention Mr. Greenidge.)

Under date of December 11, 1922, the Secretary of the Treasury approved an order of the commissioner to revalue copper-mining companies for the purpose of determining their tax liability for 1919 and subsequent years. In said order silver-mining companies were inadvertently mentioned. In view of the fact that numerous hearings were granted to copper-mining companies and the silver-mining companies were not notified of such hearings and had no hearing, and that silver mining was not discussed in the various meetings and it was the intention at the time to revalue only copper-mining companies, you will therefore ignore all reference to silver-mining companies in said order.

D. H. BLAIR, *Commissioner.*

Approved:
A. W. MELLON,
Secretary of the Treasury.

EXHIBIT E

Silver (E. and M. J. prices at New York)—Computation of March 1, 1913, 10-year average price

Year	January	February	March	April	May	June	July
1903			48.72	50.56	54.11	52.86	53 92
1904	57.005	57.592	56.741	54.302	55.430	55.673	58.095
1905	60.690	61.023	58.046	56.600	57.832	58.428	58.915
1906	65.288	66.108	64.597	64.765	66.976	65.394	65.105
1907	68.673	68.835	67.519	65.462	[1] 65.971	67.090	68.144
1908	55.678	56.000	55.365	55.505	52.795	53.663	53.115
1909	51.750	51.472	50.468	51.428	52.905	52.538	51.043
1910	52.375	51.534	51.454	53.221	53.870	53.462	54.150
1911	53.795	52.222	52.745	53.325	53.308	53.043	52.630
1912	56.260	59.043	58.375	59.207	60.880	61.290	60.554
1913	62.938	61.642					

Year	August	September	October	November	December	Total
1903	55.36	58.00	60.36	[1] 58.11	55.375	547.375
1904	57.806	57.120	57.923	58.453	60.563	686.603
1905	60.259	61.695	62.034	63.849	64.850	724.221
1906	65.949	67.927	69.523	70.813	69.050	801.495
1907	68.745	67.792	62.435	58.677	54.565	783.906
1908	51.683	51.720	51.431	49.047	48.766	635.368
1909	51.125	[1] 51.440	50.923	50.703	52.226	618.021
1910	52.912	53.295	55.490	55.635	54.428	641.826
1911	52.171	52.440	53.840	55.719	54.905	640.143
1912	61.606	63.078	63.471	62.792	63.365	730.021
1913						124.580

[1] Later prices used.
Total for 120 months, 6,933.561 cents.

$\frac{6,933.561}{120}$ = 57.78 cents per ounce, the 10-year average price of silver at Mar. 1, 1913.

EXHIBIT F

INCOME TAX UNIT ENGINEERING DIVISION,
April 17, 1924.

Memorandum to: Mr. Grimes, chief, metals valuation section.
In re: Revaluation of silver mining companies and commissioner's memorandum, dated April 11, 1924.

The last sentence of the commissioner's memorandum, noted above, states among other things:

"It was the intention at the time to revalue only copper mining companies."

This, I take, it, is insufficient instruction for this division not to revalue any metal producing companies other than copper unless, of course, fraud or gross error can be clearly demonstrated.

You are, therefore, directed not to revalue silver mining companies.

S. M. GREENIDGE,
Head of Division.

EXHIBIT G

June 8, 1924.

Memorandum to the commissioner.
Through Mr. S. M. Greenidge, head, engineering division, and Mr. J. G. Bright, deputy commissioner, income tax unit.

Reference is made to your memorandum of April 11, 1924 to Mr. Bright, in which your previous instructions with respect to the revaluation of silver mining companies, contained in your memorandum of December 11, 1922, were rescinded, on the grounds (1) that the silver mining compaies were not accorded a hearing (2) that the revaluation of silver mining compnaies was not discussed in the various meetings held in 1922 and that it was the intention at that time to revalue only copper mining companies.

It is true that the silver mining companies were not accorded a hearing with respect to revaluation ,and that the question of revaluation of the silver mining companies was not discussed in any public hearing, but there seems to be some misunderstanding as to whether or not it was the intention of the Natural Resource Division at that time to ask for authority to revalue silver as well as copper mining companies.

In view of the fact that I am the only person now remaining in the Income Tax Unit who had intimate knowledge of, and participated in the numerous discussions during 1922 with respect to revaluation, I am taking the liberty of again presenting the matter of the revaluation of the silver mining companies to your attention, That the question of the revaluation of the silver mining companies was presented for the consideration of your office at the time when copper revaluation was considered, is attested by various memoranda prepared in that connection, of which excerpts are attached to this memorandum, as Exhibits A to H, inclusive.

The original request for your permission to revalue is contained in a memorandum prepared by O. R. Hamilton and J. A. Grimes of the metals valuation section, with the approval of A. H. Fay, head of the natural resources division, which memorandum is dated January 7, 1922. The request was made because there were apparent inequities and discrepancies in the methods of valuing the mines of different metal mining industries, in use by the Income Tax Unit. In the memorandum of January 7, 1922 (represented for your consideration prior to the hearing accorded to the copper mining companies on June 30, 1922), and in the memorandum of July 25, 1922 (prepared in rebuttal of arguments advanced by the copper mining companies in briefs and at the conference of June 3, 1922), the Income Tax Unit presented a number of general principles of valuation for your approval. These general principles apply to all metal mine valuations, irrespective of the metal produced, and were approved in your memorandum of December 11, 1922.

The metals valuation section, engineering division, Income Tax Unit, has made an exhaustive study, in which at least a dozen men have participated for over four years, with a view to developing systematic valuation methods which would be equitable to the Government and to all metal mining taxpayers; capable of administrative application to income tax valuation work; and in harmony with the consensus of opinion and the best practice of authorities on the subject of mine valuation. That the methods developed are not inequitable to any taxpayer, and in fact very liberal, is conclusively proven by the fact

that in more than four years only two court actions have been instituted in which the methods of valuation were at issue. That the methods developed have the interest of the Government constantly in view, can be proven by the records of the metals valuation section. In the revaluation of the copper mining companies for 1919 and subsequent years, the January 1, 1919, value remaining for depletion compiled from the first 33 revaluations to be completed, have been reduced from $1,108,933,738 allowed by the original or provisional valuations, to $242,285,579 allowed in the revaluation authorized by your memorandum of December 11, 1922. The copper revaluations results just summarized are not due to any drastic action but are consistent with the methods applied to and results obtained from the valuation of the other metal industries, with the sole exception of the silver industry, for the revaluation of which your permission is now requested. A summary sheet of the results of valuation work performed by the metals valuation section from July 1, 1923 to April 30, 1924, is attached as Exhibit I.

These data are cited as confirmatory evidence to the contention that the work of the metals valuation section has improved and advanced since the inception of the section late in 1919. The statement is frequently heard when questions of improvement of valuation methods are discussed, that Mr. this or Mr. that was a very able engineer, and that the opinions he advanced or the guesses he made are as good as could be done then or can be done now. The engineers at present in the metals valuation section are not claiming judgment superior to that of the engineers who initiated the work of metal mine valuation, but they are claiming that sufficient data has been gathered and that a sufficient test of valuation methods has been made by their application to actual problems, to enable any reasonable person to see that a few improvements are possible and that a few inequities exist in the methods of valuation originally adopted. Such inequities and errors were inevitable under the conditions existing when this section was formed, and it is remarkable that so few have become evident. But the errors which have been made should be corrected at the earliest possible date if the Bureau of Internal Revenue expects to hold the confidence of those taxpayers who receive no financial benefit from the perpetuation of such errors and who are fully aware that they exist.

The principal inequity existing at present in the methods employed in metal mine valuation is the price of silver used in the valuation of silver mines. For copper mine valuation under your instructions of December 11, 1922 and expected future price of 57.78 cents an ounce has been established for silver. For other metal mines under your instructions of April 11, 1924, the expected future price of silver as at March 1, 1913, is 65 cents an ounce. For iron, copper, lead, and zinc mines the March 1, 1913, expected future prices for which their products will be sold are determined in a consistent manner on a statistical basis. The expected future price of silver as at March 1, 1913, was determined by pure guesswork and is most inconsistent with determinations of other metal prices and highly inequitable to producers of other metals.

For the purpose of illustrating the inequity of allowing valuations to be made on the basis of a 65 cent an ounce March 1, 1913, expected future price for silver as against the approved prices for iron, copper, lead, and zinc a chart is attached to this memorandum as Exhibit J.

If prices were equitably determined for each of those metals, the price trend line for each, would be on the 100 per cent line at March 1, 1913. When too high a price is used for any metal as at March 1, 1913 in comparison with other metals, the price trend line for that metal will be below the 100 per cent line at March 1, 1913; and, vice versa.

Three other charts are attached, indicated as Exhibits K, L, and M. These charts illustrate metal price trends and show conclusively that if the expected future price of copper of 16.25 cents a pound was incorrectly determined on a price trend basis as at March 1, 1913; the silver price of 65-cents an ounce at March 1, 1913 was even more incorrect on a price trend basis and should be revised.

In a large number of appraisals of mines by reputable engineers which have been furnished to the Income Tax Unit within the last four years, not one, to the best of my knowledge and belief, is based upon an expected future price of silver in excess of 60-cents an ounce at any date within the period 1909 to 1915. If desired, a confidential list can be furnished showing name of mine, person or corporation for whom report was made, name of engineer, and price of silver used in his valuation.

If any further evidence of any nature is desired in support of the contention that the allowance of a March 1, 1913, expected future sales price of 65 cents an ounce for silver is inequitable to the taxpayers in other metal mining industries, and that the 65 cent price is excessive, I am confident that the evidence can be obtained if you will indicate the nature of the evidence sought.

The metals valuation section therefore requests that you again consider its request for permission to revalue the mines of the silver mining industry on a basis consistent with the methods employed in other industries, and in accordance with the principles and methods which you have approved for use in the revaluation of the copper mining industry. The values previously allowed for silver mines as at March 1, 1913, and for invested capital in a few instances, are excessive. The depletion rates allowed for the years 1913 to 1923 might be regarded as reasonable even when based on the existing values. For your information, if you desire to hold conferences and hearings with the silver mining industry, lists of the more important silver mining companies are attached to this memorandum.

Your authority is also requested for delegation of authority to the head of the engineering division to order revaluation for years in which tax returns are open, in any case in which the original valuation is made on a basis inconsistent and inequitable in comparison with valuations allowed to competitor taxpayers in an industry. A revaluation is always made at present when the valuation is inequitable to the taxpayer, but is almost never made when the original specific valuation is inequitable to the Government and competitor taxpayers because the procedure is so complicated that authority can seldom be obtained.

JOHN ALDEN GRIMES,
Chief Metals Valuation Section.
F. T. DONAHOE,
Assistant Chief Metals Valuation Section.

EXHIBIT A OF G (GRIMES REPORT)

EXCERPTS FROM MEMORANDUM TO THE COMMISSIONER BUREAU OF INTERNAL REVENUE

JANUARY 7, 1922.

Page 1: The metals valuation section of the Income Tax Unit presents for your consideration the following recommendations for the standardization of valuations by analytic appraisal methods within the metals valuation section—

(1) That a standard basis for the determination of expected future sales prices of the common metals be adopted. The metals valuation section suggests that the arithmetical average price for the 10 years preceding the basic date be adopted as the expected future sales price, except in the case of metals for which such an average price is not available or for which the price trend during the 10 years' period is strongly and consistently up or down.

(Four other recommendations then follow as to standardization of valuation methods.)

Page 2: The changes in valuation methods outlined above will apply to all classes of metal mine valuation. The effect of the changes, however, will be felt chiefly by the copper and silver mining industries.

Page 10: There can be no question that gross errors have been made in the provisional valuations of many of the copper mines, and that the basis of valuation for copper and silver mines will have to be changed if these industries are not to receive preferential treatment in comparison with other metal mining industries.

Page 11: The metals valuation section respectfully requests decision of the following question:

Question (3): "Are the principles of valuation recommended in this memorandum approved subject to any limitations imposed by the answers to the two questions preceding?"

———,
Deputy Commissioner.

EXHIBIT B OF G (GRIMES REPORT)

EXCERPTS FROM MEMORANDUM OF FEBRUARY 7, 1922, FROM A. H. FAY, HEAD OF NATURAL RESOURCES DIVISION TO DEPUTY COMMISSIONER E. H. BATSON

Page 1: Among these valuations were 30 or 40 dividend paying copper mining companies and some silver mining companies.

Page 2: However, in many of these cases the valuation given the dividend paying copper and silver mining companies was in error, and high compared with coal mining, oil wells, and other mineral industries, resulting in a comparatively low tax rate.

EXHIBIT C OF G (GRIMES REPORT)

EXCERPTS FROM MEMORANDUM OF FEBRUARY 16, 1922, FROM DEPUTY COMMISSIONER E. H. BATSON TO A. H. FAY, HEAD OF NATURAL RESOURCES DIVISION

I have given much thought to the attached memorandum with respect to the revaluation of copper and silver mines for 1917 and subsequent years.

I suggest, therefore, that you arrange for a conference with representatives of the industry.

As the situation now stands, if we were to reach a decision without consultation with the industry we will doubtless be charged with having broken faith with the industry.

E. H. BATSON,
Deputy Commissioner.

EXHIBIT D OF G (GRIMES REPORT)

EXCERPT FROM MEMORANDUM TO MR. E. H. BATSON, DEPUTY COMMISSIONER

APRIL 1, 1922.

Inasmuch as the tax year of 1917 is involved in a number of copper and silver mines, the period during which these additional taxes, if any, may be collected and assessed will end about March 1, next year, leaving only about 11 months in which to make revaluations and complete audits of these cases.

I would respectfully request that the matter be taken up with the commissioner and see if there is any way in which an early answer as to policy may be obtained.

A. H. FAY, *Head of Division.*

EXHIBIT E OF G (GRIMES REPORT)

From June 21 to June 23, 1922, representatives of several of the principal copper-producing companies were notified by letters signed by the commissioner that a hearing would be held up on the subject of revaluation of copper mines on June 30, 1922, at 10 a. m., in the office of the commissioner.

The hearing was held as scheduled, on June 30, 1922, at 10 a. m., but in the office of Mr. Beal, the Assistant Secretary of the Treasury, and as Mr. Beal was ill, Mr. C. P. Smith, the Assistant Commissioner of Internal Revenue, presided.

Briefs and oral argument were presented by attorneys, engineers, and other representatives of the copper-mining companies.

In reply to these briefs and arguments memoranda were prepared by the income tax unit, which only mentioned silver-mine valuations incidentally. As these memoranda were in answer to specific arguments advanced by the representatives of the copper mining industry; and as copper-mine revaluation was far more important in dollars than was silver-mine revaluation; and as it followed that, if the basis of determination of the March 1, 1913, expected future price of 16.25 cents a pound for copper should be revised because it was inconsistent with determinations of expected future prices for other metals, the March 1, 1913, expected price of 65 cents an ounce for silver should also be revised, as it was even more inconsistent with other metal prices than was the 16.25 cent price for copper.

Excerpts from these memoranda follow:

Exhibit F of G (Grimes Report)

EXCERPTS FROM MEMORANDUM TO THE COMMISSIONER

July 25, 1922.

Page 3: Printed briefs were filed to show the inequitable treatment of the lead and zinc industries in comparison with the copper and silver industries. The St. Joseph Lead Co was informed that errors might have been made in the determination of copper and silver prices, but that such an argument would not be permitted to be the foundation for other errors.

Page 3: The commissioner was asked to permit the revision of copper and silver valuations to a reasonable basis, consistent with the methods employed in other valuations, and to eliminate extravagant allowances of paid-in surplus previously made.

Page 14: Ten-year average prices have been used in the valuation of iron, lead, zinc, and other mines. Silver and copper alone depart from this practice.

Page 16: This memorandum contains in brief form the arguments which the metals valuation section advances in support of the following conclusions:

(3) That copper and silver prices used in the valuations should be revised in order that other taxpayers do not bear the burden of tax which should be borne by these industries, or that all other metal prices be computed on the trend theory and large refunds of taxes made by the Treasury.

Deputy Commissioner.

Exhibit G of G (Grimes Report)

EXCERPTS FROM MEMORANDUM FOR MR. BATSON

Attention of Mr. Fay.

October 9, 1922.

Shortly after Mr. A. H. Fay became the head of the natural resources subdivision, the St. Joseph Lead Co. raised a strong protest against the price of lead used in the valuation of their mines. Printed briefs were filed to show the inequitable treatment of the lead and zinc industries in comparison with the copper and silver industries. The St. Joseph Lead Co. was informed that errors might have been made in the determination of copper and silver prices, but that such an argument would not be permitted to be the foundation for other errors.

The commissioner was asked to permit the revision of copper and silver valuations to a reasonable basis, consistent with the methods employed in other valuations, and to eliminate extravagant allowances for paid-in surplus previously made.

I am convinced that the overwhelming weight of evidence is to the effect that the price trend method is not the method accepted by most authorities in valuing ore bodies.

The valuations of copper and silver mining companies should be made along the same lines as the valuations of other metal-mining companies. The income tax unit is authorized and instructed to proceed to the revaluation of the copper and silver mining companies in accordance with its recommendations.

C. P. Smith, *Acting Commissioner.*

Exhibit H

(Refer to Exhibit B of the report.)

Exhibit I

(Refer to Exhibit D of the report.)

List of the more important silver producers

[From United States Geological Survey Reports. Addresses may be found in the alphabetical list of silver producers.]

Name of producer	Order of importance by years					
	1916	1917	1918	1919	1920	1921
Anaconda Copper Mining Co	1	1	1	1	1	1
Hercules Mining Co	2	2	4	18	4	24
Tonopah Belmont Development Co	3	3	9	9	5	6
Butte & Superior Mining Co	4	5	3	4	6	
Tonopah Extension Mining Co	5	10	7	8	9	12
Chief Consolidated Mining Co	6	6	2	2	2	2
Tonopah Mining Co	7	8	8	14	19	16
Bunker Hill & Sullivan Mining Co	8	4	10	5	7	8
Caledonia Mining Co	9	12	20	21		
Federal Mining & Smelting Co	10	11	14	16	12	5
United Verde Copper Co	11	7	7	12	14	
North Butte Mining Co	12	20	13	11	16	
Silver King Coalition Mining Co	13	14		20	20	22
Calumet & Arizona Mining Co	14	13	12	7	18	23
Hecla Mining Co	15	9	5	10	33	10
Green Hill Cleveland Mining Co	16	19				
Kennecott Copper Co	17	15	19			
Copper Queen Consolidated Mining Co	18	17	23	24		
Jim Butler Tonopah Mining Co	19	16				
Nevada Wonder Mining Co	20	18				
Presidio Mining Co	21	25	25	17	25	25
Iron Blossom Consolidated Mining Co		21		23		
United States Smelting, Refining & Mining Co		22	22	25		15
West End Consolidated Mining Co		23	17	19	15	9
Smuggler Union Mining Co		24		6		11
Timic Standard Mining Co			6	3	3	3
Ontario Silver Mining Co			15	22	17	19
Tamarack & Custer Consolidated Mining Co			16		25	
Elm Orlu Mining Co			18	13	10	13
Davis-Daly Copper Co			21	15	11	7
Utah Apex Mining Co			24			
California Rand Silver (Inc.)					8	1
Eagle & Blue Bell Mining Co					21	18
Vipont Silver Mining Co					22	14
Daly West Mining Co					24	
Rochester Silver Corporation						17
Bingham Mines Co						20
Judge Mining & Smelting Co						21

MEMORANDUM

APRIL 12, 1921.

Mr. S. M. GREENIDGE,
Head Engineering Division:

The principal silver mining companies, exclusive of the companies producing both copper and silver, are given in the following list, which will comprise between 80 and 90 per cent of the silver production, exclusive of that produced in connection with copper. (* Denotes the more important producers in the United States.)

Ajax Mining Co., Spokane, Wash.
Alameda Mining Co., Wallace, Idaho.
Alta Tunnel & Transportaton Co., Salt Lake City, Utah.
*Alvardo Mining & Milling Co., New York, N. Y.
Amalgamated Silver Mines Co., Helena, Mont.
American Fork Exploration Co., American Fork, Utah.
American Mining & Exploration Co., Salt Lake City, Utah.
Amparo Mining Co., Philadelphia, Pa.
Angelica Mining & Development Co., Wicks, Mont.
Armstead Mines (Inc.), Talache, Idaho.
Atlas Mining & Milling Co., Ouray, Colo.
Bay State Mining & Development Co., Salt Lake City, Utah.
Bingham Mines Co., Boston, Mass.
Bipont Silver Mining Co., Spokane, Wash.
Black Mines (Inc.), Salt Lake City, Utah.
Black Hawk Consolidated Mines Co., Milwaukee, Wis.
Boston-Montana Corporation, Butte, Mont.
Bristol Silver Mines Co., Salt Lake City, Utah

Brunswick Consolidated Gold Mining Co., Grass Valley, Calif.
Bullion Back & Champion Mining Co., Boston, Mass.
*Bunker Hill & Sullivan Mining & Concentrating Co., San Francisco, Calif.
*Butte & Superior Mining Co., New York, N. Y.
*Caledonia Mining Co., Kellogg, Idaho.
*California Rand Silver (Inc.), Bakersfield, Calif.
*Cardiff Mining & Milling Co., Salt Lake City, Utah.
Cascade Silver Mines & Mills, Butte, Mont.
Cash Boy Consolidated Mining Co., Reno, Nev.
Coeur d'Alene Crescent Mining Co., Spokane, Wash.
Cerro Gordo Mines Co., San Jose, Calif.
*Chief Consolidated Mining Co., Salt Lake City, Utah.
*Cinco Mines Co., New York, N. Y.
Colorado Consolidated Mines Co., Provo, Utah.
Columbus Rexall Consolidated Mining Co., Salt Lake City, Utah.
Colorado Superior Mining Co., Telluride, Colo.
Consolidated Cortez Silver Mines Co., New York N. Y.
*Consolidated Interstate Callahan Mining Co., New York , N. Y.
Consolidated Virginia Mining Co., San Francisco, Calif.
Consolidated West Extension Simon Mines Co., Mina, Nev.
Cubo Mining & Milling Co., Chicago, Ill.
*Cusi Mining Co., Chicago, Ill.
*Daly Mining Co., Salt Lake City, Utah.
Cusi Construction Co., El Paso, Tex.
*Daly West Mining Co., Salt Lake City, Utah.
Denhigh Mining Corporation, Boston, Mass.
Down Town Mines Co., Leadville, Colo.
Dragon Consolidated Mining Co., Provo, Utah.
*Eagle & Blue Bell Mining Co., Boston, Mass.
El Centro Mining & Milling Co., Lordsburg, N. Mex.
Elko Prince Mining Co., New York, N. Y.
*El Potosi Mining Co., New York, N. Y.
El Rayo Mines Co., New York, N. Y.
El Salvador Silver Mines Co. (Inc.), New York, N. Y.
Emma Silver Mines Co., Salt Lake City, Utah.
Enterprise Mining Co., Kellogg, Idaho.
Esperanza Mining Co., New York, N. Y.
Estella Mining Co., Los Angeles, Calif.
Eureka-Holly Mining Co., San Francisco, Calif.
Evergreen Mines Co., Denver, Colo.
Fairview Round Mountain Mines Co., San Francisco, Calif.
Fanny Rawlings Mining Co., Colorado Springs, Colo.
*Federal Mining & Smelting Co., New York, N. Y.
Pemini Mining Co., Salt Lake City, Utah
Grand Central Mining Co., Provo, Utah
Granite Bi-Metallic Construction Mining Co., St. Louis, Mo.
*Guanajuato Construction Mining & Milling Co., New York, N. Y.
*Guanajuato Reduction & Mines Co., Columbus, Ohio.
Hamburg Mines Co., Salt Lake City, Utah.
Hampton Consolidated Mines Co., Denver, Colo.
*Hecla Mining Co., Wallace, Idaho.
Hemlock Silver Lead Mining Co., Saltese, Mont.
*Hercules Mining Co., Burke, Idaho.
*Horn Silver Mines Co., Salt Lake City, Utah.
Howe Sound Co., New York, N. Y.
Humboldt Mines Co., Telluride, Colo.
Idaho Continental Co., Spokane, Wash.
Idaho Mining, Reduction & Transportation Tunnel Co., Idaho Springs, Colo.
*Iron Blossom Consolidated Mining Co., Provo, Utah.
Iron Blossom Mining Co., Laramie, Wyo.
*Iron Silver Mining Co., Leadville, Colo.
Jim Butler Tonopah Mining Co., Philadelphia, Pa.
*Judge Mining & Smelting Co., Salt Lake City, Utah.
Knight Investment Co., Salt Lake City, Utah.
Latest Out Mining & Smelting Co., Aurora, Ill.
Liberty Bell Gold Mining Co., Boston, Mass.
MacNamara Mining & Milling Co., San Francisco, Calif.

Majestic Mines Co., Boston, Mass.
*Mammoth Mining Co., Salt Lake City, Utah.
Marsh Mines Consolidated, Spokane, Wash.
Michigan-Utah Consolidated Mines Co., Salt Lake City, Utah.
*Mogollon Mines Co., Mogollon, N. Mex.
Montana-Bingham Consolidated Mining Co., Salt Lake City, Utah.
Montana-Tonopah Mines Co., Tonopah, Nev.
Montezuma Silver Mines Co., New York, N. Y.
*Nevada Packard Mines Co., Reno, Nev.
Nevada Silverfields Co., New York, N. Y.
Mountain Top Mining Co., Ouray, Colo.
Nevada Wonder Mining Co., Philadelphia, Pa.
*New York & Honduras Rosario Mining Co., New York City.
Nicaragua Mining Co., New York City.
Northern Light Mining Co., San Francisco, Calif.
*Ontario Silver Mining Co., Salt Lake City, Utah.
*Ophir Hill Consolidated Mining Co., Ophir, Utah.
Pittsburgh-Idaho Co. (Ltd.), Pittsburgh, Pa.
Presidio Mining Co., San Francisco, Calif.
Rescue Eula Mining Co., San Francisco, Calif.
Rico Wellington Mining Co., Provo, Utah.
Rio Plata Mining Co., New York, N. Y.
Rochester Silver Corporation, Rochester, Nev.
Round Mountain Mining Co., San Francisco, Calif.
Ruby Silver Mines Corporation, Idaho Falls, Idaho.
San Louis Mining Co., San Francisco, Calif.
San Toy Mining Co., Pittsburgh, Pa.
Sells Mining Co., Salt Lake City, Utah.
Silver Canyon Mining Co., Salt Lake City, Utah.
Silver Gulch Mining Co., Denver, Colo.
*Silver King Coalition, Salt Lake City, Utah.
Silver King of Arizona Mining Co., Superior, Ariz., or New York City.
Slate Range Minerals Co., Bakersfield, Calif.
Smuggler Union Mining Co., Boston, Mass.
South Hecla Mines Co., Salt Lake City, Utah.
South Utah Mines and Smelting Co., New York, N. Y.
Spruce Monarch Consolidated Mining Co., Wells, Nev.
Standard Silver Lead Mining Co., Spokane, Wash.
Swastika Silver & Copper Co., Huntington, W. Va.
Tamarack & Custer Consolidated Mining Co., Wallace, Idaho.
Tecoma Consolidated Mining Co., Salt Lake City, Utah.
*Silver King Consolidated Mining Co., Salt Lake City, Utah.
Tecopa Consolidated Mining Co., Tecopa, Calif.
Tintic Milling Co., Provo, Utah.
Tintic Mining & Development Co., New York, N. Y.
*Tintic Standard Mining Co., Salt Lake City, Utah.
Tintic Standard Milling Co., Salt Lake City, Utah.
Tonopah Belmont Development Co., Philadelphia, Pa.
Tonopah Extension Mining Co., New York, N. Y.
Tonopah Midway Consolidated Mining Co., Tonopah, Nev.
Tonopah Mining Co. of Nevada, Philadelphia, Pa.
Union Consolidated Mining Co., San Francisco, Calif.
United Silver Copper Co., Spokane, Wash.
*United States Smelting, Refining & Mining Co., Boston, Mass.
Utah-Apex Mining Co., Fall River, Mass.
Utah Consolidated Mining Co., New York, N. Y.
*Utah Metal & Tunnel Co., Salt Lake City, Utah.
Utah Silver Lead Mines, Salt Lake City, Utah.
Utopia Mining Co., Dillon, Mont.
Victoria Consolidated Mining Co., Salt Lake City, Utah.
Vipont Silver Mining Co., Salt Lake City, Utah.
Vulcan Consolidated Mining Co., Tucson, Ariz.
Wellington Mines Co., Kansas City, Mo.
West End Consolidated Mining Co., Oakland, Calif.
West End Opoteca Mines Co., Oakland, Calif.
*White Caps Mining Co., Tonopah, Nev.

Wilbert Mining Co., Salt Lake City, Utah.
*Yak Mining, Milling & Tunnel Co., Leadville, Colo.
Yellow Pine Mining Co., Los Angeles, Calif.
Yosemite Mines Co., Boston, Mass.

Sirs: On December 11, 1922, the Commissioner of Internal Revenue and the Secretary of the Treasury authorized and directed the Income Tax Unit to revalue silver mines on a basis consistent with that used in the valuation of other metal mining properties. Such revaluation applies to all returns for 1919 and later years unless written agreements have been made with the commissioner under the provision of section 1312 of the revenue act of 1921 or section 1006 of the revenue act of 1924.

Inasmuch as the silver mining companies were not accorded a hearing prior to the issuance of this order, it is deemed advisable to give representatives of the companies an opportunity to be heard before a general revaluation of the silver properties is made. You will be advised promptly of the time and place for you to appear.

To give you sufficient opportunity to make such a showing as you may desire in this connection and to protect the Government's interests against the running of the statute of limitations, request is made that you execute the attached waiver consenting to the assessment of any additional tax that may be found due in accordance with section 278 of the revenue act of 1924. This waiver should be returned to this office within two weeks from the date of this letter.

In the event you decide not to fill a waiver it will be greatly appreciated if you will notify this office to that effect. If a waiver is not filed it may be necessary to make a jeopardy assessment as provided for by section 274 (d) of the revenue act of 1924. Should a jeopardy assessment be made the collector of internal revenue for your district will accept a claim in abatement when supported by a sufficient bond to cover the amount of the assessment.

Your reply should be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:En:M:JAG.

Respectfully,

J. G. BRIGHT, *Deputy Commissioner.*

The CHAIRMAN. During one of the hearings this week, I asked Mr. Nash if he could give us the number, or the total amount involved—I am not sure which—of the compromise made in tax settlements, because of the inability to pay through possible insolvency or bankruptcy proceedings.

Mr. NASH. They are gathering that information in the solicitor's office, Mr. Chairman. It is going to take several days to compile it and get it together. The committee will have it as soon as we have it ready.

Mr. MANSON. May I ask whether, in compiling that information, you are making a list of the cases?

Mr. NASH. We were not making a list. Mr. Box called me yesterday and asked me if we would make a list of all offers of $100,000 or more since 1921. We found, Mr. Chairman, that the records prior to 1921 were not very complete. I explained that to Mr. Box, and he said, if we could get him the cases since 1921, it would be agreeable.

Mr. MANSON. He took that up with you, did he?

Mr. NASH. Yes, sir.

The CHAIRMAN. Is that arrangement satisfactory?

Mr. MANSON. Yes.

The CHAIRMAN. To go back to 1921?

Mr. MANSON. Yes.

The CHAIRMAN. I would like to ask if that will include the Lincoln Motor Car Company, because that is still in my mind. I suppose that is because it is an institution in my home town. In that case

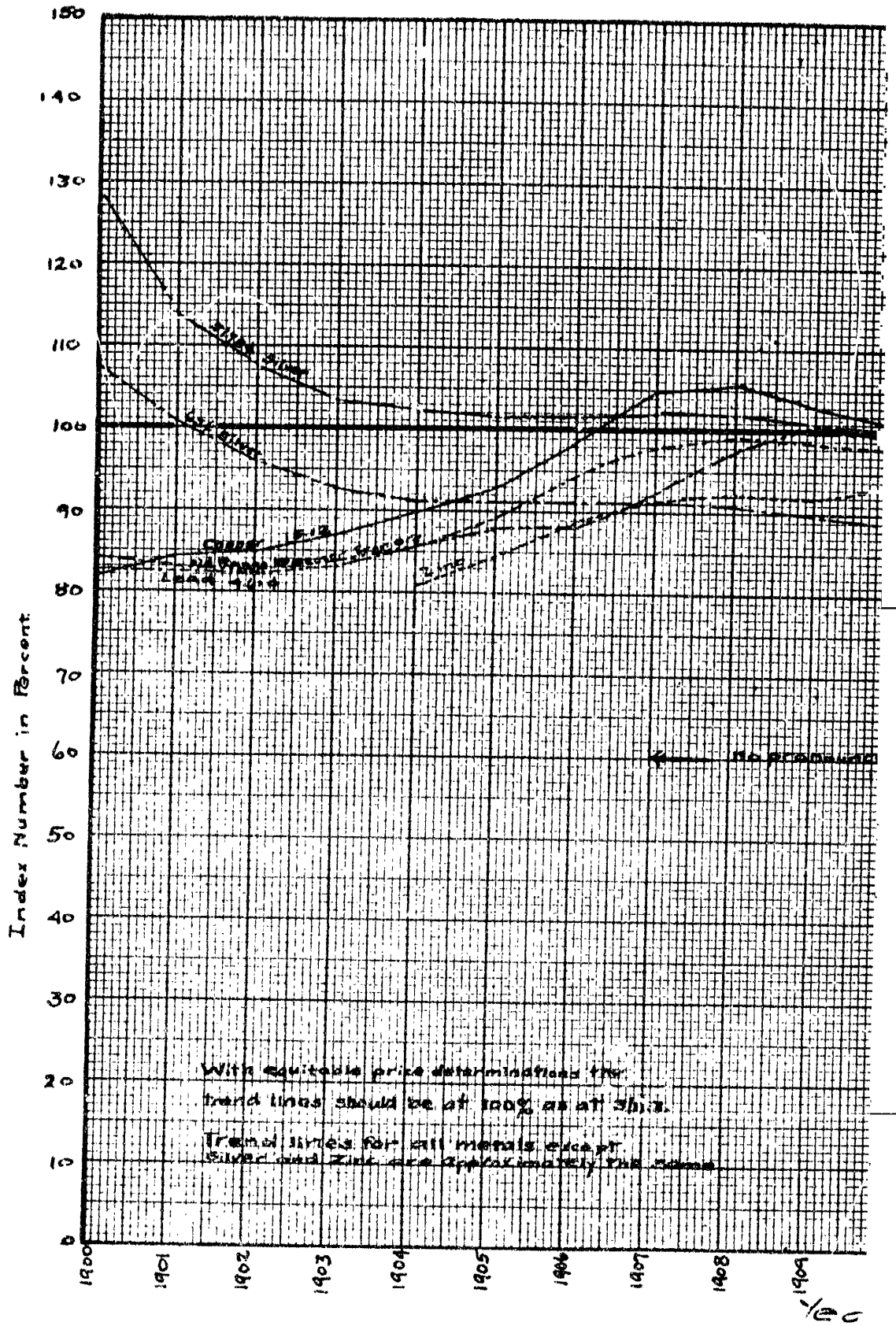
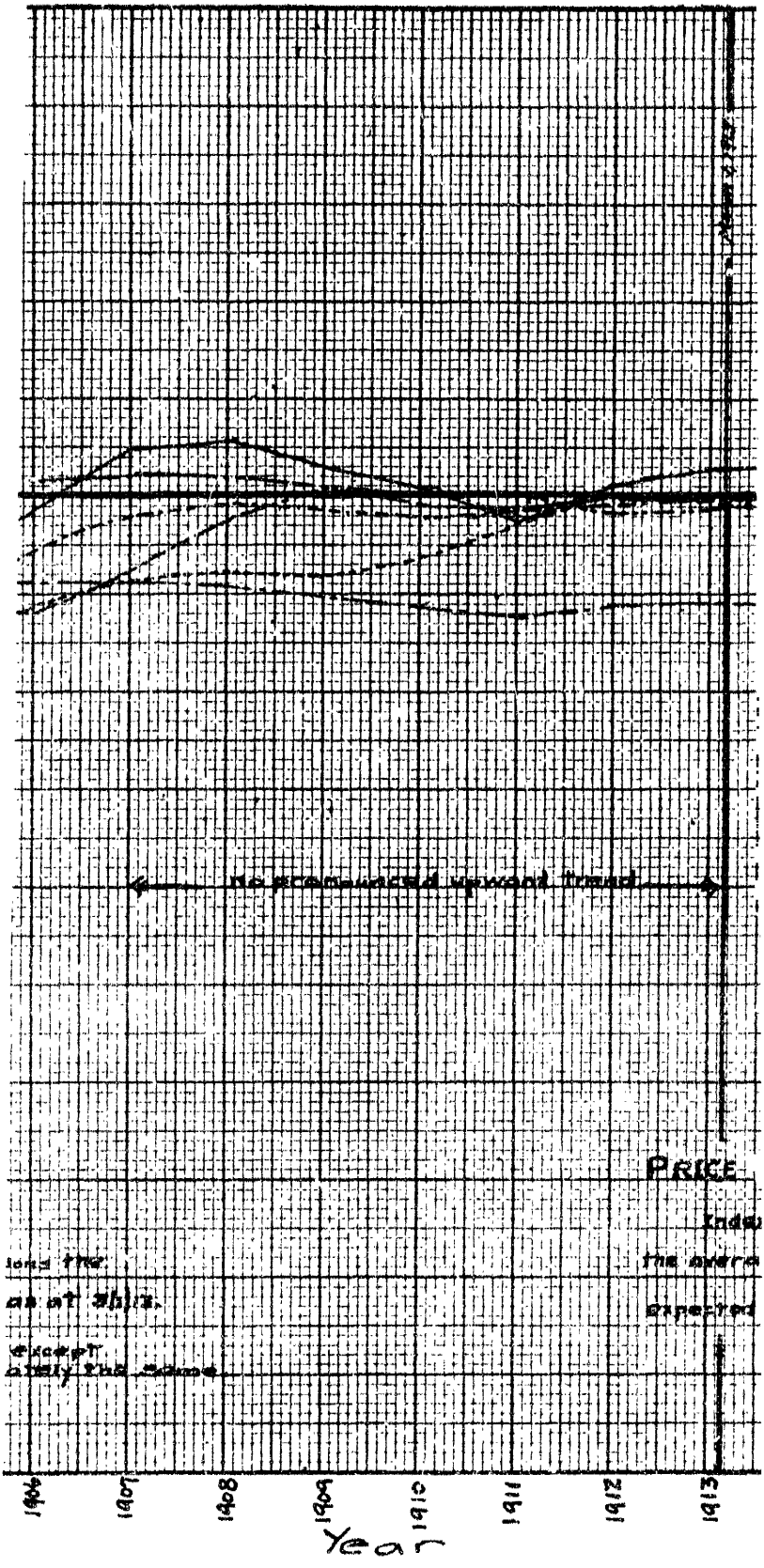
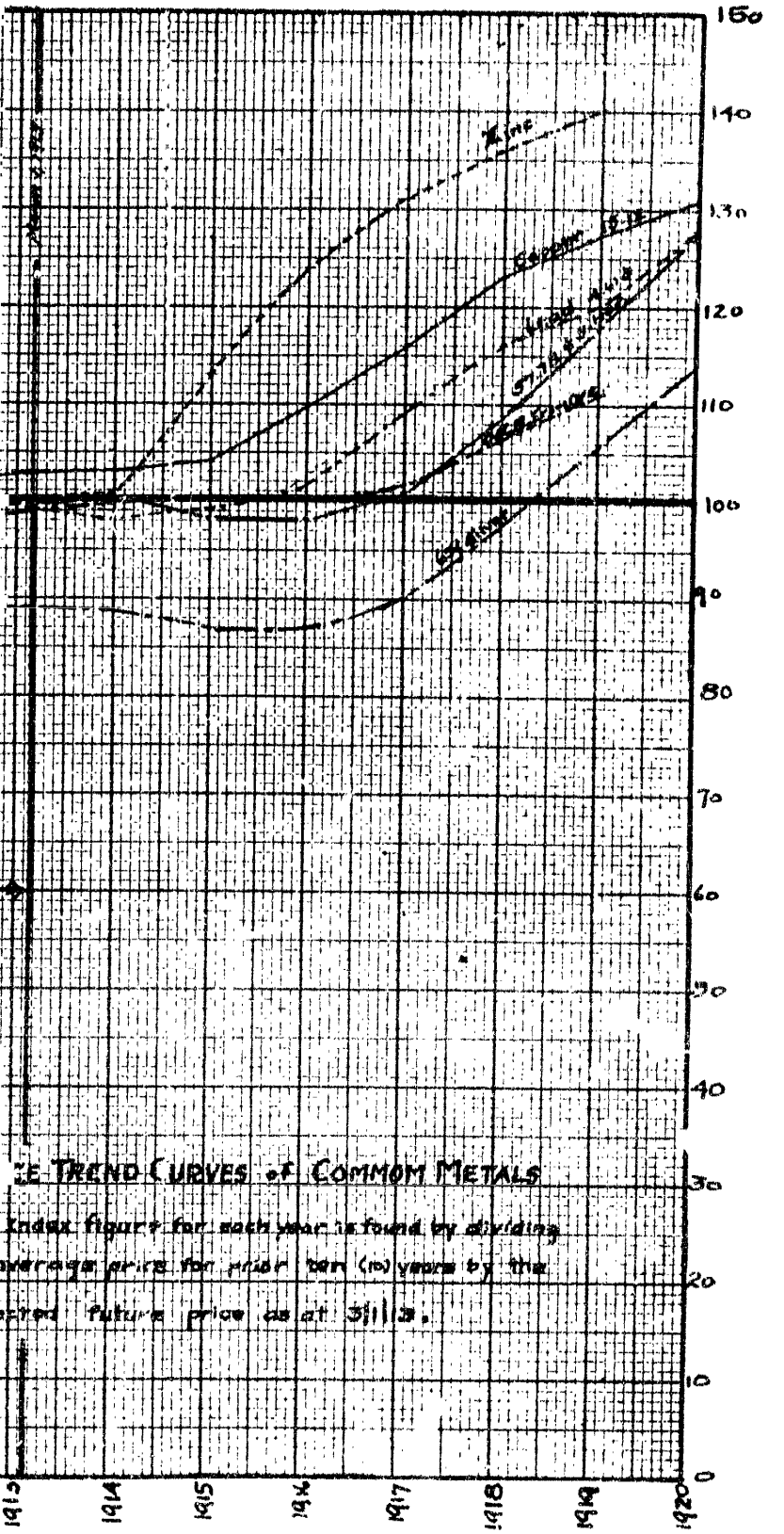

Index Number in Percent
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
1900
1901
1902
1903
1904
1905
1906
1907
1908
1909
Silver Price
Exchange
Copper
Lead
Tin
Zinc
No precedent
With equitable price determinations the trend lines should be at 100% as at 1913.
Trend lines for all metals except Silver and Zinc are approximately this course

CHART J


No pronounced upward trend
PRICE
1906
1907
1908
1909
1910
1911
1912
1913
Year



E TREND CURVES of COMMON METALS

Index figure for each year is found by dividing
average price for prior ten (10) years by the
ted future price as at 3|11|3.

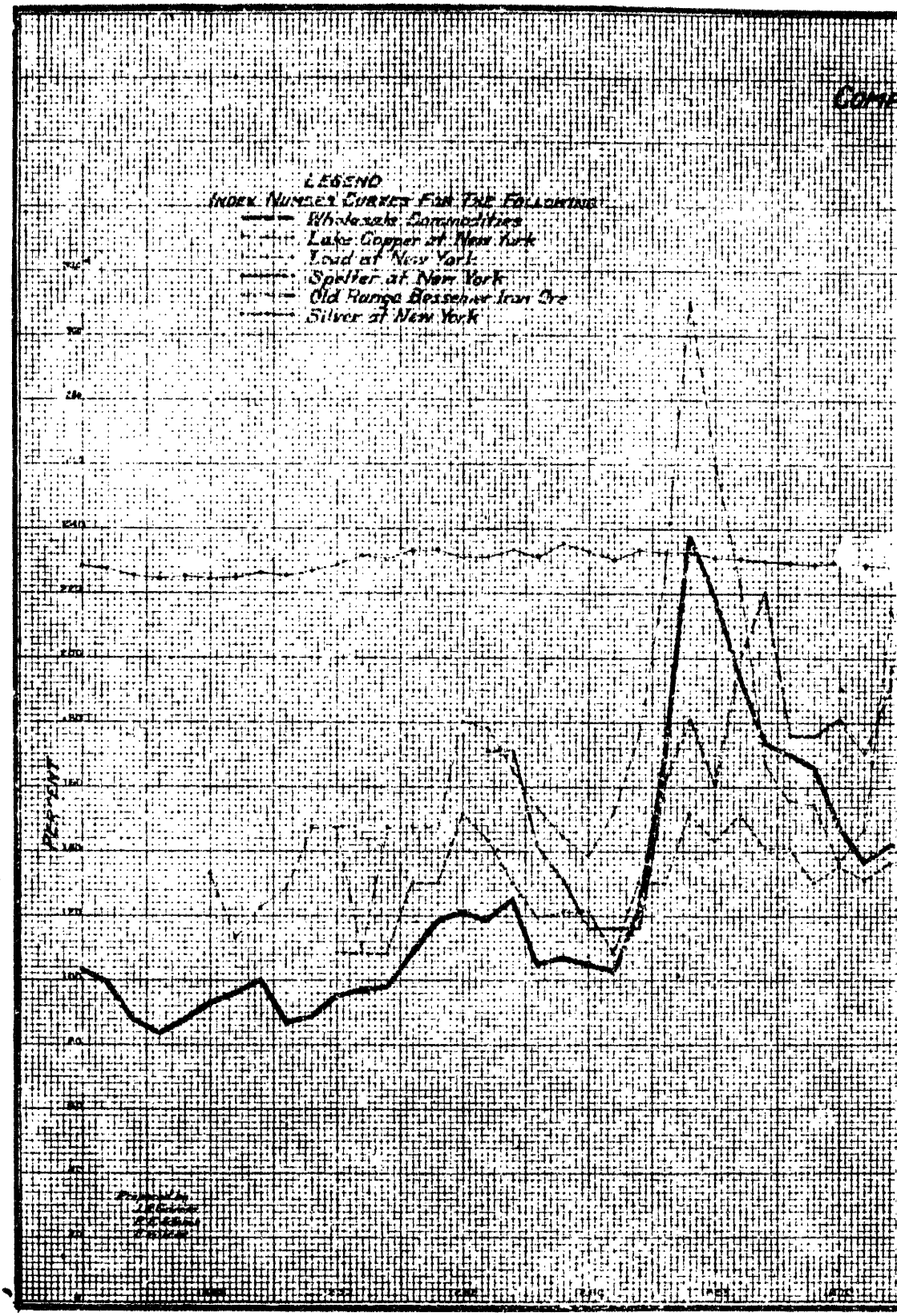

LEGEND
INDEX NUMBER CURVES FOR THE FOLLOWING:
Wholesale Commodities
Lake Copper at New York
Lead at New York
Spelter at New York
Old Range Bessemer Iron Ore
Silver at New York

CHART K

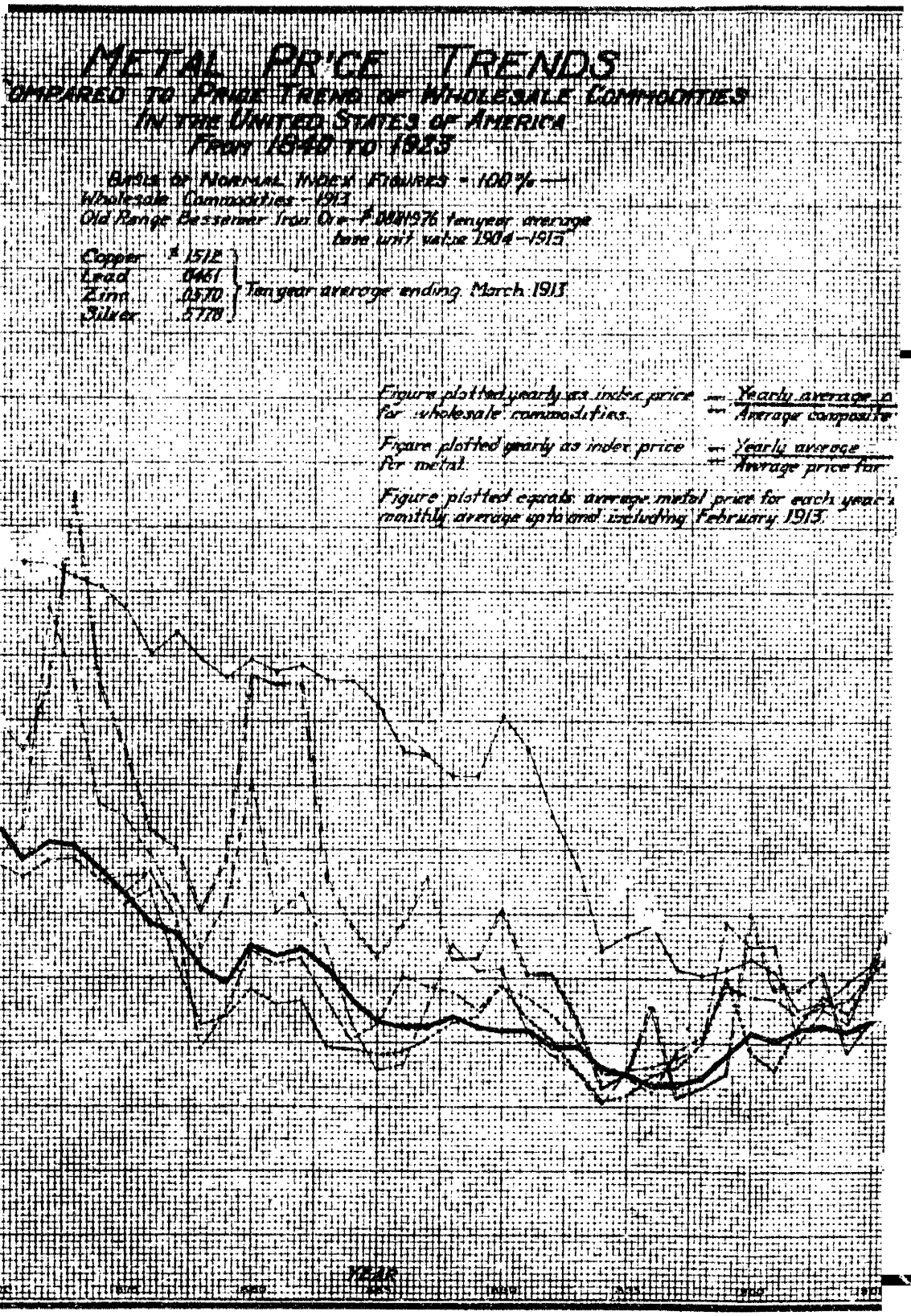

METAL PRICE TRENDS
COMPARED TO PRICE TREND OF WHOLESALE COMMODITIES
IN THE UNITED STATES OF AMERICA
FROM 1840 TO 1913
Basis of Normal Index Figures = 100%
Wholesale Commodities - 1913
Old Range Bessemer Iron Ore - $1.88976 ten year average base unit value 1904-1913
Copper $ 1512
Lead .0461
Zinc .0570
Silver .5778
Ten year average ending March 1913
Figure plotted yearly as index price for wholesale commodities.
Yearly average
Average composite
Figure plotted yearly as index price for metal.
Yearly average
Average price for
Figure plotted equals average metal price for each year's monthly average up to and including February 1913.
YEAR

DIAGRAM NUMBER I

Source Of Data

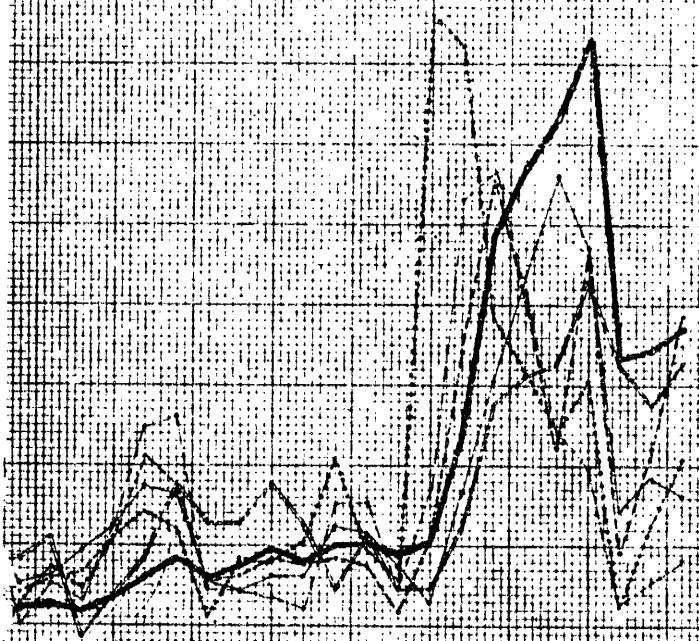
Wholesale Commodities — The Annalist, April 9, 1921
Dept of Labor Bulletins

- Iron Ores — Iron Trade Review Prices
- Copper } E. & M.J.P.
- Lead } American Metal Market
- Spelter } Mines Handbook, U.S. Geological Survey
- Silver — Director of the Mint
  E. & M.J.P.

average composite price for wholesale commodities
e composite price for wholesale commodities for 1914

average metal price
price for 10 years prior to March 1, 1915.

ach year divided by the 10 year
1915



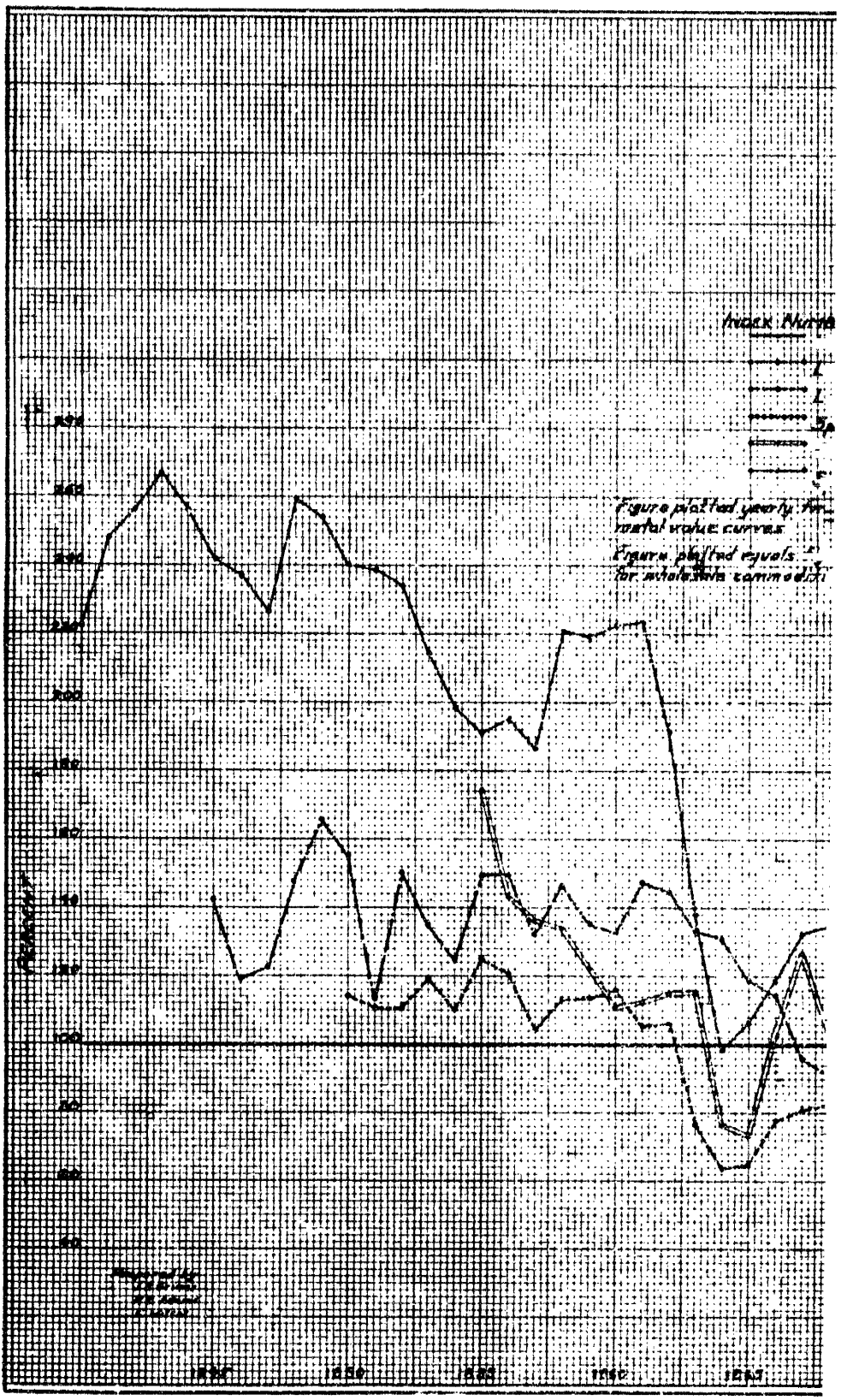

Index Numbers
Figure plotted yearly for
rental value curves
Figure plotted equals
for wholesale commodity
1850
1855
1860
1865

CHART I.

METAL PRICE TRENDS

COMPARED TO PRICE TREND OF WHOLESALE COMM
IN THE UNITED STATES OF AMERICA
FROM 1840 TO 1923

LEGEND

Index Numbers Curves For The Following

Wholesale Commodities

Lake Copper at New York

Lead at New York

Spelter at New York

Old Range Bessemer Iron Ore

Silver at New York

Curves showing variat
The trend of wholesale commodi
prices on Diagram Number I has
prices by the index number for the

This has eliminated from th
fluctuation in the prices of gover
in the value of the metals themse
of commodities. The effect of th
and the actual purchasing power o
wholesale commodities. The index c
constant value of 100%.

Sources of information, a
are the same as in Diagram Number

Each yearly figure ——— Metal Price Index Figure used in Diagram No I
curves. ——— Wholesale commodity Price Index for same year
and equals figure plotted on Diagram No I divided by the Index
of commodities prices for same year.

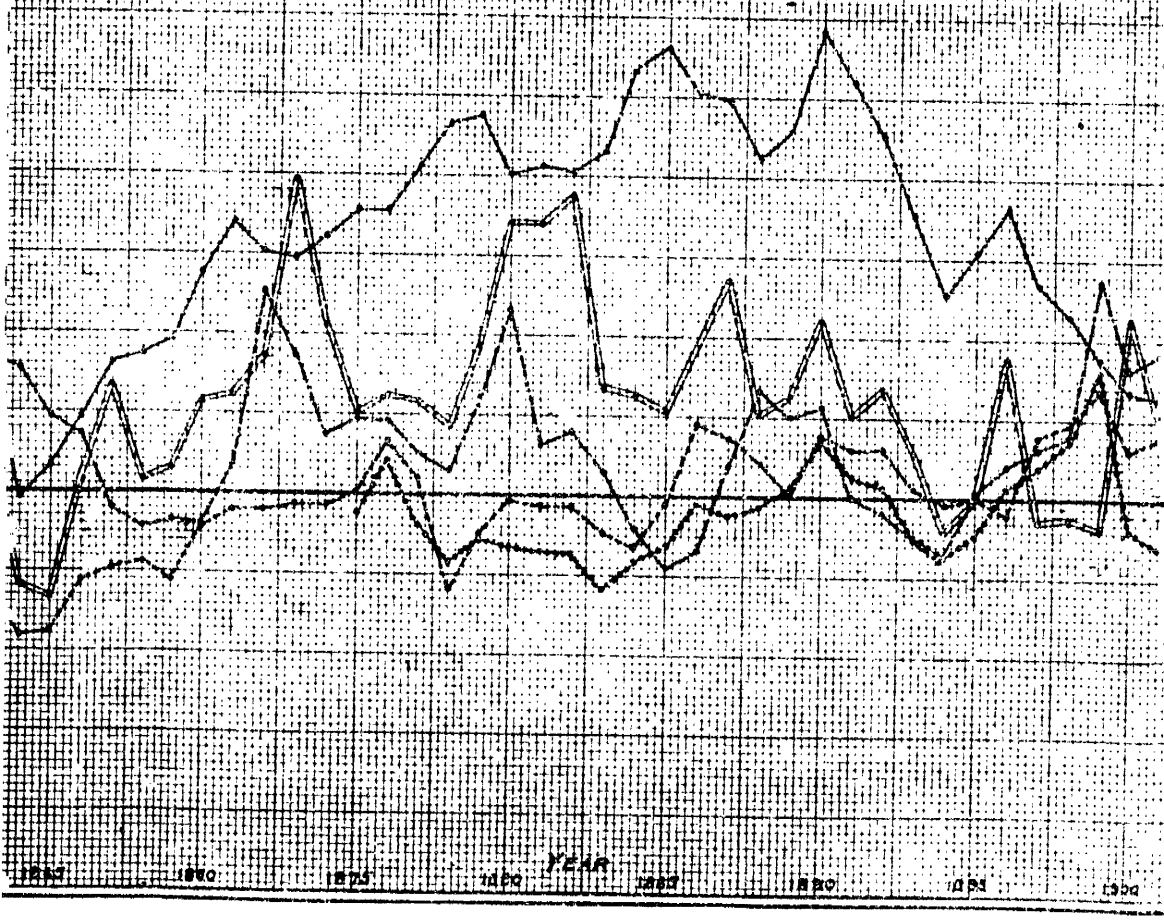
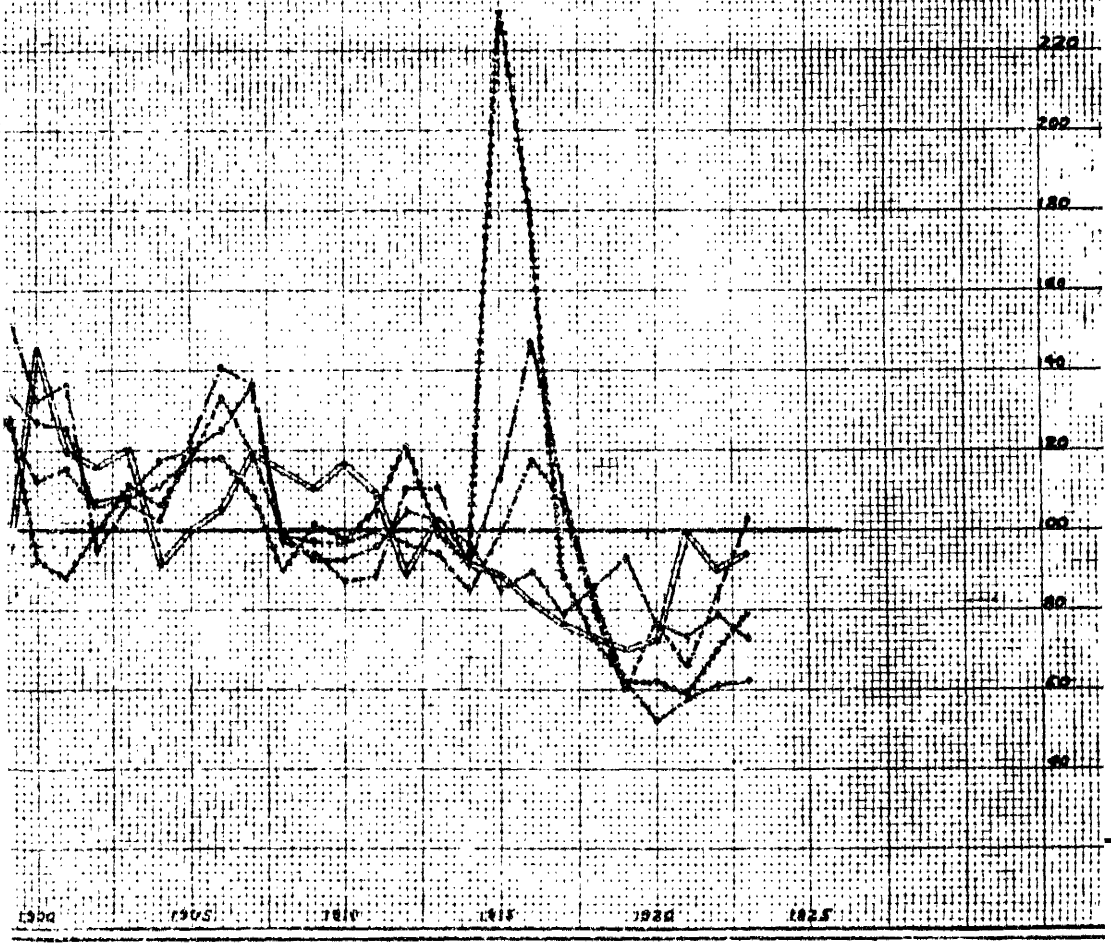


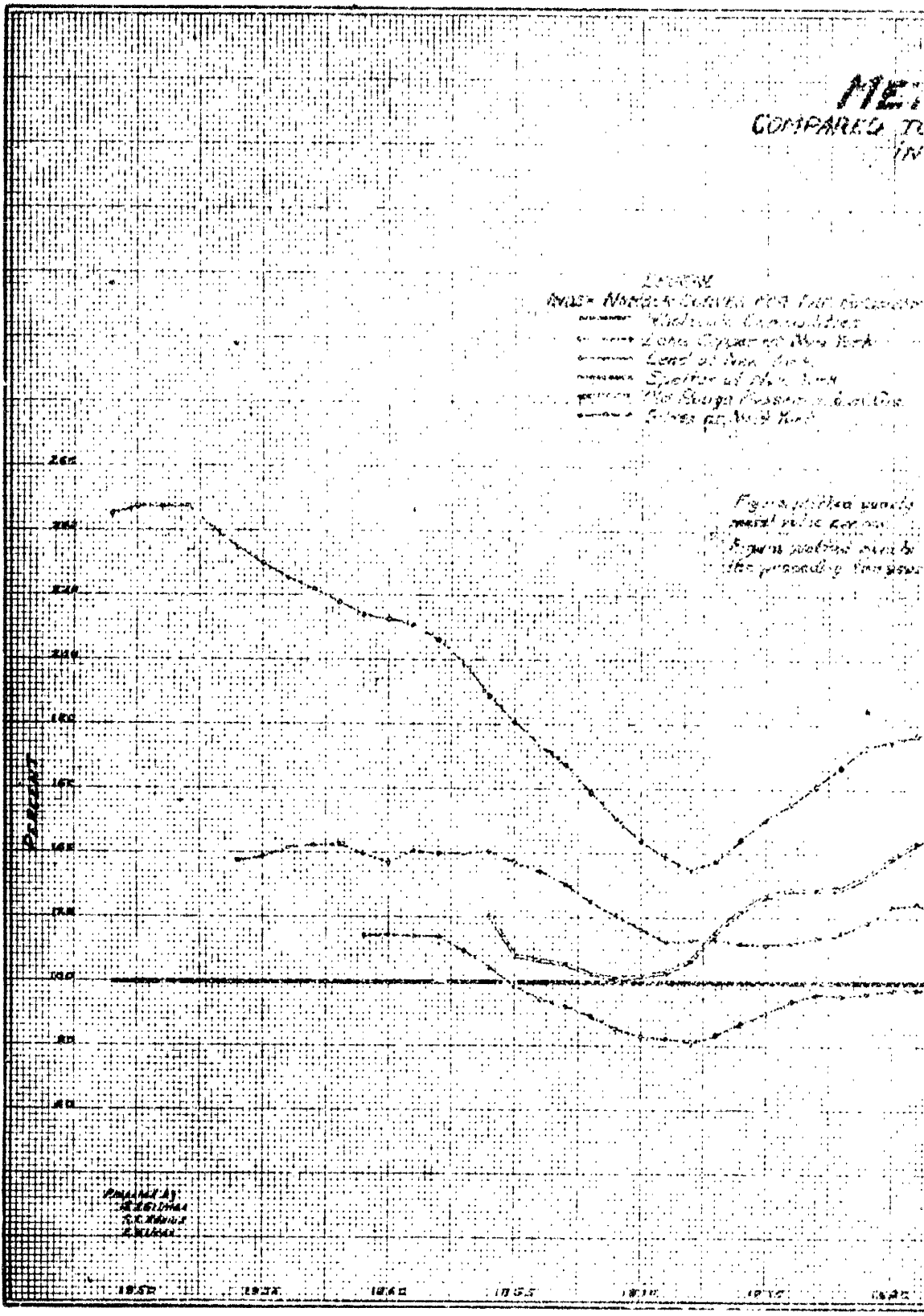
Diagram Number III

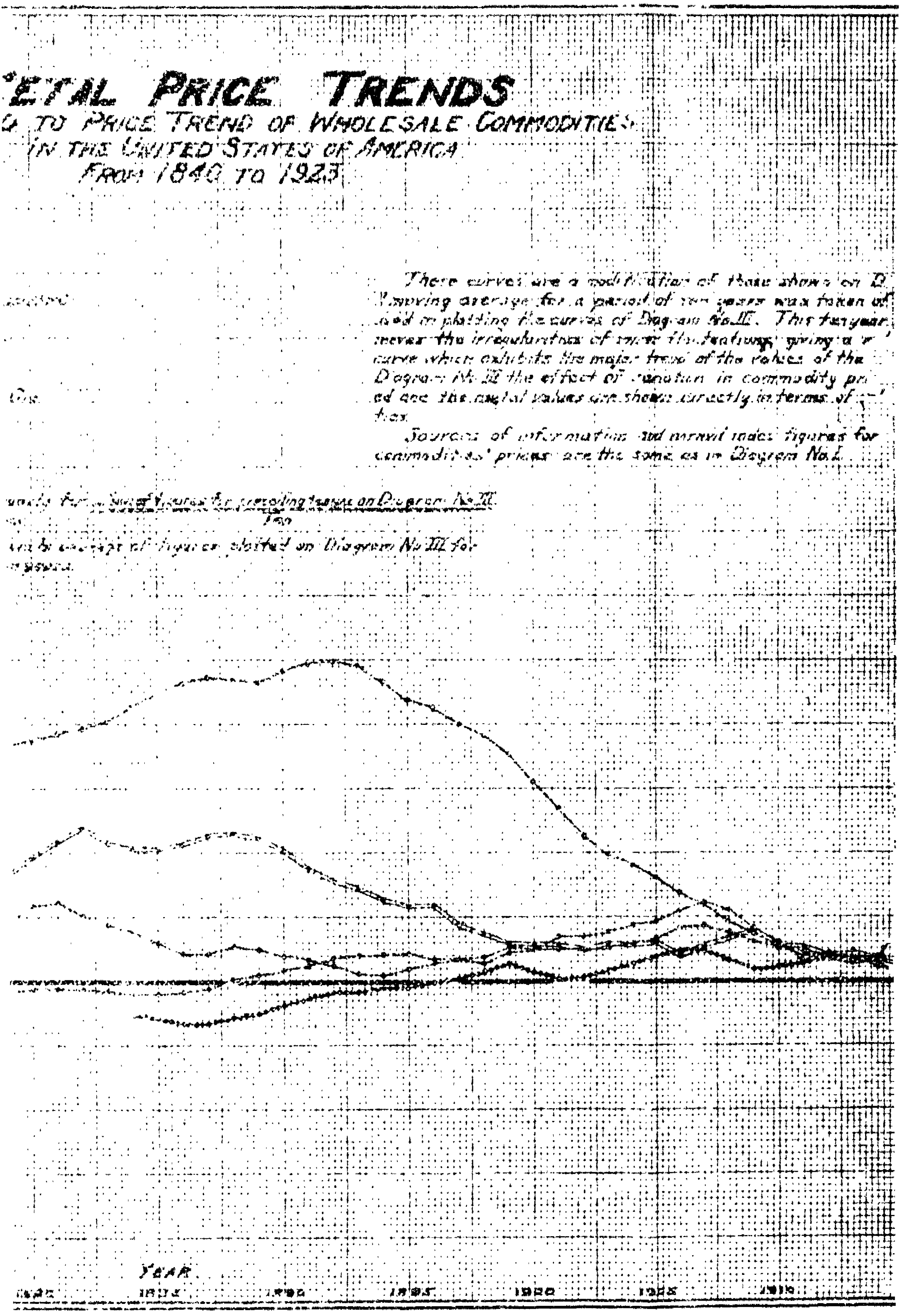
S
COMMODITIES

variation in value of the metals in terms of value of commodities
mmodity prices shown by the index curve of wholesale commodity
r I has been eliminated by dividing the index number for the metal
for the commodity prices for the corresponding years
from the index curves for Metals the series for which results solely from
general commodities, and brings forth more clearly the actual changes
themselves during the period plotted in terms of the wholesale value
t of the so-called variation in the value of the dollar, is thereby eliminated
ever of the metal is shown as a percent of the purchasing power of the
index curve for wholesale commodities becomes a horizontal line with a

tion, and normal index figures for metal and commodities prices
index I.




ME
COMPARED TO
IN
Percent


ETAL PRICE TRENDS
TO PRICE TREND OF WHOLESALE COMMODITIES
IN THE UNITED STATES OF AMERICA
FROM 1840 TO 1923
Sources of information and general index figures for commodities' prices are the same as in Diagram No. I.
YEAR

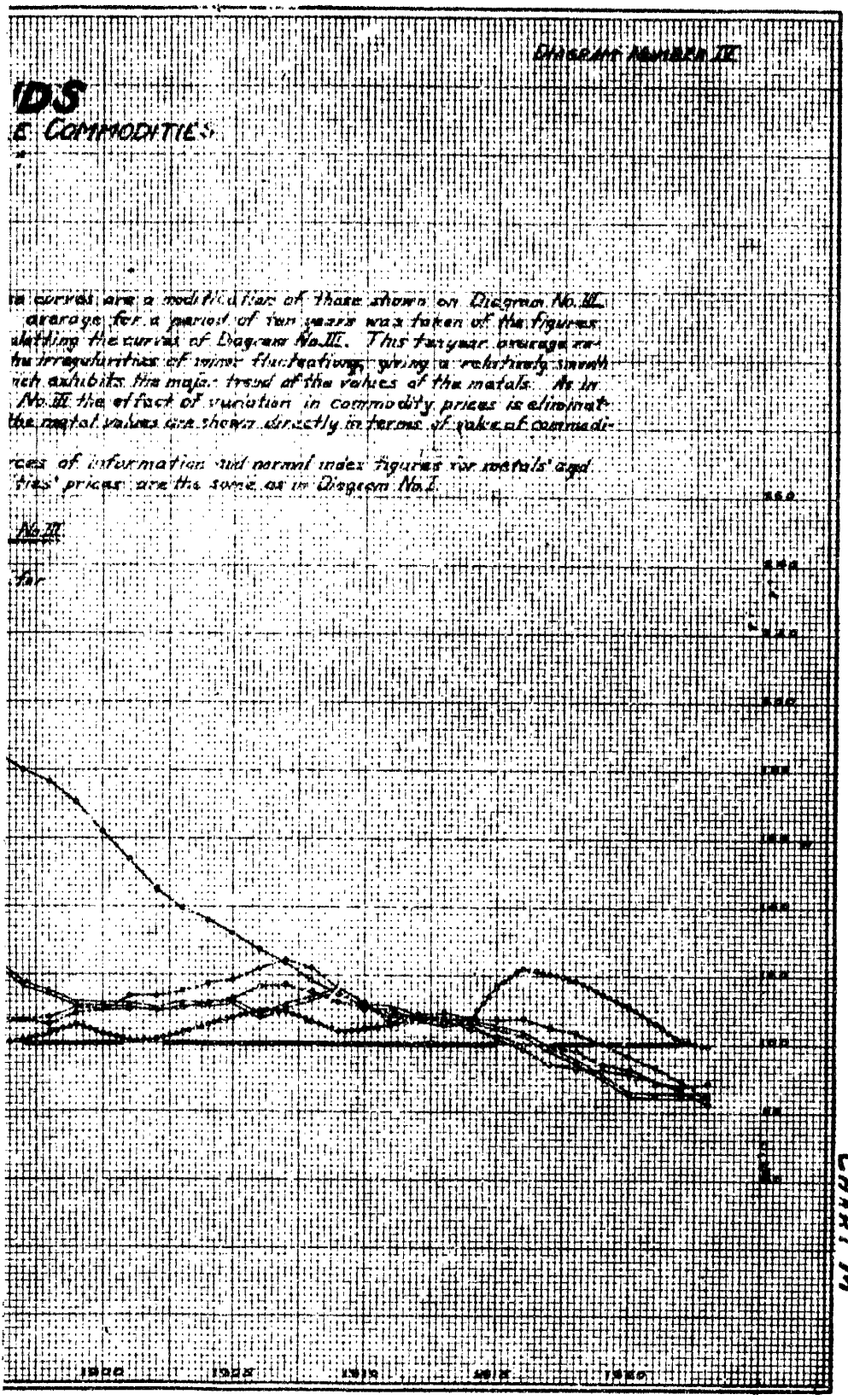


Diagram Number III.
IDS
E COMMODITIES
curves are a modification of those shown on Diagram No. II.
average for a period of ten years was taken of the figures
plotting the curves of Diagram No. III. This ten-year average re-
the irregularities of minor fluctuations, giving a relatively smooth
ich exhibits the major trend of the values of the metals. As in
No. III the effect of variation in commodity prices is eliminat-
the metal values are shown directly in terms of price of commodi-
rces of information and normal index figures for metals and
ties' prices are the same as in Diagram No. I.
No. III.
for
1920
1925
1930
1935
1940
CHART N.

the Government assessment of income taxes or excess profits taxes—I am not sure exactly which—exceeded some four million dollars, and the enforcement of the collection of that tax really put the company into a receivership. I only desire to straighten my own mind out on the subject, so as not to go away with a wrong impression.

Mr. HARTSON. I would be glad, Mr. Chairman, to find out just what was done in the Lincoln Motor Car Co. case with regard to the assessment and possible compromise of its tax, and I will inform the Chairman.

The CHAIRMAN. Are you through now?

Mr. GREGG. Can you give us an idea as to the future action of the committee, within the next three or four days?

The CHAIRMAN. I do not know that I can, because I am sitting here alone, and do not know just what my colleagues are going to do. I do not know just what their program is, assuming that the Treasury Department allows this resolution to go through to continue the work. It seems incumbent upon me to at least confer with my colleagues as to what they wish to do; but so far as the next few days are concerned, I want to have at least one or two more days on the Prohibition Unit because, in so far as I am concerned, and speaking only for myself, I hope to close up that feature in a few days, so that we can get it out of the way and concentrate on the Income Tax Unit of the bureau.

I do not know whether Mr. Manson has anything specific in mind.

Mr. MANSON. I think I could go ahead to-morrow. If you want to hold a hearing on the Prohibition Unit to-morrow it will please me very much.

The CHAIRMAN. What do you have in mind for to-morrow?

Mr. MANSON. I have some oil matters.

The CHAIRMAN. I think we had better go ahead on these oil matters to-morrow, because I want to talk with Mr. Pyle about closing up this prohibition question.

We will go ahead on the oil cases to-morrow, if you are ready with them.

Mr. HARTSON. Mr. Chairman, the bureau may very possibly have some matters to present at the hearing to-morrow, and will probably occupy a fair share of the time of to-morrow's session. We have two or three cases that we would like to reply to, and Mr. Manson need not plan to take up the entire session, if he will permit us to go ahead and consume a portion of the time.

The CHAIRMAN. We will adjourn, then, until 10 o'clock to-morrow morning. We will allow Mr. Manson to proceed at that time, and then, when he is through, we will let the bureau put in their replies.

(Whereupon, at 11.35 o'clock a. m., the committee adjourned until to-morrow, Friday, February 27, 1925, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

FRIDAY, FEBRUARY 27, 1925

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senator Couzens, presiding.

Present also: Mr. L. C. Manson, of counsel for the committee; Mr. L. H. Parker, chief engineer for the committee; and Mr. A. H. Fay, consulting engineer for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. A. W. Gregg, special assistant to the Secretary of the Treasury; Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, solicitor, Bureau of Internal Revenue; Mr. S. M. Greenidge, head, engineering division, Bureau of Internal Revenue; and Mr. W. N. Thayer, chief of the oil and gas section, Bureau of Internal Revenue.

Mr. MANSON. At the time we were considering the Atlantic, Gulf & West Indies matter, the chairman requested counsel for the committee to investigate the present market value of the stock.

On December 31, 1922, there were 146,934 shares of common stock outstanding. The high quotation on January 2, 1924, which is the date that this offer was accepted, was 15½. The low was 15⅜ and the average was 15 7/16. The market value at that date of the common stock, that is, on January 2, 1924, was $2,309,974.88.

On February 21, 1925, the high quotation was 32⅛; the low was 30; the average 31 1/16 and the market value of the common stock on that date was $4,648,006.13.

On December 31, 1923, there were 137,429 shares of preferred stock outstanding. The high quotation on the preferred was 13½ cents; the low was 12¾; the average 13⅛, and the market value as of January 2, 1924, was $1,803,755.62.

As of February 21, 1925, the high quotation on the preferred was 43; the low was 42; the average 42½, and the market value of the preferred stock was $5,840,732.50.

The total shares of common and preferred outstanding on December 31, 1923, was 287,063.

On January 2, 1924, the market value was $4,113,730.50; and on February 21, 1925, the market value was $10,488,738.63.

The source of these quotations is the Commercial and Financial Chronicle.

The CHAIRMAN. It would have paid the Government to have taken the stock for this claim, would it not?

Mr. MANSON. Yes.

Mr. MANSON. Mr. Fay has some additional oil matters to present this morning.

STATEMENT OF MR. A. H. FAY, CONSULTING ENGINEER FOR THE COMMITTEE—Resumed

Mr. FAY. I have just a brief note here, Mr. Chairman, on the Alpine Oil Co., the company that made the discovery in this Eldorado (Kans.) field, wherein the Gypsy Oil Co. set up a valuation on the Shumway lease.

This Alpine well was drilled, perhaps, half a mile from where the larger wells came in.

Referring to discovery valuations for the extension of Eldorado pool on which the Gypsy-Shumway lease was situated, as has already been stated, the Alpine Oil & Gas Co., of Kansas City, drilled the original well that discovered this oil pool. This discovery well was one-half mile west of the Gypsy well and was drilled in March, 1917. Well No. 1 of the Alpine Co. came in with an initial production of 250 barrels a day, and in accordance with both law and regulations, this taxpayer was entitled to set up a discovery valuation for this well. However, in checking up the income-tax returns for this corporation for the year 1917 it contained the notation "no production for 1917." The 1917 returns were audited and closed April 8, 1919, on the basis of the company not making a claim for discovery valuation, nor making any claim for depletion on cost basis. This company had a "paid-up common stock" of $19,500 and was operating on borrowed money to the extent of $4,500. Apparently this taxpayer sold this lease but he does not state the price received. He places the value of the lease as $15,000, being the par value of the common stock less the borrowed capital. He sets up $8,478.94 as operating expenses, making a total deduction of $23,478.94. The return, however, does not show in any way the amount of money actually received from this lease when sold, if sold. The case was closed, as stated above, with "no tax due." The taxpayer's return for the year 1919 shows a loss of $7,007. The returns for 1918 and 1919 were closed July 16, 1923, with "no tax due." This statement is submitted to show that the real discoverer received no credit therefor, while those who followed up and drilled offset wells benefited by the Alpine discovery.

The CHAIRMAN. They discovered it?

Mr. FAY. They discovered it; yes.

The CHAIRMAN. But they made no discovery claim?

Mr. FAY. They made no discovery claim to which they were entitled. That is their fault, but I would judge, from what little information we can get on the returns, and they are very meager, they have apparently sold this lease to some one, and then they have deducted from the sale price the par value of their stock, $15,000, as representing the value of the lease; but in their returns they show no income of any kind whatever, either from oil or from a sale of a lease.

The CHAIRMAN. Where did you get the information that they sold it, then?

Mr. FAY. The only line I have for that is on the income-tax return under "cost of property sold," and opposite that they set 15,000.

The CHAIRMAN. Is it not unusual that the bureau did not make an inquiry as to what they got for it when they sold it?

Mr. FAY. It looks like it might have been.

The CHAIRMAN. I should think that the sale price would have been a part of the income of the taxpayer.

Mr. FAY. It would have been. Now, I have been able to work up from the return of the lessors, their interests in the Shumway lease, which was operated by the Gypsy Co., the two lessors owning the major portion of the royalty are A. G. Winchester and G. H. Hunter, and this has a bearing on the apportionment of value as between lessor and lessee.

LESSOR'S EQUITIES

As regards the equitable apportionment of the valuation of a lease as between lessor and lessee, it has been brought out in previous hearings that the Gypsy Oil Co. received a depletion unit of $1.528 per barrel on its well No. 1, and a composite unit of $1.466 per barrel for its entire lease (Shumway) of 160 acres. Mrs. Atlanta G. Winchester, a co-lessor in this case, received an income from five-eighths of one-sixteenth royalty in this lease. The lessor claimed a discovery valuation within 30 days of date of discovery and the well was valued by the unit on the basis of $1.70 per barrel (depletion unit, $1.0833) for oil, while the Gypsy Co. (lessee) set up its valuation on the basis of 1.90 per barrel for oil, the posted price on the 31 days after discovery, which set-up was also allowed. The lessor taxpayer also set up discovery valuation on wells Nos. 2, 10, and 23 at the market price of oil, resulting in a composite depletion unit of $1.1612, while the composite allowed the lessee taxpayer was $1.466.

It should be remembered that the lessor has no operating costs, no drilling costs, in fact no expenses connected with the handling of his oil. The lessee bears all the drilling costs, operating expenses, and delivers to the lessor oil in storage, or monthly payments based on pipe-line runs. The differential as between lessor and lessee of the present worth of a barrel of oil over the four years life of the well at the date of discovery is the cost of operating and development. The lessee's cost of pumping and running oil into tank or line is 32 cents per barrel, and 4.6 cents for development cost, making a total cost of 36.6 cents per barrel. This is the differential as between lessor and lessee.

Since the department has allowed the lessor $1.0833 per barrel as representing the value of a barrel of oil in the ground for well No. 1, and from which no operating cost is to be deducted, the value of the oil for the lessee on this basis should be this amount ($1.0833) less the operating and developing costs (36.6 cents), which would give a net value of $0.7173 per barrel, instead of $1.528 that was claimed by and allowed the lessee. The underground reserves as estimated for the lessor taxpayer were 513,810 barrels as of 1917. The oil and gas section estimated that 85.8 per cent was actually produced in 1917 and 1918, a period of 18 months. The 1918 production amounted to 54.4 per cent of the total estimated production. The

lessee taxpayer claimed and was allowed 95 per cent of the estimated production as returnable during the first 12 months while the lessor was allowed 85.8 per cent as returnable in 18 months.

I have here as Exhibit No. 1 a copy of the valuation given by the oil and gas section.

On July 1, 1917, G. H. Hunter purchased a royalty interest (one-sixth of one-sixteenth) in the Gypsy-Shumway lease for $11,250 and set up discovery valuation based on Gypsy well No. 6 which was brought in October 19, 1917.

On May 21, 1917, the Carter Co. drilled discovery well No. 1 on the Orban 40 acres adjoining Gypsy Shumway. The Carter discovery area overlapped the Shumway lease to such an extent that wells Nos. 1, 5, 7, and 9 were drilled on what the regulations defined as proven ground.

The Income Tax Unit ruled that inasmuch as the Carter well No. 1 Orban proved the western part of the Shumway lease, the taxpayer (Hunter) had purchased a proven area and was denied discovery valuation on the area drained by Gypsy wells Nos. 1, 5, 7, and 9, and allowed depletion on cost only for this area. Four discoveries for depletion were given on the remaining area, and the composite depletion unit allowed the lessor was $0.92688 per barrel for the same oil that the Gypsy Co. was allowed $1.528 per barrel on discovery well No. 1. The composite depletion unit for Gypsy's four discovery wells was $1.466.

The lessor had no expenses connected with his production, while the Gypsy Co. had all the operating expenses, development expenses, and the pumping of royalty oil, yet it receives this large depletion unit. If Hunter's oil was worth only $0.92688 per barrel in the ground, certainly the Gypsy oil should have been less than this by the amount of development and production costs, namely 36.6 cents per barrel, leaving the depletion value for Gypsy Co. 56.088 cents per barrel instead of $1.466 per barrel as claimed by and allowed the lessee taxpayer.

Section 214, act of 1918:

> In the case of leases, the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee.

G. H. Hunter set up his appraisal data on October 27, 1921, giving his date of valuation as August 25, 1917. The date of August 25 is one week after the price of oil had reached the $2 mark, which may be one reason for setting up this date instead of a date prior to August 14, 1917, when oil was selling at $1.70 per barrel. The lessee taxpayer in this case was given a discovery valuation on well No. 1 which came in about two weeks after Hunter purchased his lessor interest. Hunter is properly denied discovery value on a portion of this discovery area covered by Carter Well No. 1, but at the same time he sets up his discovery claim on Well No. 6 which is drilled within the proven area of Gypsy Well No. 1. This latter well came in October 9, 1917, with an initial production of 7,296 barrels. The use of this well has two effects with reference to his discovery valuation:

(1) It was larger than was No. 1 which would give him larger reserves.

(2) Price of oil was 30 cents higher than it was when Gypsy well No. 1 came in.

It is questionable whether he has the right to set up discovery valuation on well No. 6 which was drilled within the discovery area of well No. 1 when he had been receiving royalty oil for about three months from well No. 1 and on which the lessee had set up discovery value. It seems that whatever valuation he should have set up for this particular area outside of the portion of this tract that was proven by Carter well No. 1 should have been based on Gypsy well No. 1. The lessor accepts Gypsy wells 2 and 10 for discovery valuation as set up by the lessee taxpayer; however, he does not accept well No. 33, which came in April 12 at 100 barrels per day, upon which the lessee taxpayer claimed and was allowed a discovery valuation. The lessor sets up well No. 36, which came in April 14, 1917, with an average daily production of 600 barrels. This again gives the lessor an undue advantage over the lessee in the total number of barrels available for valuation and does not, in accordance with section 214, act of 1918, equitably distribute value as between lessor and lessee.

While the lessor has been given a much lower depletion unit than the lessee, the claim set up and allowed the lessor does not come within the regulations on two counts, namely:

(1) The date of valuation for the first discovery being 10 days beyond the 30-day period for the first well and about 6 weeks before well No. 6 came in and upon which he claims discovery. Apparently he has used August 25 as an average date and one that is conveniently within the $2 oil price.

(2) The lessor should have confined his valuations to the same wells that the lessee did. It would have been just as proper for the lessee to have set up values on these other wells as for the lessor, but the intent of the law and the regulations is that the discovery valuation should be set up on the first commercial well that comes in outside of a proven area.

As Exhibits Nos. 2 and 3 I will file statements showing the valuation as allowed by department on this particular lease.

Now, applying these lessor values and assuming that the value allowed by the department represents the value of a barrel of oil in the ground, I have taken this and applied it to the lessee's interests, on which I have a few notes.

LESSEE'S VALUATION BASED ON LESSOR'S VALUES

Details of the valuation of the lessor's equity in the Shumway lease are given in the foregoing pages, both of which are supported by a copy of the valuation report prepared by the income tax unit. Assuming that a proper valuation has been made for the lessor's interests, this figure may rightly be applied to the estimated reserves of the lessee to determine the value of his holdings as of the same date, namely, 1917. The lessee for well No. 1 has estimated 5,339,014 barrels as his reserves for 40 acres. The depletion unit allowed Mrs. A. G. Winchester, lessor (five-eighths of one-sixteenth), for this particular area is $1.0833 per barrel. Assuming that this is the correct value of a barrel of oil in the ground, as determined by the income tax unit, then the lessee's interests should be this amount less all operating and development expenses. The lessee taxpayer's estimate for operating costs, which should include the cost of pumping the royalty oil, is 32 cents per barrel, while the development

costs, based upon the necessary additional wells, amount to 4.6 cents, or a total of 36.6 cents per barrel for delivering the oil into the pipe line. This differential as between lessor and lessee deducted from the lessor's depletion unit ($1.0833 minus $0.366) leaves $0.7173 to be applied to the lessee's reserves above noted. This, then, would give a value of $3,829,675 as the lessee's interest in the 40 acres, for which the unit previously allowed $8,190,392, a difference of nearly $5,000,000.

Taking into consideration the discovery values allowed the lessor (Winchester) for the additional wells Nos. 2, 10, and 33, and combining the total values and reserves of these discovery areas with area No. 1, gives the composite depletion unit of $1.1612 per barrel for the lessor's interest then in the entire 160 acres. The lessee's interest then in the entire lease should be this depletion unit ($1.1612–0.366) minus the operating and development expenses of 36.6 cents or $0.7952. This unit applied to the lessee's reserves of 6,836,894 barrels would give the value of the lessee's interest as $5,436,698, for which the lessee taxpayer (Gypsy Oil Co.) was allowed in 1921, $10,020,325, with a composite depletion unit of $1.466 as compared with $1.1612 for the lessor.

A further discrepancy as between lessor and lessee is shown in the valuation of lessor Hunter's interests in this property. Hunter purchased on July 1, one-sixth of one-sixteenth royalty interest in the 160 acres for $11,250. A small portion of the area had rightly been considered by the department as proven area, and on this he had been given depletion on cost of about 13 cents per barrel. However, Hunter sets up 4 valuations on the remaining territory, and has received from the department a depletion unit of $0.9268 per barrel as a composite unit for his interest in the 160 acres as compared with the composite of $1.466 for the lessee. It will also be noted that there is a discrepancy as between the two lessors, but this is probably justifiable on the basis that when the composite unit was determined, a portion of Hunter's oil was valued on cost, and would, therefore, reduce his depletion unit to some extent. Now, applying the value of the lessee's oil ($0.9268 minus $0.366 equals $0.5608) in the ground as determined on the basis of Hunter's interest, it gives a value of $3,834,130 for the entire 160 acres, for which the lessee taxpayer was allowed $10,020,325. The following table shows the comparative results.

	Lessee's Interest	
	Well No. 1, 40 acres	Entire 160 acres
1. Value claimed by and allowed lessee	$8,161,398	$10,020,325
2. Value based on Lessor Winchester	3,829,675	5,436,698
3. Value based on Lessor Hunter	2,994,119	3,834,130
4. Average of valuations 2 and 3	3,411,897	4,635,414
5. Excess valuations allowed	4,749,501	5,384,911
6. Excess valuation, per cent	130.3	116.17

On the 160 acres, the lessee claimed $10,020,325, on which was allowed the value based on the Winchester lessor interest, of $5,436,698. The value based on the Lessor Hunter's interest was $3,834.130. The average of these two valuations of lessor interests

would be $4,635,414, leaving an excess valuation for the lessee, of $5,384,911; or, reduced to percentage, an excess valuation of 116.17 per cent.

It will be noted from the above table that the excess valuation allowed for lessee's interest in discovery well No. 1 was 130.3 per cent, while the excess valuation for the entire 160 acres was 116.17 per cent.

Figures compiled from the records of the Internal Revenue Bureau show that from March 1, 1913, to the close of 1919, the Gypsy Oil Co. was allowed discovery valuations to the extent of $27,188,170. This amount includes the $10,020,325 as mentioned above. This Shumway lease represents more than one-third of the entire discovery valuations allowed during the seven years, and therefore may be considered as fairly representative of the other discovery valuations. Since the lessee's interests in the 160 acre Shumway lease were given a valuation of 116.17 per cent in excess of the average allowed on the basis of the two lessors, it shows that a proper valuation for the discovery values during the seven year period should have been $12,577,217.19 instead of $27,188,170.40. In other words, during this seven year period, assuming that the valuations allowed the lessors in the Shumway lease are correct, this lessee taxpayer has received excessive discovery valuations to the extent of $14,610,953.21 for the seven years to the close of 1919. This is for the Gypsy holdings only.

The CHAIRMAN. That is a subsidiary of the Gulf Oil Co.?

Mr. FAY. That is a subsidiary of the Gulf Oil Co.; yes, sir.

The CHAIRMAN. Can anyone tell us just what difference that made in the taxpayer's total tax?

Mr. PARKER. The taxpayer was in the 30 per cent bracket in 1918, and in the normal bracket in 1919. That was about 12½ per cent. It would be very rough, but you could estimate it somewhat on that basis. Whatever the deduction was, it would make a difference of about 30 per cent of the tax, but you would have to know the depletion which would be taken off each year. It would not be on the amount of valuation. I can probably get you those figures.

The CHAIRMAN. I think that would be interesting, so the committee could get a complete story of just what this really meant.

Mr. MANSON. I will ask the reporter to insert in this record the exhibits accompanying Mr. Fay's statement.

(The exhibits referred to are as follows:)

EXHIBIT No. 1

OIL AND GAS VALUATION SECTION

(Lessor, Butler County, Kans.)

Mrs. Atlanta G. Winchester, Greenwood, Ind. Taxable years 1918–19. No valuation of prior years has been made by this section. Depletion computed upon discovery. Valuation due to discovery, $526,939.16. Price of oil at dates of discovery:

Well No. 1, July 25, 1917	$1.70
Well No. 2, Oct. 19, 1917	2.00
Well No. 11, Nov. 23, 1917	2.00
Well No. 33, Apr. 12, 1918	2.25
Depletion units	1.0833
Do	1.1612

Depletion

Taxable year	Gross income from oil	Depletion claimed		Depletion allowable
		Return	Form O	
1918	$447,358.62	$227,074.19	$285,663.91	$227,209.99
1919	67,531.01	21,627.89	19,833.16	19,332.76

Discussion: Taxpayer receives an income from five-eighths of one-sixteenth oil royalty in the NE. ¼ of section 11–26–4, Butler County, Kans. The working interest in this property is controlled by the Gypsy Oil Co., of Tulsa. On March 28, 1918, a one-eighth of one-sixteenth interest was deeded to each of her three children, viz: Clyde and Oscar Winchester and Mrs. Olive A. Core. This transaction has been investigated by this office and proven to be bona fide.

Of the total estimated underground reserves (513,810 barrels) accredited taxpayer as of 1917 fully 85.8 per cent were produced in 1917 and 1918. The 1918 production above amounted to 54.4 per cent of total estimated production; hence the apparently excessive amount of allowable depletion in 1918.

Recommended by—

J. H. SIMMONS,
Engineer.

Approved by—

W. S. THAYER,
Chief of Section.

June 26, 1923.

EXHIBIT No. 2

OIL AND GAS VALUATION SECTION

Lessor, El Dorado field

George H. Hunter, 1005 South Washington Avenue, Wellington, Kans. Taxable year 1917.

Depletion claimed in return	None.
Depletion claimed in Form O	$3,374.89
Depletion allowable	3,374.89
Gross income from oil	48,177.99
Depletion unit	.1387

On cost.

Discussion: Taxpayer owns a one-ninety-sixth royalty interest in the Shumway property, for which he paid $11,250. The depletion claimed is on cost.

Taxpayer also has another royalty interest upon which no depletion is claimed.

This case is forwarded to audit for immediate action on the year 1917 only.

Recommended by—

H. E. W., *Engineer.*

Approved by—

RUSSELL BEALL,
Chief of Section.

OCTOBER 28, 1922.

EXHIBIT No. 3

OIL AND GAS VALUATION SECTION

George H. Hunter, Wellington, Kans. Taxable years 1918 to 1921, inclusive.

Year 1918:

Depletion claimed, return	$34,659.60
Depletion allowable	41,846.89
Depletion unit on cost and discovery	.92688
Gross income from oil sales	49,660.67

Year 1919:	
Depletion claimed, return	42,428.93
Depletion allowable	4,112.07
Gross income from oil sales	61,514.46
Year 1920:	
Depletion claimed, return	3,697.50
Depletion allowable	2,398.09
Gross income from oil sales	8,970.00
Year 1921:	
Depletion claimed (Form O)	None.
Depletion allowable	1,795.37

Discussion: Taxpayer purchased a one-ninety-sixth royalty interest in the Shumway lease, Eldorado field, on July 1, 1917. At that date, a portion of this lease was proven oil territory as defined in regulations 45, article 220 (a) (2) because of well No. 1 (M. Orban, 80 acre lease) which was drilled May 21, 1917, with an initial daily production of 895 barrels. It is held, therefore, that Nos. 1, 5, 7, and 9 on the Shumway lease came within the scope of the Orban discovery well; consequently appreciation due to discovery on these wells has been disallowed.

Four discoveries have been allowed—three on $2 and one on $2.25 oil. The portion of this lease proven as of date of purchase has been given a share of the purchase price proportionate to the production of the wells drilled thereon.

The wide variation existing between claimed and allowable depletion in 1918 and 1919 is due to the fact that depletion, in taxpayer's Form O, is based on barrels paid for each year instead of actual yearly production runs.

Taxpayer's Form O does not include 1921 production, however, allowable depletion for this year has been calculated from data submitted in lessee's Form O.

Recommended by—

J. J. SIMMONS,
Engineer.

Approved by—

RUSSELL BEALL,
Chief of Section.

FEBRUARY 19, 1923.

Mr. MANSON. We have two other items in that connection here with reference to the Gypsy Oil Co.

Mr. FAY. Excuse me. Is that the Gulf Production Co?

Mr. MANSON. No; what I have before me is with reference to the Gypsy Oil Co.

In the proceedings a few days ago, as reported on page 1926 of volume 11 of the hearings, I gave the valuation placed on several leases of the Gypsy Oil Co., and the chairman at that time requested that we ascertain the prices of oil that were used in fixing those values. I have a statement here giving those prices which I will insert in the record at this point. I will furnish you with a copy of it.

Mr. HARTSON. All right.

(The statement referred to is as follows:)

Gypsy Oil Co.—Discovery valuations

Name of lease	Net receipts	Valuation	Life (years)	Total profit	Composite discount factor	Actual price per barrel as per price chart	Price used in valuation (per barrel)
Leona Fife (p. 6)	$793,252.00	$730,109.00	16	$63,143.00	7.96	$0.75	$1.00
Leona Fife (p. 7)	270,704.00	249,156.00	16	21,548.00	7.96	.55	1.00
Leona Fife (p. 7)	48,772.00	47,426.00	6	1,346.00	2.76	1.20	1.20
Leona Fife (p. 8)	30,572.00	29,728.00	6	844.00	2.76	1.30	1.30
Leona Fife (p. 8)	22,486.00	20,696.00	16	1,790.00	7.96	1.70	1.70
Eliza Howe (p. 3)	71,702.00	65,995.00	16	5,707.00	7.96	.75	1.00
Eliza Howe (p. 4)	19,206.00	18,570.00	9	636.00	3.31	.40	1.00
Total	1,256,694.00	1,161,680.00		95,014.00			

Mr. MANSON. In connection with the Gulf Production Co., which I understand is a subsidiary of the Gulf Refining Co., we have secured data on 53 leases, showing the total expected receipts, the valuation, the total profits that were contemplated by those valuations, composite discount factors, the prices of oil upon which the valuations were based, and the approximate life, in years, which I will also insert in the record. This covers 53 leases, as I say.

(The statement referred to is as follows:)

Gulf Production Co., Book 1180—Discovery valuation

NORTH TEXAS, ELECTRA, AND EARLY BURKBURNETT FIELDS

Page	Total expected receipts	Total valuation	Total profits	Composite discount	Price per barrel	Approximate life (years)
				Per cent		
19	$144,620.00	$128,219.95	$16,400.05	11.3401	$2.00	14
22	40,846.25	36,214.25	4,632.00	11.3401	.45	14
25	71,897.00	63,743.81	8,153.19	11.3401	2.25	14
28	166,736.25	147,828.19	18,908.06	11.3401	2.25	14
31	72,105.00	63,928.22	8,176.78	11.3401	2.00	14
34	74,641.53	66,177.11	8,464.42	11.3401	2.25	14
22	198,069.00	175,607.78	22,461.22	11.3401	1.55	14
22	76,728.00	68,026.97	8,701.03	11.3401	1.55	14
40	20,304.00	18,001.51	2,302.49	11.3401	1.05	14
46	22,873.50	20,279.62	2,593.88	11.3401	1.60	14
49	322,655.25	286,065.82	36,589.43	11.3401	1.55	14
52	252,800.00	224,132.23	28,667.77	11.3401	2.25	14
58	287,735.00	255,105.56	32,629.44	11.3401	2.25	14
61	322,072.50	285,519.16	36,523.34	11.3401	2.25	14
64	266,493.75	236,273.69	30,220.06	11.3401	2.25	14
70	55,061.00	48,817.03	6,243.97	11.3401	2.25	14
75	54,830.00	48,612.22	6,217.78	11.3401	2.25	14
79	183,804.00	162,960.44	20,843.56	11.3401	2.00	14
82	78,077.50	69,223.43	8,854.07	11.3401	2.25	14
85	23,132.00	20,508.81	2,623.19	11.3401	.75	14
88	212,070.60	188,021.64	24,049.62	11.3401	2.25	14
91	159,453.75	141,371.53	18,082.22	11.3401	2.25	14
102	438,351.00	388,641.56	49,709.44	11.3401	1.70	14
105	42,321.60	37,521.76	4,799.24	11.3401	2.25	14
108	367,569.00	325,886.31	41,682.69	11.3401	2.00	14
120	80,520.00	71,388.95	9,131.05	11.3401	1.70	14
126	36,642.00	32,486.76	4,155.24	11.3401	2.25	14
129	184,889.25	163,922.62	20,966.63	11.3401	2.00	14
135	99,216.00	87,964.81	11,251.19	11.3401	2.00	14
141	136,463.40	120,988.32	15,475.08	11.3401	1.70	14
Total	4,492,977.59	3,983,469.46	509,508.13			

EASTLAND AND VICINITY (TEXAS)

169	$34,368.00	$33,565.37	$802.63	2.3354	$2.25	3
176	249,980.00	244,141.97	5,838.03	2.3354	3.00	4
182	416,313.00	406,590.43	9,722.57	2.3354	2.25	3
185	270,415.00	264,099.73	6,315.27	2.3354	2.25	3
193	724,782.00	707,855.45	16,926.66	2.3354	2.25	3
198	1,440,694.00	1,407,243.36	33,450.64	2.3354	2.25	3
205	523,989.75	511,447.96	11,632.79	2.2239	2.25	3
198	840,693.00	821,059.46	19,633.54	2.2239	2.25	3
205	371,614.67	363,349.74	8,261.33	2.2354	2.25	3
209	1,901,892.00	1,859,595.82	42,296.18	2.2239	3.00	4
212	1,139,831.71	1,114,482.99	25,348.72	2.2239	2.25	3
216	153,870.00	150,448.08	3,421.92	2.2239	2.25	3
219	1,947,733.50	1,904,417.85	43,315.65	2.2239	2.25	3
219	878,925.00	859,378.59	19,546.41	2.2239	2.25	3
225	252,333.60	246,721.95	5,611.65	2.2239	2.75	3
228	803,279.13	785,415.01	17,864.12	2.2239	2.25	3
228	96,761.68	94,609.99	2,151.69	2.2239	3.00	3
232	221,774.40	216,842.36	4,932.04	2.2239	2.50	3
235	3,042,167.88	2,974,513.11	67,654.77	2.2239	2.25	3
239	177,148.75	173,209.14	3,939.61	2.2239	2.25	3
245	2,262,627.00	2,212,308.44	50,318.56	2.2239	2.25	3
249	1,046,512.25	1,023,238.86	23,273.39	2.2239	2.25	3
253	238,290.00	232,990.67	5,299.33	2.2239	2.25	3
Total	19,035,086.72	18,607,526.33	427,560.39			

The CHAIRMAN. Do you give the name of the lease, or the number of what?

Mr. MANSON. We give the page number of the claim. Is not that it, Mr. Parker?

Mr. PARKER. The page number and also the volume number of the Gulf Production Co.'s claim; yes, sir.

Mr. MANSON. That is all I have this morning.

Mr. HARTSON. I desire to make a brief statement setting forth the bureau's position in the Houston Collieries Co. case, that having been referred to by Mr. Manson some days ago.

The CHAIRMAN. That is a bituminous coal company?

Mr. HARTSON. Yes; that is a bituminous coal company.

Counsel for the committee has criticized the settlement of that case because the bureau allowed the taxpayer to write off or amortize the cost of three leases of coal land rather than to deplete on the unit basis as the coal was taken out of the mine.

The leases in question were acquired in 1902 at a cost of $477,610.84, and were to extend for a period of 30 years, with a right of renewal for 30 years.

The taxpayer claimed that the cost of leases should be written off on the basis of a 30-year life. The unit contended that this cost should be written off on the basis of tonnage mined. The committee—that is, the committee on appeals and review—decided that an aliquot part of the cost should be written off each year on the basis of the original life of the lease, without reference to the extensions.

It is the contention of counsel for the committee that the writing off of a lease as provided for in article 109, regulations 62, has no proper application in the case of a lease of mineral; that the recovery of the cost of a mineral lease is properly obtained through depletion allowances, and not properly written off in the manner of an ordinary lease.

Counsel's position apparently is that the writting off of this lease was properly a part of the allowance for depletion. The bureau contends that this is not correct. The taxes involved in this case were for the year 1917, and under the revenue act of 1916, as amended by the revenue act of 1917, a lessee of mineral lands was not entitled to depletion.

The allowance in this case was granted under a different provision of the law, namely, that of permitting the deduction of ordinary business expenses.

The view of the bureau is that an amount paid as a bonus for a mineral lease is advanced royalties, such view being supported by the decision of the Supreme Court of the United States in the case of United States *v.* Biwabik Mining Co. (247 U. S. 116), in which the following remarks of the District Court in the same case were quoted with approval:

> The defendant paid $612,000 for the lease under consideration and in addition assumed the payment of the royalties stipulated for therein. This may be properly and justly considered payment in advance of an increased royalty, etc.

Royalties are in the nature of rent, and are an expense to a lessee. Being an expense, they were deductible from gross income, under the provisions of the law relating to the deduction of ordinary and necessary business expenses. (Section 5, revenue act of 1916.)

They are not depletion deductions under the revenue acts prior to 1918, and are not properly treated under article 210 (b), regulations 62, as suggested by counsel.

The distinction between allowances for depletion and for ordinary business expenses was brought out in Law Opinion 615, dated August 15, 1918, which dealt with the rights of a lessee of mineral land under the revenue acts of 1909, 1913, and 1916. It was there said:

> But because no allowance for depletion can be made in the case of a lessee, it does not follow that he is entitled to no relief. Under the provisions of the statutes authorizing the deduction from gross income of the ordinary and necessary expenses of the business, the lessees may deduct royalties paid as such necessary expenses, and in the event that he paid a lump sum for his lease, that may be considered rent paid in advance and may be apportioned over the life of the lease, for the purpose of deduction, as provided in articles 171 and 172 of regulations No. 33 (revised). Although the theory of the regulations is inexact in apparently treating such deductions by a lessee as a return of a capital invested, the right result is reached. See also article 140. But there is no tenable ground under the existing or prior statutes for taking the value of the lease as of March 1, 1913, as a basis for deductions.
>
> This conclusion is strengthened by the proviso in sections 5 (b) and 12 (a) of the act of 1916, referring to depletion, that when the allowance authorized shall equal the cost, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made. The use of "purchase" tends to indicate that the deduction for depletion was not meant to extend to a lessee, and even on the assumption that it was the proviso, limits the allowance to the cost, except in the case of a purchase (not a lease) made before March 1, 1913.
>
> It is accordingly held that under the acts of 1909, 1913, and 1916, the lessee of a mine may deduct from gross income the ratable cost of his lease, together with royalties, as an expense of the business, but is not entitled to any allowance for depletion or otherwise based upon the value of his lease as of March 1, 1913, if acquired prior thereto.

In Solicitor's Memorandum 1245, dated November 5, 1919, it was stated that:

> The department has held, after careful consideration, that under the act of October 3, 1913, and the revenue act of 1916, the lessee of a mine may deduct from gross income the ratable cost of his lease, together with royalty as an expense of the business, but is not entitled to any allowance for depletion or otherwise, based on the value of his lease as of March 1, 1913, if acquired prior thereto.

Regulations 33, revised, also provide in article 8, paragraph 113, that:

> Where a leasehold is sold for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year based on the number of years the lease has to run.

From the foregoing, it is clear that the bureau has recognized that an aliquot part of the cost of a lease, based on the number of years the lease has to run, may be taken as a deduction for each year. It is also apparent that prior to the revenue act of 1918 there was no provision of the law or regulations which would require a lessee of mining property to amortize the cost of his lease on the basis of tonnage mined. As stated before, this case arose under the revenue act of 1917, which was an amendment of the revenue act of 1916.

With respect to bonuses paid for ordinary leases—not embracing mineral lands—there have been a number of rulings of the bureau holding that the bonus should be amortized over the original term of the lease without regard to the right to renew. The ruling under consideration conformed to these rulings.

Whether or not the ruling in the present case should be applied to cases involving years subsequent to 1917, is a question which was not before the committee on appeals and review.

In the revenue acts of 1918 and 1921, Congress extended to lessees the right to depletion, and under these acts depletion is intended to return to the lessee the March 1, 1913, value of his property, or, if the property was purchased subsequent to that date, the cost thereof. If the lessee's cost is returnable through depletion allowance, it would appear that under the regulations the allowance should be calculated on the tonnage basis rather than on an aliquot part of the cost. Such a method would be in accord with Article 210 (b), Regulations 45 and 62, which provides:

(b) When the value of the property at the basic date has been determined, depletion sustained for the taxable year shall be computed by dividing the value remaining for depletion by the number of units of mineral to which this value is applicable, and by multiplying the unit value for depletion, so determined, by the number of units sold or produced within the taxable year. The depletion deduction for the taxable year is subject, however, to the limitation contained in article 201 (b). In the selection of a unit for depletion preference shall be given to the principal or customary unit or units paid for in the product sold.

The CHAIRMAN. Let me ask you this question:

Assume that at the end of or in the middle of the thirtieth year the lessee sold his lease say, for a million dollars, under the option which he had to extend it for thirty years more, and that he sold it to a company which he also owned. Under that ruling he would be entitled to deplete or amortize, or whatever you call it, that $1,000,000 for the succeeding thirty years, would he not?

Mr. HARTSON. I do not so understand it, Mr. Chairman, and I want to amplify this statement that I have made by a further explanation, which may not have been clearly brought out by what I have already said, namely, that for years subsequent to 1917, under the law, a lessee was entitled to an equitable apportionment of the deduction for depletion, I believe that in those years the depletion should be computed on the so-called unit basis. In other words, I am prepared to concede that Mr. Manson's position is correct as to what should have occurred in this case for 1918, and subsequent years, because of the change in the law; but this case and the opinion which was objected to so strenuously by Mr. Davis, the chief of the coal valuation section of the unit, are before the committee for the year 1917. It came up in that way, and was settled, I think, properly, under the law at that time.

Now, in answer to the chairman's question if, for 1918 and subsequent years, the depletion had been computed on a unit basis, there would have been an exhaustion, assuming that the coal had been mined during those years, of the assets to a point which is readily ascertainable, and then the cost or the purchase price for which sold would have been based with that depletion clearly in mind.

Mr. MANSON. Take the situation just as it was in 1917, and assume that the taxpayer is permitted to deduct business expenses, of which royalty would be one. Let us assume further that he took his deduction at the rate of one-thirtieth of the total amount of the bonus, and paid for this lease each year up to the end of the thirtieth year, but mined no coal. It is very clear that his right to renew would be at least as valuable, in view of the fact that the coal became scarcer, it would be very much more valuable than the price that he originally

paid for that lease. He has secured as a deduction the entire purchase price or the entire bonus of the lease, and he still has something that is more valuable than what he started out with. There is no question but that the purchaser of that lease would have the right to deplete under the depletion statutes. Assuming that the law had not been amended and was still in the same condition as it was in 1917, the purchaser of that lease would have a right to deduct, as a business expense, the purchase price of that lease over the period over which it runs.

My position with respect to this case is that the statute with reference to depletion does not make any difference, that the depletion statute merely expresses in clear language the right that a mine owner had prior to the passage of the depletion statute, namely, the right to deduct the cost of something that was consumed in his business, and that under any rule of sound economics and in accordance with the principles stated by the solicitor, the bonus is merely a prepaid royalty. It is clear that that bonus should be distributed and deducted as royalty; and it would be distributed and deducted upon every theory that it is a prepaid royalty, and royalty would be distributed and deducted in accordance with the actual depletion of the property.

The CHAIRMAN. Mr. Hartson, you said a while ago that the contention of counsel was correct for 1918 and subsequent years?

Mr. HARTSON. I have, yes, to this extent: I think, starting with 1918, depletion should be computed on the unit basis, namely, upon the basis of the coal as mined, rather than on the exhaustion of the term of the lease.

The CHAIRMAN. Well, what was actually done?

Mr. HARTSON. I do not know, and I have no information on that. I am prepared to say that if the ruling that was made for 1917 was to be uniformly applied for 1918 and subsequent years, I think it was wrong.

Mr. MANSON. I do not know, myself.

The CHAIRMAN. Who examined that case?

Mr. MANSON. Mr. Wright. I will have that looked up.

Mr. HARTSON. We are looking it up ourselves, but we have not had an opportunity to verify it; at least, I have not.

The CHAIRMAN. Entirely regardless of that, I still think that what would actually happen would be that if the lease was sold at the end of the first 30 years, on the basis of the option, the bureau would give credit for deductions for the price paid for the lease in subsequent years.

Mr. HARTSON. I do not know as I understand the chairman's question or statement.

The value of a lease at or near its expiration would be based almost entirely on whether there was any coal left in the ground, of course. If coal was left in the ground and the law had not been changed, and they had gotten back, so to speak, their original expenditure or investment in this property, without having mined any coal, then I think the Income Tax Unit would treat the amount received entirely as income for that year. Everything received would be income, and except for the possible difference in rates, the transaction would wash itself out, and it would be as broad as it is long; but that is all based on the assumption, as I understand it, that the law had not been changed.

Now, I think with the law changed, permitting and requiring the unit to base its depletion on the method of computing on the unit basis, then, if no coal was mined, there would be no depletion deductions for those subsequent years.

The CHAIRMAN. Let me put it in another way:

Assuming that the law had been amended and that the tax was 12½ per cent; assuming further that a new taxpayer bought this mine, with 50 per cent of the coal left, would not the bureau allow a deduction from the taxpayer's taxes for amortizing or depleting the amount paid for the mine?

Mr. HARTSON. If the coal was exhausted by 50 per cent of what had been estimated to be in the ground and a sale took place, there would, under the law, have been a depletion allowance to the taxpayer in such an amount as would properly be based on the amount of coal mined, and, of course, that would figure into the amount that the purchaser would pay for the mine.

Mr. MANSON. Yes; but, Mr. Hartson, is it not true that any purchaser of a mining property or a mining lease is entitled to deplete the cost, regardless of what taxes he paid or regardless of what allowances were made to the previous owner of the property?

Mr. HARTSON. That is true, Mr. Manson.

Mr. MANSON. That is what I was trying to get at.

Mr. HARTSON. But the price that the purchaser would pay is predicated entirely on how much coal is left in the ground.

The CHAIRMAN. Yes.

Mr. HARTSON. But if the prior owner had depleted it to the point that only 50 per cent of what was originally there remained, then the price or cost to the new purchaser would be reduced by that amount.

Mr. MANSON. My point is that in this ruling the committee has failed to distinguish between the purchase of the use of property and the purchase of property which may be consumed. In the case of purchase of the use of property, that use is exhausted as time runs on, regardless of whether any actual use is made of the property or not. In the case of the purchase of the right to use property——

The CHAIRMAN. I understand that, but what I am trying to get at is this. This practice will enable a coal mine to be pyramided as years go on, so that the taxpayer pays little or no tax, or the owner, in view of the fact that there was practically a 60-year lease, as I understand it. That would not apply in all cases, but it would apply in this particular case, or in cases where there were long leases. In other words, if this lease which was originally, in substance, a 60-year lease, that is, a 30-year lease with an option to renew for 30-years more, during that time transfers or sales of that lease can be made to new buyers as time goes on, and the price so paid would be pyramided, so that the value of the mine would be so high, and therefore depleted to such an extent each year as to make the taxpayer almost free from the payment of taxes.

Mr. HARTSON. I do not think that is true, Mr. Chairman. I can not see how the value would increase in subsequent transfers, unless there had been no exhaustion of the coal, and further assuming that the price of coal had gone up, and of course that is a thing that very readily might occur. But if the coal had been exhausted during the

ownership of the present owner, the depletion that that owner would be entitled to would be on the basis of the coal he takes out. If he took it all out within 29 years, then, of course, this option would be worthless to anybody else to continue on. He could not sell it to anybody and he would not care to exercise it himself and continue to mine, because there would be no coal left. But if he had taken out 50 per cent, then he would have a mine which had coal existing there yet to a very substantial degree, and if he sold it, the price would be arrived at with knowledge that he had only so many tons of coal left in the ground. If he continued to mine it for the subsequent 30 years, and exercised his option, then there would not be any double depletion allowance. The depletion would go on from the point where it had left off under the old or first 30-year lease.

Now, I do not really see that such a policy of depleting on the unit basis, which is the basis that counsel contends for, and which I think I have stated I concede is the proper one, that any such miscarriage as the chairman suggests would result from depletion on that basis. At any rate, the law recognizes it and the bureau has recognized it, and I have not heard any very serious criticism of that manner of depleting.

Counsel's criticism here is that we proposed in this decision of the committee on appeals and reviews to allow this taxpayer a yearly deduction because of the exhaustion of the lease through the running of time, rather than the exhaustion of the mineral in the ground, and, as a result of that, so counsel argues, at the end of the 30 years, there might have been no coal taken out, and the taxpayer would have gotten back, so to speak, his entire cost through the deductions for the amortization of this lease; that the coal was still there in the ground, and he could exercise his option to dispose of the lease, or mine it himself, and have both the return of the money he originally paid and the opportunity to deplete on the theory that the entire coal was there in the ground.

That would be true, assuming that the 1917 law, which did not allow depletion to lessees in the case of minerals, had remained in effect.

Now, I do not know what was done with this case in 1918 and subsequent years. It would not surprise me if they had followed the recommendation of the committee on appeals and review for 1918, and possibly subsequent years. If they did that, I think it is wrong, and should be changed.

Mr. FAY. Mr. Chairman, may I interpose a word here? I was not at the hearing; I did not appear at that hearing, but I would like to say a word with reference to the question you asked.

The CHAIRMAN. You say you want to make a statement?

Mr. FAY. Just a short statement, to more or less clarify the answer that Mr. Hartson has given you.

The CHAIRMAN. Yes.

Mr. FAY. Assuming that the original owner had mined his coal out to 50 per cent of his reserves at the end of 30 years, and he sells that mine to somebody else. The other party pays a stipulated price for it. His entire depletion will be the stipulated price, divided by the remaining tons in there. He would secure his depletion on the remaining amount, based on the actual amount that he paid for the property, regardless of what happened before.

The CHAIRMAN. That is what I contend, in spite of the fact that the original cost of the mine had been entirely returned to the taxpayer.

Mr. HARTSON. No; the original cost of the mine had not been entirely returned to the taxpayer if he only mined 50 per cent of it.

The CHAIRMAN. Oh, yes, it had, because you allowed it on the 30-year period. In other words, you took off one-thirtieth each year, and at the end of 30 years you thereby returned the entire investment, in spite of the fact that at the end of 30 years he may have sold it for twice as much.

Mr. GREGG. Mr. Chairman, there are two objections still pointed out to the settlement. The first is that the depletion in this case should be based on the units produced, as the 1918 and subsequent acts provide. Counsel says those acts are just in clarification of the prior acts, and I am inclined to agree that that is correct; but it is not what the courts have held. The question arose under the 1916 and 1917 acts as to the right of a lessee to deplete on the basis of units produced. The bureau took the position that they did not have such a right. The question went to the court, and in the Mowhawk case—and I can not give you the citation of that——

Mr. HARTSON. I have it here.

Mr. GREGG. You have that citation here?

Mr. HARTSON. Yes. It is 247 U. S. 116.

The CHAIRMAN. I understand what you are getting at, Mr. Gregg, but the point that stands out in my mind is that this was practically a 60-year lease and was depleted in 30 years. That is the great objection that I see to the settlement, notwithstanding what the court may have said as to other cases, where the situation was not the same. For example, in the cases cited by Mr. Hartson, the question of an option to continue the lease for another 30 years was not involved. In the cases he cited, it was assumed from the citations that there was a specific time in which the leases ran out, or the contract was closed; but in this case one of the objections of counsel, as I understand it, was that the lease was amortized over 30 years while it really had a 60-year period in which to run.

Mr. GREGG. Then the only remaining objection is that the depletion was not based on a 60-year period, but on a 30-year basis?

The CHAIRMAN. That is one of the criticisms, and I think it is sound.

Mr. GREGG. Of course, we have taken the position consistently, that the right of renewal in the case of a lease does not affect the lease; that we are bound by the terms of the lease, and not by the fact that a right of renewal exists.

Mr. MANSON. When a man buys, if he buys a lease for 20 years, with an option to renew, that is, if the lessee has the option to renew, the lessee buys the right to use the property for 40 years. He may surrender that right at the end of 20 years, but he actually buys the right to a 40-year use.

Mr. GREGG. Well, I think the matter of the right of renewal does raise a difficult point.

Suppose you take a commercial lease, for which a bonus is paid. You have the question there of whether the bonus should be spread over the life of the lease, or over the life of the lease plus the period of the renewal. Suppose you spread it, as counsel suggests, over

the life of the lease plus the period of renewal, and at the end of the lease the taxpayer does not renew?

The CHAIRMAN. That is his loss. That certainly is his loss, because, otherwise, he would have the lease for 20 years, without having any bonus applied, and he would have gotten credit for it in his income tax.

Mr. GREGG. He would not have gotten credit for all of his deductions.

The CHAIRMAN. He has gotten credit for it over 20 years. I am talking about what the practice of the bureau was in spreading it over the period before the option.

Mr. GREGG. He is all right in that case, but if he does as counsel suggests, it is all wrong in the particular case.

The CHAIRMAN. That is where you and I disagree, because I do not consider it is all wrong. I consider, as counsel contends, he bought the right of the use of the property for 40 years, and not the right to have it only for 20 years. If he does not care to exercise the option, that is his lookout. If he has paid for the right for 40 years, and only wants it for 20 years, it is no concern of the Government if he does not use it for 40 years.

Mr. GREGG. You would not still continue to give him a deduction of an aliquot part of the bonus payment after he surrendered the lease?

The CHAIRMAN. Oh, no; but he loses when he fails to use the property for as much as 20 years.

Mr. GREGG. Then he loses half of his deduction.

The CHAIRMAN. Certainly; but he bought the right for 40 years, and he only used it for 20 years. When he came to the end of the 20 years he knew all that, and then exercised his best judgment.

Mr. GREGG. I do not follow that.

Mr. MANSON. Suppose you had a lease for 10 years, for which you paid a bonus. You get one tenth of that as the deduction for each of 3 years.

The CHAIRMAN. For each of what?

Mr. MANSON. For each of the first 3 years. At the end of the third year, he agrees with the lessor to cancel that lease. You have exactly the same situation there as you have in the case of a 10 years' lease with a right to renew. If the thing has a value, the thing which you have paid for, and it was deducted over the period, the period over which deduction should be made is certainly the period over which the value should be spread.

Mr. HARTSON. There are some complications there that have not been brought to light. Most of these options to renew are based upon the possibility that the parties can get together on a new basis for renewal.

The CHAIRMAN. Oh, yes; I understand that.

Mr. HARTSON. Which may involve an entirely new cost to the taxpayer.

The CHAIRMAN. Oh, yes; I understand that. In that event, of course, that is different; but we are talking about where the option does not carry new terms.

Mr. HARTSON. Well, you will find, Mr. Chairman, I think, very few leases which have an option to renew where the terms remain identically the same.

The CHAIRMAN. That may be true, but oftentimes the terms are stated, so that the bureau has the figures on which to base it. In the case of an option to renew, where new figures may be the subject of negotiation, then I confess the bureau must amortize the bonus over the first period; but where the terms are settled, or where there are no terms entering into it at the expiration of the first period, then I think it is perfectly simple for the bureau to arrive at the amount of amortization for the bonus.

Mr. MANSON. In this case, the lease provided that it may be renewed at the same royalty rate without a bonus.

The CHAIRMAN. Yes. Have you anything further, Mr. Hartson?

Mr. HARTSON. Mr. Chairman, I have something to say at this point with regard to the Pond Creek Coal Co. case.

Counsel's criticisms, I think, can be set forth in two general statements.

The first is that no paid-in surplus should have been allowed because of the specific provision of section 207 of the revenue act of 1917, notwithstanding the provision of article 63, regulations 41.

The other criticism is that the valuation of the coal land at date of acquisition, as arrived at by the committee on appeals and review, was clearly in excess of the true value.

I think counsel stated that the engineers of the unit had allowed a value of $137.50 per acre for a portion of the land which was accessible to railroad transportation, but had allowed only $35 per acre for the portion of the land which was not accessible. The committee changed this allowance to $137.50 per acre for the entire tract, without hearing the engineers' views on the case.

With reference to the first point, Mr. Gregg's statement as to the origin and basis for article 63, regulations 41, which provides for the allowance of paid-in surplus under section 207 of the revenue act of 1917, should be sufficient to show the validity of this regulation. But if there is any doubt as to the intention of Congress to approve this regulation by its enactment of the revenue acts of 1918 and 1921, such doubt will be removed by a reading of the statements of the Senate Finance Committee reporting the revenue act of 1918 to the Senate.

In the report of the committee, dated December 6, 1918 (p. 13), the following language appears:

INVESTED CAPITAL—TANGIBLE PROPERTY PAID IN FOR STOCK OR SHARES

In its definition of invested capital the House bill provides that tangible property paid in for stock or shares may in no case exceed the par value of the original stock or shares specifically issued therefor. Such a limitation would work grave injustice in case of highly conservative corporations which have acquired property for stock or shares, the par value of which was (at the date of acquisition) materially less than the actual value of the tangible property acquired. The committee recommends, therefore, that where the actual cash value of such tangible property is shown to the satisfaction of the Commissioner of Internal Revenue to have been clearly and substantially in excess of the par value of the stock or shares paid therefor, such excess shall be treated as paid in surplus.

This amendment seeks to enact into law the substance of a regulation of the Treasury Department, which has worked well, and which has not led either to abuse or the filing of an excessive number of claims. It is highly important that this regulation be placed on a more statutory basis and continued.

The amendment proposed consisted of adding the following words:

Unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid in surplus.

Mr. MANSON. There is no provision making that expressly retroactive, and it is a well-settled rule of statutory construction that unless a statute is expressly made retroactive it shall not be so considered.

Mr. HARTSON. Congress had definitely in mind what the department had done by these regulations, and the Finance Committee report stated that it is highly important that the regulation be placed on a statutory basis and continued. I think that language is very significant, in view of what was done.

The CHAIRMAN. I think so, but I wonder why they did not make it retroactive in the act itself.

Mr. HARTSON. I do not know. I can not answer that, Mr. Chairman.

Mr. FAY. Mr. Chairman, I can give you the history of that particular case to some extent.

The CHAIRMAN. You mean the Pond Creek Coal Co. case?

Mr. FAY. The Pond Creek Coal Co. case. I do not consider it so much a question of whether they should be allowed a paid-in surplus, but how much paid-in surplus is involved.

Mr. HARTSON. Yes; I understand, Mr. Fay, and I will refer later on to your views on this case. I know that you have criticised the settlement.

Since article 63, regulations 41, was thus specifically approved by Congress in the revenue act of 1918, and also in the revenue act of 1921, there can be no legitimate doubt as to its validity.

The second point of criticism relates to the valuation of $137.50 per acre for the entire tract, as arrived at by the committee on appeals and review. The record of the case shows that several valuations of this property were prepared, and that the opinions of the engineers in the bureau as to the value changed from time to time. The first valuation was approved September 9, 1919, and allowed $137.60 per acre for 9,448 acres and $35 per acre for 17,875 acres of the property. The company protested this valuation, and had several conferences with the then heads of the coal valuation section and natural resources division. In one of the subsequent valuations it appears that the company was granted a value of $180 per acre for depletion purposes. It appears further that in a conference with the members of the natural resources division the company agreed not to press its claims for the valuation of $180 per acre if the unit would grant a value of $137.50 for the entire tract.

The notes of the conference, in so far as they are material, are as follows:

JANUARY 29, 1921

Conclusions: That $137.52 per acre, value for the entire property, would be acceptable by taxpayer, and that valuation section would revise case, seeking to reconcile the estimate with the amount.

TAIT.

SECOND CONFERENCE

JANUARY 29, 1921.

Issues discussed: Basis for surplus and differential in valuation, if any, between date of purchase and basic date.

Conclusions: That little, if any, appreciation occurred in this period and that $137.50 an acre for entire tract probably reflected a fair value for both dates. Hearing adjourned until Saturday at 11.30 a. m.

GODFREY M. S. TAIT,
Chief of Section.

Interviewed by J. C. Dick (head).

MR. TAIT.

Mr. Tait and Mr. Dick, who held these conferences on behalf of the natural resources division, subsequently left the service, and a question then arose as to whether the allowance of $137.50 had been made for both depletion and invested capital, or only for depletion. It was contended by the company that the allowance was proper, and that inasmuch as it had been agreed upon by the bureau, this agreement should be adhered to.

On presentation of the case to the commissioner, it was referred to the committee on appeals and review, which, after consideration of the record, and of the statement from Mr. Fay, head of natural resources division, as well as statements from the taxpayer, arrived at the opinion that the Bureau had agreed upon the valuation of $137.50 per acre for the entire tract, and that the taxpayer was entitled to this valuation. This opinion was the unanimous conclusion of the nine members who constituted the committee at that time.

From the foregoing it appears clear that there was a difference of opinion between the engineers of the bureau as to the valuation allowable; that the case was carefully considered by the committee on appeals and review before its decision was arrived at, and that the opinion was the unanimous view of the nine committee members. Whether an engineer appeared before the committee is not shown, but the committee was in possession of a statement of the case prepared by the engineers of the natural resources division, under date of January 6, 1922.

The result reached by the committee may or may not have been correct, but the case was given careful consideration, and it is by no means certain that the same result would not be reached by a reconsideration of the case at this time.

There is attached here a chronological history of the case, which merely states the steps that it went through. I do not think it is material to read that into the record.

The CHAIRMAN. I think that in all such cases the burden of proof ought to be on the taxpayer, but we have not heard any evidence here that the taxpayer proved that it paid any such amount as this, either in cash or in tangible property, or anything else, as a matter of fact. I understand that this statute is only intended to take care of somebody or some concern that pays in more than the par value of the stock shows it to have paid in.

Mr. HARTSON. That is true, and in order to ascertain it in this case, it is necessary to determine the value as of date of acquisition of this tract of land.

The CHAIRMAN. I do not so interpret it. I think the burden of proof is on the corporation or the taxpayer to prove that they

actually paid in more than the par value of the stock, and the question of the value of the property is not involved.

Mr. HARTSON. Is not that just the point, Mr. Chairman? In cases of transfers of property in exchange for stock, if the property has a value in excess of the par value of the stock, and conceding that the burden is on the taxpayer to establish that value, then certainly, under this Article 63, of Regulations 41, they are entitled to a paid-in surplus for that excess.

It comes down to a question of value of the property.

Mr. MANSON. As I remember the facts in that case, they are these——

The CHAIRMAN. Let us get this question of policy out of the way first. I have heard no evidence that the taxpayer proved that the property was worth the amount allowed by the Bureau. In other words, the burden of proof is certainly upon the taxpayer.

Mr. HARTSON. I agree with you.

The CHAIRMAN. And there is nothing in the record to show that the taxpayer proved that this value was so much higher than the value placed on it by the engineers.

Mr. HARTSON. I think the record does show that these nine committee members were satisfied that the taxpayer's showing was sufficient to warrant the inclusion of that excess amount as paid in surplus.

The CHAIRMAN. That is probably true, but I mean there is nothing that anybody, in after days, or in after months or after years can produce; there is no evidence that they can produce to prove the taxpayer's contention. In other words, it is just proved in the minds of the committee. So a court settles a case like that. If a judge dies, the record does not die with him; but in this case, apparaently, the record dies when the individual dies, because there is no documentary evidence to sustain the taxpayer's contention. All they did was to satisfy the minds of the particular men who heard the case.

Mr. HARTSON. I think they must have done that by some documentary evidence, and not knowing just what that was, I think the files will show, Mr. Chairman, the basis for the taxpayer's claim for that value per acre.

The CHAIRMAN. If that is so, then my contention is still right, that it is not in the record.

Mr. HARTSON. It is not in this record?

The CHARIMAN. No.

Mr. HARTSON. Yes.

The CHARIMAN. And of course that is the only thing that we have to go by here.

Mr. HARTSON. I shall be very glad to attempt to——

The CHAIRMAN. I think it is incumbent upon our counsel, as well as upon the Bureau, to submit some evidence to explain the contention or the conclusions that were reached by the Board.

The CHAIRMAN. I shall be glad to go through the files and determine whether there is any evidence to support the taxpayer's claim for an increased value because of this.

Mr. MANSON. If we go back to the facts here, we will clear this up. The question of the value was not before the committee. Therefore there could not be any evidence taken on it. The question before the committee was whether the engineers for the bureau had

entered into agreement to allow a value upon the entire tract of $137.50 an acre, or whether the value determined by the engineers of the bureau was $137.50 an acre for 9,000 acres, and $35 an acre for the rest of it.

Mr. HARTSON. Mr. Manson, conceding that, for the purpose of discussion here, your statement is correct, the files, I believe, show the basis for the engineers' findings that were originally made, which the taxpayer contended was a final and conclusive determination. In other words, conceding that the evidence might not have been submitted to the committee on appeals and review, it seems to me the files must show that the taxpayer did introduce evidence before the natural resources division which warranted the engineers down there, some of them, at least, in stating to the taxpayer that this $137.50 for the entire tract should be the basis for the allowance. It was on that agreement that the taxpayer went to the committee to have it sustained and upheld.

Mr. MANSON. As to that, Mr. Fay was head of the section at that time, I believe. He is here, and he apparently knows something about it. I suggest that the committee hear him.

The CHAIRMAN. In that connection, I do not think it is of particular interest to this committee to go beyond the records, as has already been stated, the committee would like to know what the records show, and not what somebody remembers. In other words, my whole criticism is that the records in the settlement of these enormous cases are incomplete; that the bureau is remiss in protecting itself by not having stenographic records of the settlement of these cases, and I am particularly reminded of the desirability of that by a stupid remark made by a very able Senator in the last few days in which he said, when expressing his opposition to this investigation, that he was in favor of having a committee of Congress investigate the Supreme Court and go over all of its decisions for a period of five years, and to have all of the attorneys who lost their cases to appear before the committee and tell the committee wherein they disagreed with the Supreme Court. Of course, the absurdity of that is apparent, but the analogy is not so terribly bad if the bureau had the same methods to hear cases that the Supreme Court has, or if there was a record made of the arguments for and against a settlement that might be looked up, so that it could be ascertained how they reached these conclusions. Then, of course, there would be no necessity for this investigation, because it would be open for anybody to go in and find out how you arrived at these conclusions, the same as you can go in and hear the Supreme Court and find out how the Supreme Court reaches its conclusions.

I think, if I were charged with the responsibilities that the Commissioner of Internal Revenue is, or the Secretary is, in this matter I certainly would not let these cases go by without having a record showing why the conclusions were reached and how they were reached.

Mr. HARTSON. I think the Supreme Court records themselves might be incomplete if the Supreme Court had to pass on the number of cases that we have to pass on.

The CHAIRMAN. Oh, yes; I think that is true, but still you might say that that was equally true of the Federal Courts, and yet all the Federal Courts have as much to do as the bureau in controverted

cases, but not in the aggregate, of course. They do not have as many cases as you do, but by no means is there such an enormous percentage of the bureau's cases controverted. In other words, out of these 53,000,000 tax returns that Mr. Gregg testified to before the Finance Committee that had been returned, I think it is safe to say that a very small percentage of the aggregate were contested cases.

Mr. HARTSON. I made the statement—I do not know how long ago, but early in the hearings of this committee—that, in my opinion, it would be highly desirable to have a court reporter present to take down every word that is said by counsel for the taxpayer and by the representatives of the Government in all important conferences.

The CHAIRMAN. There is no doubt about it, and you do not even need to transcribe the notes. You could have them put into the files, to be transcribed later on, if needed. It would be well worth while to have those notes, because, then, anybody could tell from the records of the bureau what was said in these cases; but no one can find out now, after the cases are closed, in a year or so, or even a week or so afterward, if the employes have happened to resign from the bureau, just what was said, or what influence was brought to bear, to get a favorable decision. I am willing to assume that no influence, or no improper influence, was used; but you always leave the situation open to suspicion when the taxpayer gets a settlement that some engineer or some other employee thinks was unwarranted.

Mr. FAY. Mr. Chairman, may I make a correction of Mr. Hartson's statement regarding my connection with that?

The CHAIRMAN. Yes.

Mr. FAY. Mr. Hartson made the statement there that I, with others, had agreed to $137 an acre.

Mr. HARTSON. I did not so intend to quote you.

Mr. FAY. Well, that is the way you read the statement.

Mr. HARTSON. I do not believe you did, Mr. Fay.

Mr. FAY. I have a written statement in the case, where I agreed, or acquiesced, I should say, in allowing $137 an acre for about 9,000 acres, which had previously been passed upon by Mr. Talbert, and one of the engineers who applied this amount to only the 9,000 acres. I strenuously objected to applying the $137 an acre to the 17,000 acres that was on the other side of the mountain, and I held that at $35 or $37 an acre.

The CHAIRMAN. Have you anything more to put in, Mr. Hartson?

Mr. HARTSON. I have not this morning, Mr. Chairman.

The CHAIRMAN. Have you anything further, Mr. Manson?

Mr. MANSON. No.

The CHAIRMAN. Have you substantially reached the end of your criticisms of the oil section?

Mr. MANSON. No, indeed.

The CHAIRMAN. You have something more?

Mr. MANSON. Yes. We have reached the end of our discussion of the Gulf case.

The CHAIRMAN. In that connection, I think the committee would be very inadequately supplied with information if we did not have some reference to the taxes that were actually paid by the Gulf Corporation during the years under discussion, and what, in the opinion

of counsel, should have been paid had a proper depletion been used. I used the word "proper" because counsel charges that improper figures were used there. In other words, we do not get any picture of it, and all of this is an academic discussion. It should be reduced to a question of the tax, if we are going to understand what the whole thing means; so I suggest that counsel get these figures and give them to us, so that we can understand what it means in dollars and cents.

Mr. MANSON. I will do that.

The CHAIRMAN. Have you anything for to-morrow, Mr. Manson?

Mr. MANSON. I do not think we have anything for to-morrow.

The CHAIRMAN. You have nothing for to-morrow?

Mr. MANSON. No.

The CHAIRMAN. What has Mr. Box done with any of those consolidated cases? Has he any of them ready?

Mr. MANSON. I understand he has some of them practically ready.

The CHAIRMAN. You had better talk with him and find out if he has any ready. I want to keep things going, if it can be done without any undue inconvenience to the staff or to the bureau. Our time is limited, and these things stretch out longer than we expect them to.

I wish you would find out from Mr. Box whether he has anything to present to-morrow, and then call up Mr. Hartson and Mr. Gregg and let them know.

Mr. MANSON. I will do that.

The CHAIRMAN. Do that as early as possible.

Mr. MANSON. Yes.

The CHAIRMAN. Unless you hear otherwise, we will have no meeting to-morrow.

(Whereupon, at 11.35 o'clock a. m., the committee adjourned until to-morrow, Saturday, February 28, 1925, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

MONDAY, MARCH 2, 1925

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to call of the chairman.

Present: Senator Couzens, presiding.

Present also: Mr. L. C. Manson, of counsel for the committee; Mr. George G. Box, chief auditor for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. A. W. Gregg, special assistant to the Secretary of the Treasury; Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, Solicitor, Bureau of Internal Revenue; Mr. S. M. Greenidge, head engineering division, Bureau of Internal Revenue; Mr. John A. Grimes, chief metals valuation section; Mr. Sidney Alexander, Income Tax Unit; Mr. Granville S. Borden, valuation engineer, valuation division; and Mr. Alexander R. Shepherd, engineer, metals valuation section.

Mr. HARTSON. Mr. Chairman, this is the bureau's reply to counsel's further criticism of the adjustment in the case of the Aluminum Co. of America.

Counsel takes the position that the bureau failed to consider the years of peak production of the Aluminum Co., namely, the years 1919, 1920, and 1923, in calculating the value in use of the company's property. Comparisons are made, showing that by taking an average of the years 1919 to 1923, or an average of the years, 1919, 1920, and 1923, a much greater value in use would have been obtained and a smaller amortization allowance would have been granted than was actually granted. He further shows that by using the peak year of 1920 alone, which counsel contends was the best year to use, the result would be a still greater value in use and a smaller amortization allowance.

In answer to this, it may be said that the use of the average of the production for the three years 1921, 1922, and 1923 was not peculiar to this case but was the established practice of the bureau. As has been stated before this practice was adopted for two reasons, first, because the official termination of the war was March 3, 1921 (see joint resolution of Congress, 41 Stat. 1359), and, second, because the average for these three years was unquestionably more representative of normal postwar conditions than was the average of 1919 and 1920. The years 1919 and 1920 are generally known as years of postwar inflation and are recognized by all who have given study to the subject as not representing normal postwar conditions.

It is true that the Aluminum Co., as well as a number of other business concerns, enjoyed large business during 1919 and 1920, but in 1921 the same concerns were undergoing a most severe business depression, which brought many of them into bankruptcy.

In support of these statements reference is made to the report of the Congressional Joint Commission of Agricultural Inquiry, which was issued as report No. 408, House of Representatives, and ordered printed under date of October 15, 1921. The following is quoted from Part II, pages 42 and 43:

Beginning in March, 1919, the situation changed, and we entered upon a period of tremendous inflation, increase in prices, unbridled speculation, and extravagance. This change in the situation was first apparent on the stock exchange. By March, 1919, transactions on the stock exchange numbered 21,174,184 shares, and by May had increased to 34,236,574 shares, and by October, 1919, had reached a total of 36,886,384 shares. The high wages of the war period continued. The personal restraints which considerations of patriotism had induced the people to adopt for themselves were in large measure abandoned. The restraints which the Government imposed upon individuals and upon industry, including those of the Food Administration, the War Industries Board, the Railroad Administration, the Capital Issues Committees, and the various other measures designed to restrict personal expenditures and use of credit were one by one removed. Thousands of persons who had bought Liberty bonds sold these bonds or converted them by one method and another in high-priced land, worthless oil stocks, etc. There was an orgy of spending. Merchants could not get goods from the manufacturer as fast as they could be sold.

Prices rose with tremendous rapidity, as indicated by the indices of various commodities of the Bureau of Labor Statistics. A comparison of the indices of prices for March, 1919, with May, 1920, is shown in Table 7.

* * * * * * *

In the spring of 1920 evidences that deflation was at hand began to multiply. Exports of farm products, particularly continued to decline in volume. Domestic consumption in many lines also began to decline; the stream of production flowing from the farmer to the consumer began to back up in the channels of distribution, although higher discount rates and tight money, like dikes erected along the banks of the stream, served as influences to keep goods flowing in the channels of trade, notwithstanding the obstacles of declining prices and slackening demand. As demand fell off the difficulties of disposing of the crop of 1920 increased. Prices fell far below the costs of production, which were higher in 1920 than in any preceding year. The receipts from farm products grew constantly less and less adequate to liquidate the indebtedness against them and to provide for new production. More and still more credit was required to finance new production and to carry goods of 1920 production until they could be moved. The process of forcing these goods upon the market, in the face of lessening demand, served to still further force down prices, and as prices dropped, the proceeds of the sales of goods became less and less adequate to pay the accumulated debts made in producing them. Thus customary credit requirements were embarrassed because costs of production could not be liquidated at current selling prices, and the interest costs of carrying the goods until a better market could be obtained had to be added to the losses incident to declining prices.

Toward the end of 1919 the demands of the consuming public reached such proportions as to develop on the part of the retailers a kind of buyers' panic. A supply of goods adequate to supply this extravagant demand was not forthcoming. Then the wholesalers and merchants began to experience a sudden and marked increase in their orders, out of all proportion to even very prosperous conditions. This was the direct result of duplication. Many large firms finding themselves unable to supply their customers, had adopted a policy of allocation, giving to the buyers only a percentage of their orders, and endeavoring to distribute the supply as equitably as possible This forced or led many retailers to place orders with a number of different firms, where perhaps they had dealt with but one heretofore. By placing two, three, or four orders for the same amount of goods they were able then to obtain, perhaps, in this way the full amount of the supply they desired.

This led to a runaway market, a purely sellers' market, and gave a wholly fictitious impression of the probable demand of the coming year. As the mills

running overtime began to catch up with these orders, and to complete deliveries, the retailers suddenly found themselves with far larger stocks than they had anticipated, while on the other hand the rapid rise in retail prices had brought about a distinct, though probably at the time grossly exaggerated, curtailment of the buying power of the public. It was inevitable that this bubble of inflated prices must burst at some time, and the first warnings that it was coming were found in the cancellation of these duplicated orders. These cancellations, moderate at first, soon became, as the fall in prices progressed, simply an avalanche and so far as the most careful investigation discovers, it was this wave of cancellation, the fright which accompanied it, and the exhaustion of credit which preceded it which were the main or precipitating causes which carried prices down in such a headlong fashion. While there were probably many to anticipate a fairly drastic reaction from the unexampled boom of 1919–20, there were few probably, and possibly none, really to anticipate the tremendous decline which actually took place. Records of price changes run back now to the beginning of the nineteenth century. In this period of 120 years the debacle of 1920–21 was without parallel.

In view of the conditions above described, and that is quoted, Mr. Chairman, for the purpose of showing that conditions in 1919 and 1920 were purely fictitious, the first year being one of inflation and the next year being one of tremendous deflation, and the result of it was that those two years were excluded in the use of this formula, so-called, which the bureau used in computing the amortization allowance as not being directly representative of postwar years.

The CHAIRMAN. Just when was the first amortization act passed by Congress?

Mr. HARTSON. In 1918. It was the act of 1918. It was not passed until the spring of 1919, I think.

The CHAIRMAN. When did the bureau first consider applying that act?

Mr. HARTSON. Of course, the returns that were filed under that act started to come in in 1919. I imagine that the cases which arose when those returns were audited, or came up for audit, were up for settlement along in 1920, 1921, and those years. Investigations, as the committee has learned, were made in 1921, some of them not until 1922, and some of them not until 1923, although they covered those war years.

The CHAIRMAN. How many cases were settled in 1920, do you think, before you had reached any such conclusion as this?

Mr. HARTSON. I have not any figures, Mr. Chairman, but I should say very few—very, very few. I think the cases for the war years involving amortization allowances are much the same in point of time of settlement as some of the other difficult provisions of the law which the bureau has had to administer.

As the chairman has discovered here in this inquiry, the more difficult cases have been settled last, and there have been cases settled right through this postwar period, 1921, 1922, and 1923, but they were not settled immediately after the years involved.

The CHAIRMAN. When did you first decide upon the policy of using the years 1921, 1922, and 1923 to arrive at postwar production?

Mr. HARTSON. I could not answer that definitely. I really do not know, Mr. Chairman. I think it was done sometime in 1921 or 1922.

The CHAIRMAN. Then, for all prior settlements, you used what years?

Mr. HARTSON. I think that this formula, which is the only method which requires the use of a postwar period in computing the amor-

tization allowance, was itself not conceived of, nor followed, nor adopted, until we were well into this postwar period 1921 or 1922. I do not know just exactly when that was adopted, but about that time.

The CHAIRMAN. I would like to ask Mr. Manson if he knows when they adopted that policy of using those years for postwar production?

Mr. MANSON. I do not know definitely, but the indications are that the statement just made by Mr. Hartson is correct.

The CHAIRMAN. That would result in a situation that in all cases where they were settled prior to this being adopted, they were settled on a much more favorable basis to the Government and unfavorable basis to the taxpayer than subsequent settlements.

Mr. HARTSON. No, Mr. Chairman, I do not believe that is true. This should be borne in mind, that this formula, which, as the chairman knows, was used in the settlement of the larger and more difficult cases, which it seemed to the bureau were impossible of adjustment and settlement and closing in any other way, was not used in the earlier period, and it was during that period, when only the simpler cases were closed, where this formula would not have been used in any event; so that I think that in cases where the formula was used and where the officers of the bureau thought it could be used, it was used in all cases. I do not believe that there were some difficult cases settled before the formula came in, and others remained to be closed under the formula. I do not believe that is the situation.

The CHAIRMAN. In the settlement of these earlier cases, then, just how was the degree of amortization arrived at?

Mr. HARTSON. Well, Mr. Chairman, this is my answer to that: The simpler cases, which involved a claim for amortization, and which further were based on the value in use of facilities during the postwar period, were settled by detailed examination of the very few facilities which that taxpayer installed. Therefore, two things came about. When the case could be settled immediately, because it was a simple case, it was not postponed until negotiations extending over a long period of time were concluded. Secondly, it was not necessary to use any formula in such cases, and the formula was therefore not used.

The CHAIRMAN. I understand that, but I do not understand how you arrived at amortization if no formula was used. You say it was not necessary in those cases. Then how did you arrive at amortization? Was it on the basis of the fact that the whole facility claimed by the taxpayer was out of existence or not required at all?

Mr. HARTSON. Mr. Chairman, it would depend on the facts in a particular case. If it were a simple case, which involved the necessity to determine the postwar value in use of a single facility, the engineer would have made an inspection, and would have, by an examination of the facility itself, come back and said, "that facility is in such a degree of use," and by an examination of that facility he could determine the percentage of value in use of that facility without the requirement of going into any complicated formula to determine that.

The CHAIRMAN. When the formula was adopted, and subsequently thereto, was used, the bureau, of course, knew the exact conditions as to the requirements of the taxpayer, and also knew whether there had been any extension of facilities over that period of time, and if

it did show that there were extensions and more capital investments, does Mr. Hartson think that amortization was justified?

Mr. HARTSON. I think the bureau had information, or could have had information, which would indicate the nature of capital expenditures, and the purpose for which they were being made. It is quite possible that big capital outlays might be made by a company which would not involve the investment in more facilities of the kind and character which were installed during the war, or on which amortization was claimed.

The CHAIRMAN. Oh, yes; but——

Mr. HARTSON. Now, I agree with the chairman that if a company did make big expenditures to acquire more facilities of the same character that were acquired during the war, and on which amortization was claimed, that it seems difficult to believe that that taxpayer is entitled to any allowance because of reduced value in use of the facilities which he installed during the war.

The CHAIRMAN. In order to clear up this situation, it seems to me that the bureau, in cooperation with the committee's counsel and assistants, might exhibit to the committee some evidence to show how these cases were settled prior to the adoption of this formula, so that it may be evident that no injustice was done to taxpayers who promptly settled their cases.

Mr. HARTSON. I think there were very few cases, if any—I do not know of any—where the formula would have been used in any event, that were settled during those early years. It is only the big cases, only the cases where detailed examination of each individual facility seemed impracticable from the standpoint of the bureau, in which they have felt it necessary to use the formula.

The CHAIRMAN. And, of course, those were the cases in which the Government had the greatest interest.

Mr. HARTSON. Yes; there was more money involved, from the standpoint of the Government.

The CHAIRMAN. In the case under discussion, I think counsel should find out, although the record may show it, but if it does, it has slipped my mind, whether these extended facilities were of the same kind of facilities, on which amortization was claimed by the taxpayer?

Mr. MANSON. We endeavored to find that out, but the letter of the taxpayer, showing the information as to capital expenditures, which, in this instance, involved something over $46,000,000, if my memory serves me right—over $40,000,000, anyway—of capital expenditures made subsequent to the war, stated that it was impracticable to furnish any more detailed information than the gross amount of the expenditures. I know of no way whereby we can secure that information without having some member of our staff make a field examination.

In the Steel case, we exhibited, in connection with our presentation, details showing the purpose for which capital expenditures were made, and made a partial check showing that the same facilities had been added since the war as had received amortization allowance; that is, amortization had been allowed on the same kind of facilities as had been added since the war. We did not make a complete check on that, but we presented a substantial list.

The CHAIRMAN. I think, in the interest of this case, and so that we may have no misunderstanding about it, it is incumbent on the taxpayer to give the committee or the bureau—I do not care which—the deatils of these capital investments, so that they may be compared with the items on which they claimed amortization, to see, in justice to everyone, whether or not they were the same kind of particular articles on which they invested capital, and on which they claimed amortization.

Mr. HARTSON. Of course, even on facilities which they installed during the war, and conceding that they installed more of the same character of facilities after the war, they would be entitled to claim amortization on those installed during the war, because of the post-war replacement value. That is another method of computing the amortization allowance, which does not involve the value in use of these facilities.

The CHAIRMAN. I understand that; but I understand further, if I remember correctly, that there was no claim made for the difference in costs.

Mr. MANSON. There was none, but in making our computations of the probable amount of tax involved, our engineers made an allowance of 20 per cent. In other words, we claimed, if I remember right, that the difference in tax was about $2,150,000. Had it not been for the rough estimate we made of the difference between the postwar and the war cost, the 20 per cent difference in tax would have been in the neighborhood of $10,000,000.

The CHAIRMAN. Will the bureau see if you can arrange that and get it to the committee?

Mr. HARTSON. An effort will be made to do that, Mr. Chairman.

Now, to continue with my statement.

In view of the conditions which have just been described of the postwar deflation, it was obviously unfair to taxpayers in general to consider either 1919 or 1920 as normal postwar years, and 1921, being a year of depression, it was equally incorrect from the Government's viewpoint, to use this year alone as a basis for determining postwar value in use. It was accordingly decided that the average of the years 1921, 1922, and 1923 afforded the most equitable basis of determining such value in use.

Counsel has stated that it is necessary to consider the year 1920 in calculating value in use, and that this year forms the best basis for such determination under the formula used by the bureau. This is clearly a biased and unfair criticism. As shown before, 1920 was an abnormal year, not only in this industry, but in many others, and to determine whether a taxpayer was entitled to amortization on the basis of the use which he made of his facilities in this one year would have been manifestly unjust and contrary to the intent of Congress in passing the amortization provisions of the law.

The CHAIRMAN. Just at that point, we might assume for argument's sake that that statement is correct, but when you assume to use estimates for 1920 and 1923, which estimates I assume principally had in mind the very great slump of 1921, I think that was equally unfair.

Mr. HARTSON The record in this case, Mr. Chairman, with regard to the estimates that were used by the Bureau, is a very good one. The estimates that the Bureau made of production for those post-

war years, and at the time they made the estimates they did not have the actual figures, were substantially correct. There was not a very great margin of error, although there was a slight one.

Mr. MANSON. There was only three and a half per cent difference.

Mr. HARTSON. In other cases we missed it a great deal, but in this case we came very close to it, I think.

The CHAIRMAN. Yes, but you understand I am not criticising it as to this particular case, because all through this investigation I am having in mind more the generel practice, and am only using cases as the basis for discussion.

Mr. HARTSON. Yes.

Mr. MANSON. I would like to observe here, if I might be permitted, that the extract from the report of the committee on agricultural inquiry seems to indicate very strongly that 1921 was an abnormal year, even more so than 1919 and 1920 were.

The CHAIRMAN. I reached that conclusion myself from the reading of the extract.

Mr. MANSON. Yes; and I might suggest right at that point that if 1919 and 1920 were to be excluded upon the ground that the business done during those years was the result of over-stimulation, it is quite clear to my mind that 1921 can be well compared with "the morning after."

Mr. HARTSON. Of course, Mr. Manson, that is not the only reason why the years 1921, 1922 and 1923 were used as the postwar years. This is one of the reasons, as has been pointed out.

The fact that 1921 was, in fact, and in law, a postwar year, the war having formally been brought to an end early in 1921, seemed to make it necessary for us to use that as the year after the war had been formally closed in our computations, and to use that alone as was pointed out, seemed to us to be unreasonable; so we averaged that with the two succeeding years.

This discussion brings this out, it seems to me, that you can, in a particular case, pick one year, exclude another, or take two years and exclude two years, or vice versa, and you can reach any result that you choose to reach by the selection of particular years after you have the history of it behind you. But here was the Bureau, in 1921 and 1922, Mr. Chairman, trying to settle these cases. They had to adopt, so it seemed to them, a method which would have general application in cases of the same character, and they tried to steer a consistent course. In some cases it worked to the advantage of the taxpayer, possibly, to pick arbitrarily three years, and to exclude others, but in the next case that came along it might have the opposite result, and yet it seems as though this selection of those three years, and I rather think, personally, it was a wise selection to take those three years and use them uniformly, when this formula was being applied, in preference to any of the other years that might have been taken—reached a reasonably fair result, assuming that the figures and factors which had been the basis when this formula was used were reasonably correct as well.

The CHAIRMAN. I observe that counsel for the bureau lays stress upon the resolution passed by Congress declaring the war at an end which I think is rather technical; but in view of the fact that they did not wait for the war to end when they settled the other amortization cases, I am just wondering how they came to settle cases before the war ended?

Mr. HARTSON. Mr. Chairman, in those cases that the chairman has reference to, that were closed before the war ended, I think they would not amount to 1 per cent on the total number of cases, and I think they were such simple ones that it would not be difficult to determine, with some degree of accuracy, without the use of any formula or computation, what amount of amortization the company would be entitled to.

The CHAIRMAN. That may be true, but still you could hardly arrive at the postwar cost before the war ended, could you?

Mr. HARTSON. I can concede, Mr. Chairman, that it would be difficult to determine the postwar cost of a facility in 1920, when later years might cause you, with the information then available, to reach an entirely different result. Of course, the answer to all of this thing is that we are trying to settle our cases; we are trying to close our cases.

The CHAIRMAN. Yes; I understand.

Mr. HARTSON. And we had to close them from day to day. We tried to close them as they came up, rather than keep them all for some distant date in the future, and settle them all at a definite date. We could not do that.

The CHAIRMAN. I am not criticizing the bureau for settling these cases as promptly as possible. In fact, if I should criticize the bureau, it would be for the delay. But it seems to me that the bureau is stretching a point by using the resolution passed by Congress in 1921 as determining the end of the war, when they knew that the war ended in 1918, and, in practice, had been proceeding on that basis long before the resolution was passed by Congress determining the end of the war.

Mr. HARTSON. We had this situation, Mr. Chairman: This is a bit of history that I think will clear that point up. The 1918 act, as I remember it, and I may be in error about it, put a limit of three years from the end of the war——

The CHAIRMAN. Which, in fact, was 1918?

Mr. HARTSON. A three-year limit within which redeterminations of amortization allowances could be demanded by a taxpayer and effected by the commissioner on his own motion. The 1921 act came along, and instead of using a three-year period, put a definite date in the future, which was March 3, 1924, as the limit within which redeterminations could or had to be made. So that the war was over when the 1918 act was passed; I mean by that the armistice had been signed when the 1918 act was passed.

The CHAIRMAN. Yes.

Mr. HARTSON. And they made a three-year limit from the termination of the war. When that law was put into effect and was placed on the statute books, it required us to attempt to get the cases closed before the end of that period. Then the 1921 act further extended it.

The CHAIRMAN. But when they passed the 1918 act in 1919, Congress knew that the war was over.

Mr. HARTSON. They knew that the armistice had been signed.

The CHAIRMAN. They understood that the war was over, and they used a three-year period; so it seems clear to me that there was no basis for the bureau to use except the years 1919, 1920, and 1921.

Mr. HARTSON. That might well have been true during the time the cases were being settled under the 1918 act, but I have tried to bring

out, Mr. Chairman, that we were not settling cases under that act. It was not until the 1921 act came into effect that we started to close these cases, about which counsel seems to have some criticism. Now, there might have been a few cases which the taxpayer and the Government could agree on, and we settled and closed those without reference, maybe, to the postwar value in use, using, possibly, the scrap value of the asset or the postwar replacement value. It would require some knowledge of postwar conditions before that determination could be arrived at. There is no exact answer to any of these things.

The CHAIRMAN. I understand that.

Mr. HARTSON. It is a difficult thing to satisfy everybody on.

The Congress itself realized that the effect of the war on a taxpayer's business could not be determined in 1919, or 1920, and because of such fact, specifically provided that the taxpayer might have the original deduction for amortization reexamined by the Commissioner of Internal Revenue at any time before March 3, 1924, and if found to be incorrect, the tax liability should be redetermined.

The CHAIRMAN. At what time in 1921 was that act passed, Mr. Hartson?

Mr. HARTSON. It was approved and became effective on November 23, 1921.

The language of the revenue act of 1918 in this respect was that he might require a redetermination at any time within three years after the termination of the war. In the revenue act of 1921, the specific date, March 3, 1924, was used, and it is to be noted that this was actually three years after the official termination of the war. It is, therefore, the position of the bureau that the use of the years 1921 to 1923 and the elimination of the years 1919 and 1920 was justified.

Counsel states that the demand for the company's products fluctuated from month to month, as shown by the records of one of its plants, and he states that if the demand fluctuates, the capacity required to fill the demand will exceed the average capacity as figured on a steady demand for the entire year. He draws the conclusion that the plant requirement is thus better reflected by monthly capacity than by annual capacity, and that the annual capacity should be arrived at by multiplying peak monthly capacity by twelve. This method of arriving at capacity is not considered sound. In the first place, it assumes that the production of the Alcoa, Tennessee, plant, which was the one under consideration, is controlled by demand, and that the capacity was, therefore, based on demand. However, the Alcoa plant is one which is operated by water power, and it is situated in a locality subject to droughts and shortages of water. Therefore, to take the capacity for a peak month and multiply such peak capacity by 12 would eliminate the periods of small capacity due to water shortage, and would result in attributing to the plant a greater capacity than it, in fact, possessed. The argument predicated upon this presumption is, therefore, believed to be unsound.

The CHAIRMAN. The argument would be sound, then, if it was an electric power plant, would it not?

Mr. HARTSON. I think it might be sound, certainly, if the ability to produce was constant during the war. I have been told personally, that this water power plant down there is one that, during the dry

months, is unable to function at anywhere near its capacity. The result of that is that they build up a fictitious production during months when they have power, in order to tide them over the dry months, and their average production during the year better reflects what their true capacity is.

Mr. MANSON. If I might be permitted to interrupt at this point, I will say that in studying the figures of monthly production of the Alcoa plant, I had in mind the fact that that was a water power plant, whose production would be influenced by the supply of water, and I was very much surprised to see that there was no relation between the production of the plant from month to month and the periods of the year when water would be scarce or plentiful.

The CHAIRMAN. So, in effect——

Mr. MANSON. There is an exhibit in the record of the case showing production from month to month. I have not the figures in my mind, of course, but I did have in mind the very point that counsel calls attention to, and in studying these figures I studied them for the purpose of ascertaining whether or not the variations would show a slack period during the middle of the summer, when water would be scarce, and during the middle of the winter when the ground in the mountains would be frozen and water would not be coming down. I discovered that there was no relationship between the peaks that I used, which showed a variation of about 25 per cent—from 25 to 30 per cent. There was no relationship between those peaks and the calendar months of the year, that is, between the dry and wet seasons of the year.

The CHAIRMAN. All right, Mr. Hartson.

Mr. HARTSON. Counsel has called attention to a letter from the company, in which it is said that capital expenditures aggregating $42,043,585.96 have been made since the war, and he draws the conclusion that a part of these expenditures must have been for the purpose of increasing the company's plant capacity. Attention is directed to that portion of the letter referred to in which it is said that these expenditures were made by the company for plants in the United States and for those in foreign countries. As to the plants in foreign countries, no amortization can be claimed, and their capacities have no bearing on the present question. The expenditures for them are, therefore, immaterial, and there is nothing to indicate whether or not a greater part or all of this $42,043,585.96 was expended on the foreign plants.

The chairman has asked for figures on that, of course, and we will attempt to secure them.

Counsel has referred to a report of the Federal Trade Commission, and has quoted extracts therefrom, tending to show that the officers of the aluminum company made statements to the effect that there has been a shortage of ingot capacity during some period. He further draws attention to the fact that the amortization claim is based on an excess of ingot capacity. When these alleged statements of the company's officers were made, or to whom they were made, or in what connection they were made, or to what period of time they refer, does not appear. It is submitted that they are entitled to but little weight.

With reference to these quotations, counsel stated (p. 2906):

I do not read this into the record with the idea that this is the kind of proof that, were I making a determination of amortization in this case, I would entertain. I do read it into the record for the purpose, however, of showing that there was extant in this report the kind of proof which should have put the bureau on its notice that inquiry along these lines should be made.

Upon inquiry at the Federal Trade Commission, it was found that the report from which these quotations were taken has not yet been printed, and that the statements were taken from a mimeographed summary of the report which was prepared in October, 1924, and which has not been generally published. To charge the bureau with failing in its duty because it did not have knowledge of the activities of an entirely dissociated branch of the Government, particularly when those activities had taken place long subsequent to the bureau's action on a particular case, is wholly unreasonable. Such statements have more the appearance of mere faultfinding than of helpful criticism.

The criticisms of counsel relating to the failure of the bureau's engineers to make a detailed examination to determine the salvage value of amortizable facilities, their comparative life and their differences of efficiency have already been answered in this case. It was shown in this answer that the plan was impracticable, because it involved more time than was available, that it would have involved hardships to many taxpayers, and that it would have been of doubtful value in producing additional revenue.

With respect to this latter point, attention is directed to the fact that another of counsel's criticisms which sounded as grave as these turned out to be wholly detrimental to the Government's interests when actually put into practice. The criticism now referred to is that pertaining to the allowance of amortization on this taxpayer's steamships. It will be remembered that counsel insisted that the engineers, after making this amortization allowance, which included an allowance for the steamships, should have learned that the taxpayer had later sold its ships and should have made an examination to determine whether the price received for the ships exceeded their residual value—such value being calculated by deducting from the original cost amounts allowed for amortization and depreciation. It was then argued that if the price received was greater than such residual value, the allowance of the bureau was improper and should be recalculated.

It will be remembered that upon following the method suggested it was found that the price received by the taxpayer was not greater than the residual value as above calculated, but was very much smaller and that by following such method, the taxpayer's amortization allowance would have been increased instead of decreased.

The CHAIRMAN. At this point, let me ask you whether the taxpayer deducted his loss on the sale of these ships?

Mr. HARTSON. Yes; he deducted his loss whenever the sale took place.

The CHAIRMAN. So that, in effect, it means that he did get his full loss on the ships, either through amortization, or through loss of——

Mr. HARTSON. That is not the fact, Mr. Chairman, because he took his loss at a 12½ per cent rate. At any rate, the rates had

changed, so that if he did not do that, which, upon reflection, I am inclined to think he did not, because that is a provision of the 1924 act rather than of any prior act, it did not result in the same benefit that he would have received had it been computed against his war profits under the excess profits tax rates during the war years, such as would have been derived by him had he been permitted to increase his amortization allowance.

It is not unlikely that the proposed method of considering salvage value, useful life and differences of efficiency would have similar results.

As the case now stands, it appears from the calculations of our engineers that had the actual production figure for 1923 been used instead of the estimated production figure, in which there was a difference of 3.5 per cent, the amortization allowance would have been $587,139.75 less than was actually allowed. On the other hand, if taxpayers were granted all of the amortization on its steamships to which it was entitled, the allowance would have to be increased by $1,291,437.00.

Under the circumstances, the recomputation of these allowances does not appear to be advisable.

The CHAIRMAN. You may proceed with your case now, Mr. Manson.

Mr. MANSON. This is the case of the individual tax of William Boyce Thompson for 1918.

The CHAIRMAN. Where does Mr. Thompson live?

Mr. MANSON. In New York.

The CHAIRMAN. Do you know what his business is?

Mr. MANSON. Capitalist, I believe. I do not know of any other business.

The amount of tax involved is $573,001.72.

This case is an important case, not only from the standpoint of the amount of tax involved, but because it discloses a laxness which we believe to be symptomatic in checking losses claimed as deductions.

Our statistical investigation has disclosed the fact that losses on the sale of stocks and bonds claimed and allowed as deductions are the most important factor in determining the rise and fall of income in the high-tax brackets. They perhaps amount to more than all of the other factors which influence the rise and fall of incomes in the high-tax brackets. For that reason the system employed in the bureau in checking those losses is a very important consideration for this committee.

This case further discloses that in spite of all the checks and reviews which have been described to this committee as the means of protecting the Government's interests, it is possible for the heads of two divisions, by cooperation, to fix a tax, and in spite of the best efforts of conscientious employees working under them, to keep from the responsible officers, such as the solicitor and the commissioner himself, the information such as goes to the liability of the taxpayer to pay a tax; so that, for those reasons, this case involves a great deal more than the amount of tax involved.

In the original return in this case, filed in March, 1919, this taxpayer made deductions for losses on sale of stocks and bonds amounting to $597,479.66.

The 1918 form of return, in Schedule D, calls for the following information to be supplied by a taxpayer who reports a profit or loss on the sale of land, buildings, stocks, bonds, and other property——

The CHAIRMAN. Is that the form used by the taxpayer in this case?

Mr. MANSON. That is the form used by the taxpayer in this case, the form supplied by the bureau for reporting the 1918 taxes.

The CHAIRMAN. This was the taxpayer's return made for the year 1918, although filed in 1919, was it?

Mr. MANSON. Yes; that is it. In the first place, this form calls for the kind of property upon which the profit or loss is required to be stated, the year the property is acquired, the name and address of the purchaser or broker, the sale price, the original cost of value of March 1, 1913, the cost of subsequent improvements, if any, and the depreciation sustained.

The instructions printed on this form provide as follows:

If the profits or losses on sales made through any one broker aggregated $1,000 or more, report the transactions on a separate line, with the name and address of the broker.

In this case, a copy of Schedule D of the taxpayer's return is our Exhibit A. There is no detail as to the kind of stock or the kind of bonds. The only date as to the year acquired is 1913 and since.

Under the name and address of purchaser or broker is the word "various." The total sale price of stocks and bonds is included in three totals, and the original cost or market value on March 1, 1913, is also included in three totals. The losses are carried out in one total of $597,479.66.

I offer that as our Exhibit A.

When this return was audited, the auditor prepared a letter for the signature of the deputy commissioner, which as is follows:

SEPTEMBER 4, 1923.

Mr. WILLIAM BOYCE THOMPSON,
14 Wall Street,
New York, N. Y.

SIR: Reference is made to your income tax return, Form 1040, for 1918.

It is noted in Schedule D that you reported a loss of $597,479.66 from the sale of stocks, notes, and bonds. With reference to each transaction you are requested to state:

(*a*) Kind of security.
(*b*) Date acquired.
(*c*) Original cost of each security.
(*d*) If acquired prior to March 1, 1913, the market value as of that date.
(*e*) Date of sale.
(*f*) Sale price of each security.
(*g*) Whether $4,437,590.64 represents the actual sale price or the inventory value furnished by your broker.

In Schedule A you deducted $26,066.02 as salaries and wages paid. You are requested to state whether this item includes any withdrawals or salaries paid to yourself or your wife. If so, state the amount or amounts.

Please give this matter your prompt attention and in your reply refer to IG PA 3 MP-302.

Respectfully,

J. G. BRIGHT,
Deputy Commissioner,
By ——— ———,
Acting Chief of Section.

The CHAIRMAN. Who was the acting chief of section at that time?

Mr. MANSON. It does not state.

I offer that as Exhibit B.

On September 4, the taxpayer furnished a statement, of which Exhibit C is a copy. In this statement, the various transactions are apparently separated, but with one or two exceptions there is no description of the kind of stock; there is no date as to sale, that being designated, as I say, with one or two exceptions, as October and November, 1918, and many of them just 1918. There is no name of the purchaser or of the broker to whom the sale was made.

Among other items claimed for here is "Foreign exchange." There was claimed on that a loss of $280,022.36. There is nothing to indicate whether an exchange was disposed of, or what sort of "Foreign exchange" it is. In fact, there is nothing upon this statement furnished by the taxpayer, in response to this letter, which would enable any auditor to make an intelligent or effective check upon these transactions.

It is submitted that if a taxpayer is required to state the kind of stock upon the sale of which he claimed a loss, is required to give the date of its purchase; so that the value of that stock as of that date can be verified; is required to give the date of the sale, so that the value of the stock as of that date can be verified, and is required to give the name of the purchaser or the broker through whom the sale is made; so that that fact can be verified, the mere fact that the taxpayer furnishes that information is almost as effective a check as though that information were afterwards verified, because a taxpayer who knows that he is supplying information which makes it possible for the bureau to check the transaction and find out whether the facts returned are true, is deterred from reporting a loss which does not, in fact, take place.

The CHAIRMAN. Did your investigation disclose any evidence that the taxpayer's books were audited by an auditor?

Mr. MANSON. They were not.

The CHAIRMAN. Do you know whether they have been audited up to date?

Mr. MANSON. I do not know whether they have been audited up to date, but no field examination of this claim was made.

The CHAIRMAN. You say you do not know whether the taxpayer's books at the office were audited up to date?

Mr. MANSON. I do not know whether they have been audited since. There is nothing in the files to indicate that they have been audited.

The CHAIRMAN. That is interesting, because the representatives of the bureau have been checking the chairman's income tax for three weeks, and have been going to great pains to find out whether I have done the Government out of anything or not.

Mr. MANSON. There is nothing in the files to indicate that any examination of this taxpayer's books has been made.

After the receipt of the statement to which I have just referred, an A–2 letter, notifying the taxpayer of an additional assessment of $482.16 was sent out on October 17, 1923. This A–2 letter, in effect, allows all of the deductions claimed for the loss on the sale of stocks and bonds claimed by the taxpayer, for the reason that it does not disallow any of them, and assess an extra tax.

The CHAIRMAN. You say "in effect." In actuality it does.

Mr. MANSON. Yes. The extra tax of $482.16, notification of which is carried by this letter, contains a statement which is as follows:

> In schedule G you failed to report $57.55, the amount of tax paid for you at the source, on tax-free covenant bonds. On page 1, line 16, you reported $4,003.75 as the value of stock dividends received. In the schedule submitted with your letter of September 21, 1923, you gave this value as $4,503.75, a difference of $500. Stock dividends do not constitute taxable income; however, the profits realized from the sale of such stock is taxable income in the year in which the sale is made.
>
> These adjustments increase your net income subject to tax at 1918 rates by $4,561.30. The surtax on $35,421.61, the corrected amount of net income in excess of the exemption of $5,000, is $3,490.11. Since $2,950.40 has been assessed, and $57.55 was paid for you at the source on tax-free covenant bonds, there is due an additional tax of $482.16.

The CHAIRMAN. And the actual tax paid by the taxpayer in that year on the basis of approximately $35,000 net income?

Mr. MANSON. Yes. Well, $35,000, plus $5,000.

The auditor who handled this return, Miss Megarity, is no longer in the section. Mr. Box, our auditor, interviewed the chief of the subsection——

The CHAIRMAN. Do I understand that this lady to whom you have just referred is in the service, but not in the section?

Mr. MANSON. We do not know whether she is in the service, but she is not in the section.

The CHAIRMAN. I see.

Mr. MANSON. Mr. Box interviewed the chief of the subsection where this case was handled, a Miss Powers, as to whether it was customary, where the schedule did not contain the information called for, and where the information supplied by the taxpayer was not sufficient, to make the basis of an effective audit, to allow the deductions under those conditions. She stated to Mr. Box that they not only made no check except on the totals, but there was no information on file in that section from which a check could be made; that no attempt was made to determine whether or not the prices at which the stock is reported bought and the prices at which it is reported sold conform to the market price as of those dates, and that if an auditor attempted to make that sort of an audit of these returns the production record of that auditor would be so poor that he or she would probably be removed from his or her position.

The CHAIRMAN. It seems to me that counsel ought to have subpœnaed the person who made that statement.

Mr. MANSON. Well, I can do so, if the chairman desires it.

The CHAIRMAN. It might be desirable, although, of course, the witness is on notice now, and it might be somewhat embarrassing, and different had the witness been subpoenaed in the first instance.

Mr. MANSON. Notwithstanding the fact that the information called for by the schedule was not supplied and the information called for by the letter was not supplied in sufficient detail to form a proper audit of these deductions, I propose to show hereafter that it was held by Mr. Alexander, in a conference with the taxpayer, that the fact that this A–2 letter was sent out for $482.16 barred the Government from reopening and reauditing and redetermining the propriety of these allowances.

In the fall of 1923, Mr. Granville S. Borden and Mr. William H. Craigue, valuation engineers of the metals valuation section, discovered that a man by the name of McConnell had sold zinc lands and leases in 1918, upon which he made a profit of approximately $600,000. When McConnell was notified of a proposed tax upon that transaction, he protested that tax, and set up the fact that this taxpayer, William Boyce Thompson, had financed his deal, and that they were equal partners in the transaction. This property was sold in 1917; that is, an agreement to sell was entered into in 1917. In that way, the fact that Thompson had a half interest in this profit was brought to the attention of the metals valuation section.

The metals valuation section then requisitioned the returns of Thompson and McConnell, and discovered that they had made no returns of any portion of the profit on the sale of these zinc lands.

An A–2 letter, which is our exhibit E dated February 12, 1924, was sent out, assessing a tax of $573,011.72, based upon the disallow-allowance of the deductions for the losses on the sale of stocks and bonds, and upon Thompson's share of the profit on the sale of these zinc lands.

The CHAIRMAN. This A–2 letter, you say, was sent to Thompson?

Mr. MANSON. This A–2 letter was sent to Thompson on February 12, 1924. This is our Exhibit E.

On February 28, 1924, Mr. C. Kelsey and Mr. T. D. Thatcher, of the law firm of Simpson, Barlett & Thatcher, representing Mr. McConnell and Mr. A. G. Dodge, representing Mr. Thompson, had a conference with Mr. Alexander. Notwithstanding the fact that the discovery of this transaction with reference to the sale of the mining lands had been made by the metals valuation section, that the metals valuation section had given a notice and had given these taxpayers a hearing, and had all the information with reference to this transaction; and notwithstanding the fact that under the organization of the income tax unit the determination of the values of mining property is a matter exclusively within the control of the metals valuation section, neither a representative of the metals valuation section nor an auditor who knew anything about the deductions for losses on the sale of stock and bonds, was brought into this conference. This conference was held by Mr. Alexander alone.

The report of that conference is our Exhibit F.

That letter is signed by "S. A.," those being the initials of Mr. Alexander, "Head, Natural Resources Audit Division."

I would now call especial attention to the fact that this was a case in which it was known at the time it was held by Mr. Alexander that these stock losses would not be reopened for consideration. It was known that this taxpayer had failed to return a profit made on the lands in this mineral case, a fact sufficient to have put the bureau upon notice, even though it is not their practice in all cases to make an effective check of losses where they run as they do in this case, to over a half million dollars.

The CHAIRMAN. In that connection, the taxpayer claims that there was no profit made; so how could a profit be returned?

Mr. MANSON. Well, I am coming to that.

There was at least a claim on the part of the metals valuation section that there had been a profit made.

The CHAIRMAN. Well, you would not criticize the taxpayer for not returning it if there was not any profit, would you?

Mr. MANSON. Taking all the facts in this case into consideration, I would criticize the taxpayer, for this reason: It is shown here that this land was purchased in December, 1912; that there was no activity in this field and nothing took place which would enhance the value of the property from December, 1912, to the 1st of March, 1913; that the land was purchased for approximately $10,000; that afterwards improvements were made on it which would run the cost of the land, with the developments, up to about $18,000; that nothing transpired after that until Germany seized the zinc fields in Belgium, and the price of zinc was immediately boosted in this country, in 1914; that great activity took place in this field in 1914 and 1915; that the price obtained for this property in 1917, that is, the price fixed in the contract of 1917, was entirely due to enhancement in the value of zinc, which began in 1914.

The CHAIRMAN. What was the property sold at?

Mr. MANSON. About $600,000.

The CHAIRMAN. In spite of the fact that it cost them about $10,000 and they sold it for $600,000, the taxpayer claimed no profit?

Mr. MANSON. They reported no profit at all. Even though there had been some enhancement in value, and in spite of the claim of the bureau that there was none in the three months' period from the time they purchased the property until the 1st of March, 1913, the fact that war conditions in Europe boosted the price and the demand for zinc tremendously in this country would create at least a part of the profit; so it can not be said in this case that the taxpayer was warranted, under any conditions, in not reporting some profit on that transaction.

The CHAIRMAN. What did the taxpayer claim the property was worth on March 1, 1913?

Mr. MANSON. He claimed that the property, together with the improvements made upon it, was worth just what he got for it.

The CHAIRMAN. The burden of proof was on the taxpayer to fix the value as of March 1, 1913, is it not?

Mr. MANSON. Absolutely.

The CHAIRMAN. And he submitted no proof fixing the value?

Mr. MANSON. And he submitted no proof fixing the value.

The engineering division had given him 30 days within which to supply data as to the value as of March 1, 1913, after a conference with the taxpayer. Such data was never supplied. The engineering division ascertained that he had consulted an engineer and had attempted to get an engineering valuation, but had not succeeded in doing so.

The CHAIRMAN. When was the case closed as to this particular transaction?

Mr. MANSON. I am just coming to that.

On April 14, 1924, Mr. Grimes, the chief of the metals valuation section, sent a memorandum to Mr. A. M. Greenidge head of the engineering division. This memorandum sets forth the facts which I have just roughly sketched.

Copy of that letter is introduced as our Exhibit G.

The CHAIRMAN. You say that was dated in April, 1924?

Mr. MANSON. That was dated April 14, 1924.

It is apparent that there are some questions of law involved here. In the first place, as to whether the transaction out of which this profit was derived was consummated in 1917 or 1918 is clearly a question of law. Second, whether or not the failure to return this tax or to return this income constituted a fraud which would prevent the statute of limitations running against the tax is another very clear question of law.

For reasons which will be hereafter explained, on April 28, 1924—that is, two weeks after this letter to Mr. Greenidge—there was prepared for the signature of the deputy commissioner, by Mr. Borden, an engineer in the metals valuation section, a communication directed to the solicitor, requesting the solicitor's opinion upon the questions of law involved in this matter, two of which I have just mentioned. This communication is our Exhibit J.

The CHAIRMAN. Did that letter get to the solicitor?

Mr. MANSON. That letter, we have ascertained, had not reached the solicitor's office last Saturday. The date is April 28, 1924.

The CHAIRMAN. In other words, after 10 months, it had not reached the solicitor?

Mr. MANSON. It had not reached the solicitor's office yet.

Our Exhibit H is a written statement of Mr. G. S. Borden, valuation engineer of the metals valuation section, which throws additional light on this situation.

The CHAIRMAN. The Mr. Shepherd mentioned was the special conferee, was he not?

Mr. MANSON. Yes. Mr. Shepherd was the special conferee of the Engineering Division.

As this engineer has stated, he made the kind of report that Mr. Shepherd instructed him to make. That report is Exhibit I, dated December 3, 1924. I am not going to read this report in full, but I do desire to call the attention of the committee to the fact that the very first statement in this report is a ruling upon a question of law, namely, "The statute of limitations has run against the claim for additional taxes for the year 1917."

That was and is one of the most important questions in this case.

Here we have this situation, identical as in the Penn Sand & Gravel Co., an engineer knowing that the ends of justice are being defeated by a taxpayer, sends a protest in writing to Mr. Greenidge. That protest is ignored. He then goes to the solicitor, the law officer of the Bureau of Internal Revenue, an officer appointed by the President and confirmed by the Senate, and put there for the purpose of passing upon questions of law. There he is advised by an assistant to the solicitor to put his case in writing and submit these questions of law to the solicitor, in order that they may be determined in the way provided by law. That communication has not as yet, or at least up to Saturday of last week, had not as yet reached the solicitor.

It is my position that regardless of the merits of this particular case, the manner in which this case has been handled shows that, in the first place, there is an entire lack of that effort which is absolutely essential for the proper check of deductions claimed for losses upon sales of stocks and bonds.

In the second place, this case establishes as no other case which has yet come to my attention establishes, the correctness of the position taken by the chairman before the Finance Committee, when

he said that some system of appeals or review whereby the Government will get some protection and whereby the subordinates of the Income Tax Unit, who have a knowledge of the facts, who are conscientious in their work and are trying to protect the Government, may have an opportunity to be heard.

The CHAIRMAN. To my mind, this develops a most astounding condition, and I think the members of the Bureau here must be impressed with the power of an individual, one solitary individual, to so route a case through the bureau as to obtain anything he desires, and yet the head of the bureau or the solicitor, would know nothing about it. It seems to me that that is incomprehensible. I have not heard of this case before. I do not know how it came to the attention of counsel, but if one man by the name of Alexander can steer cases through the bureau, wiping out all the work of the metals valuation section and the auditors of the solicitor's office, and even the commissioner himself, it is a most astounding situation that exists. Of course, I presume that there is some explanation yet to come to the committee, but, as presented, it is most astounding to learn that such a thing is possible.

Did you ever hear of this case before, Mr. Nash?

Mr. HARTSON. I think, Mr. Chairman, the bureau ought to be given further opportunity to consider what has been said, and reply to it later. I think, in view of the fact that representatives of the bureau had not known of this case until counsel called it to their attention on Saturday, I think we would prefer to have nothing said by the representatives of the bureau at this time, and I would ask that it be continued, and we be given an opportunity later on.

The CHAIRMAN. I would like to ask that the bureau present this case to the commissioner and the Secretary of the Treasury for immediate consideration. I think this is the most astounding situation that I can conceive of and I can not conceive of any reply which could contradict this apparent evidence. It does seem to me that it is of such importance that the Secretary of the Treasury and the commissioner ought to know about it, because, as I say, it is astounding to me to know that such a condition has existed.

Mr. MANSON. I wish to submit for the record our Exhibits A to J, inclusively.

(The exhibits submitted by Mr. Manson are as follows:)

EXHIBIT A

William Boyce Thompson—Schedule D, 1918 Income Tax Return

D. PROFIT FROM SALE OF LAND, BUILDINGS, STOCKS, BONDS, AND OTHER PROPERTY

Kind of property	Year acquired	Name and address of purchaser or broker	Sale price	Original cost or market value, Mar. 1, 1913	Cost of subsequent improvements, if any	Depreciation subsequently sustained
1	2	3	4	5	6	7
Stocks, etc	Mar. 1, 1913, and since.	Various	$1,912,462.42	$2,315,174.24		
Stocks	do	do	62,100.50	155,611.62		
Bonds	do	do	2,463,027.72	2,564,284.44		
Net profit from sales (total of columns 4 and 7 minus total of columns 5 and 6)			4,437,590.64	5,035,070.30		$597,479.66

EXHIBIT B

LETTER REQUESTING DETAIL OF SECURITIES TRANSACTIONS

SEPTEMBER 4, 1923.

Mr. WILLIAM BOYCE THOMPSON,
New York, N. Y.

SIR: Reference is made to your income tax return, Form 1040, for 1918.

It is noted in Schedule D that you reported a loss of $597,479.66 from the sale of stocks, notes, and bonds. With reference to each transaction you are requested to state:

(*a*) Kind of security.
(*b*) Date acquired.
(*c*) Original cost of each security.
(*d*) If acquired prior to March 1, 1913, the market value as of that date.
(*e*) Date of sale.
(*f*) Sale price of each security.
(*g*) Whether $4,437,590.64 represents the actual sale price or the inventory value furnished by your broker.

In Schedule A, you deducted $26,066.02 as salaries and wages paid. You are requested to state whether this item includes any withdrawals or salaries paid to yourself or your wife; if so, state the amount of amounts.

Please give this matter your prompt attention and in your reply refer to IG:PA:3:MP-302.

Respectfully,

J. G. BRIGHT, *Deputy Commissioner.*

EXHIBIT C

STOCKS, ETC.

Item	Kind of security	Date acquired	Shares	Original cost, or Mar. 1, 1913, value	Market value Mar. 1, 1913	Date of sale	Sales value	Value per share Mar. 1, 1913
1	Mines Co. of America stock before Mar. 1, 1913.	.....	29,384 shares.....	$88,152.00	$88,152.00	From Aug. 6 to Dec. 6, 1918.	$54,171.90	$3 per share.
1	Mines Co. of America stock after Mar. 1, 1913.	.....	24,413 shares.....	74,611.58				
2	Stock.....	1916.....	.....	73,621.00	.....	May, June, December, 1918.	57,679.04	
3	....do.....	1917.....	.....	93,500.00	.....	June and October, 1918.	111,860.08	
4	....do.....	1917.....	.....	156,165.00	.....	January to December, 1918.	176,980.06	See rate below.
4	Par value of stock dividend received.....	1918.....	180 1/16 shares, at $25..	4,503.75	.....			
5	....do.....	1917.....	.....	662,985.36	.....	February to December, 1918.	858,190.10	
5	....do.....	1918.....	.....	248,355.58	.....	October, November, 1918.	246,031.50	
7	....do.....	1918.....	.....	290,752.25	.....	....do.....	142,470.60	
8	....do.....	1917.....	.....	15,500.00	.....	1918.....	17,500.00	
9	....do.....	1914.....	.....	51,681.11	.....	1918.....	23,200.00	
10	....do.....	1914.....	.....	20,037.40	.....	1918.....	16,000.00	
16	....do.....	1918.....	.....	16,512.50	.....	1918.....	16,500.00	
17	....do.....	Oct. 30, 1913, to July, 1917.	.....	106,517.77	.....	1918.....	123,500.00	
19	....do.....	1918.....	.....	6,400.00	.....	1918.....	46,020.00	
20	El Rayo Mining Co. stock before Mar. 1, 1913.	.....	4 shares.....	16.00	16.00	1918.....	8.00	$4 per share.
21	Nevada Consolidated Copper Co. stock before Mar. 1, 1913.	.....	1 share.....	18.00	18.00	1918.....	17.00	$18 per share.
22	Stock.....	1914.....	.....	86,430.00	.....	1918.....	121.00	
24	....do.....	1917.....	.....	400.00	.....	1918.....	300.00	
26	Patents.....	1917.....	.....	112.50	.....	1918.....	112.00	
27	Foreign exchange.....	1917.....	.....	300,022.36	.....	1918.....	20,000.00	
30	Loan to mining company.....	1918.....	.....	125.00	.....	1918.....	.50	
31	Loan to Storm King Stone Co.....	1918.....	.....	280.00	.....	1918.....	100.00	
32	Mines Co. of America stock before Mar. 1, 1913.	.....	1,700 shares.....	4,129.58	4,129.58	1918.....	1,700.64	$3 per share.
33	Paid fees of experts investigating various undertakings entered into for profit.	.....	.....	14,345.50	.....	.....	.....	
	Total.....	.....	.....	2,315,174.24	.....	.....	1,912,462.42	

NOTE.—The par value of a stock dividend received was added to the cost of the original stock purchased. All of the shares, including the stock dividend, were sold during the year. The par value of the stock dividend was, however, reported as income on the original return under item 12 (a), viz: $4,503.75.

EXHIBIT C—Continued

BONDS

Item	Kind of security	Date acquired	Shares	Original cost, or Mar. 1, 1913, value	Market value Mar. 1, 1913	Date of sale	Sales value	Value per share Mar. 1, 1913
11	Sleepy Hollow Country Club bonds before Mar. 1, 1913.			$2,000.00	$2,000.00	Oct. 31, 1918	$1,600.00	Par.
12	Railroad Co. notes	1917		29,682.84		April, 1918	30,000.00	
13	Industrial corporation bonds	1916		57,975.00		June, 1918	56,355.57	
14	Foreign Government bonds	1916		395,465.42		February and June, 1918.	385,562.50	
15	do	1917		89,261.18		December, 1918	5,[illegible]00.00	
18	United States Government bonds	1918		511,100.00		1918	496,945.00	
23	do	1918		6,500.00		1918	6,136.00	
25	do	1918		500.00		1918	474.35	
28	Foreign Government bonds	1917		489,500.00		1918	518,130.00	
29	United States Government bonds	1918		962,300.00		1918	962,824.00	
	Total			2,564,284.44			2,463,027.72	

NOTES

	Washington Railway & Electric Co. notes.	(1)		$61,849.17		October, 1918	$1,000.00	
	Storm King Stone Co. notes	(2)		340.45		do	100.00	
	Iona Gold Mining Co. notes	(3)		600.00		do	.50	
	H. R. C. C. notes	1918		41,000.00		do	41,000.00	
	Zincmines Co. notes	July 15, 1918		51,822.00		do	20,000.00	
	Total			155,611.62			62,100.50	
	Total			5,035,070.30			4,437,590.64	
				4,437,590.64				
	Loss claimed			597,479.66				

[1] Loans made over a period ending July 10, 1917.
[2] Loans made over a period ending June 17, 1914.
[3] Loans made over a period ending Mar. 26, 1913.

EXHIBIT D

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, October 17, 1923.

Mr. WILLIAM BOYCE THOMPSON,
14 Wall Street, New York, N. Y.

Sir: An examination of your income tax return for 1918 discloses an additional tax liability of $482.16, as shown in detail in the attached statement.

In accordance with the provisions of section 250 (d) of the revenue act of 1921, you are granted 30 days within which to file an appeal and to show cause or reason why this tax or deficiency should not be paid. The appeal, if filed, must be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the specific attention of IT PA 3, MP 302 App.

Treasury Decision No. 3492, setting forth the privileges of taxpayers in cases of appeal, is attached for your information and guidance.

Where a taxpayer has been given an opportunity to appeal and has not done so, as set forth above, and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement of the assessment will be entertained.

This assessment is in addition to all other outstanding and unpaid assessments appearing upon the collector's lists.

Payment should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Respectfully,

J. G. BRIGHT,
Deputy Commissioner,
By ——— ———
Assistant Head of Division.

STATEMENT

OCTOBER 17, 1923.

In re Mr. William Boyce Thompson, 14 Wall Street, New York, N. Y. Additional tax, 1918, $482.16.

In Schedule G you failed to report $57.55 the amount of tax paid for you at the source on tax-free covenant bonds. On page 1, line 16, you reported $4,003.75 as the value of stock dividends received. In the schedule submitted with your letter of September 21, 1923, you gave this value as $4,503.75, a difference of $500. Stock dividends do not constitute taxable income; however, the profit realized from the sale of such stock is taxable income in the year in which the sale is made.

These adjustments increase your net income subject to tax at 1918 rates by $4,561.30. The surtax on $35,421.61, the corrected amount of net income in excess of the exemption of $5,000, is $3,490.11. Since $2,950.40 has been assessed, and $57.55 was paid for you at the source on tax-free covenant bonds, there is due an additional tax of $482.16.

EXHIBIT E

FEBRUARY 12, 1924.

Col. WM. BOYCE THOMPSON,
14 Wall Street, New York, N. Y.

Sir: An examination of your income-tax return for the year 1918, together with information submitted therewith, has resulted in an additional assessment of $573,011.72, the details of which are shown in the attached statement.

In accordance with the provisions of section 250 (d) of the revenue act of 1921, you are granted 30 days within which to file an appeal and to show cause or reason why this tax or deficiency should not be paid. The appeal, if filed, must be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the specific attention of IT HR F-1, HCH-4459 App.

It appears reasonable and fair, in the event that you desire to appeal from the conclusions set forth in this letter with respect to the adjustments for the year 1918, to request that you sign and return the inclosed form of waiver, agreeing to an extension of time of one year beyond the statutory period of limitation, of the statutory period of limitation as extended by waivers already on file with the bureau, within which additional tax may be assessed. This wi

avoid the necessity of making an immediate assessment and afford the unit sufficient time to proceed in the regular manner to the consideration of the merits of your appeal or the additional information you desire to submit.

Treasury Decision No. 3492, setting forth the privileges of taxpayers in cases of appeal, is attached for your information and guidance.

Where a taxpayer has been given an opportunity to appeal and has not done so, as set forth above, and an assessment has been made, or where a taxpayer has appealed and an assessemnt in accordance with the final decision on such appeal has been made, no claim in abatement of the assessment will be entertained.

This assessment is in addition to all other outstanding and unpaid assessments appearing upon the Collector's lists.

Payment should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Respectfully,

J. G. BRIGHT,
Deputy Commissioner.

STATEMENT

Col. WM. BOYCE THOMPSON,
14 Wall Street, New York, N. Y.

A synopsis of your return for 1918, appears as follows:

Block B, director's fees		$750.00
Block D, stocks and bonds		None.
Block E, patents		3,624.87
Block F, interest on tax-free covenant bonds		2,877.54
Tax paid at source		57.55
Block G, miscellaneous income		98,653.66
Total		105,963.58
Block A, office management loss		8,131.60
		97,831.98
Blocks H and I, general deductions		42,079.76
Balance		55,752.22
Line K-a, dividends		574,187.42
Line K-b, taxable interest on bonds		3,447.88
Total		633,387.52
One-half of profits on sale of mineral lands		291,100.00
Net income subject to surtax		924,457.52
Loss:		
Dividends	$574,187.42	
Taxable interest on obligations of the United States	3,447.88	
Exemption	1,000.00	
		578,635.30
Balance		345,852.22
Amount subject to tax at 6 per cent		4,000.00
Balance subject to tax at 12 per cent		341,852.22
Normal tax at 6 per cent		240.00
Normal tax at 12 per cent		41,022.27
Surtax		535,182.01
Total		576,444.28
Tax previously assessed:		
Original returns, Mar. 15, 1919	$2,950.40	
Additional assessment, December, 1923, page 35, line 2	482.16	
		3,432.56
Additional tax due		573,011.72

The loss from the sale of stocks and bonds shown on your return under Block D as $597,479.66 has been disallowed. Details, such as name of broker, dates of purchase and sale, and full description of each transaction, when the amount involved is in excess of $1,000, should be furnished. In the case of foreign exchange, the loss is allowed only in the event of disposal. From details furnished by you it is not apparent that you disposed of your holdings.

In regard to the profit on the sale of mineral land, you are advised that of the sale price, $650,000, a sum of $50,000 was paid as a commission. The transaction was completed in 1918, and as no portion of the profit has been returned in any year, the amount received, $291,100 will be assessed at 1918 rates.

This amount has been computed as follows:

Sale price		$650,000
Commission		50,000
Balance		600,000
Cost	$9,000	
Development	8,800	
		17,800
Profit on transaction		582,200
One-half Wm. B. Boyce Thompson		291,100
One-half O. J. McConnell		291,100

Exhibit F

CONFERENCE REPORT

FEBRUARY 28, 1924.

Taxpayers: Col. William Boyce Thompson and Mr. O. J. McConnell.
Address: New York.
Represented by: Mr. C. Kelsey and Mr. T. D. Thatcher (with the law firm of Simpson, Bartlett & Thatcher) representing Mr. McConnell; Mr. A. G. Dodge representing Colonel Thompson.

Issues: By A-2 letter dated February 12, 1924, taxpayers were advised of proposed additional tax for the year 1918, due to the apparent profit made on the sale of leases in the year 1917. The taxpayers claim that the value of March 1, 1913, plus subsequent expenditures which have not been taken into consideration, was equal to the price for which leases were sold in 1917. In view of the lack of information and data in the files, the taxpayers were requested to submit a copy of the contract in order to determine whether the sale was in 1917 or 1918, and any information that would be helpful to the unit in determining the value of the property on March 1, 1913, or about that time. It was also agreed to submit a waiver for the year 1918 in the case of Colonel Thompson.

Regarding the disallowance of an item of $597,479.66 from the return of Colonel Thompson, it was brought out by the representatives that this matter had been adjusted by the bureau in a prior communication under date of October 17, 1923, in which an additional tax of $482.16 was shown, and that the bureau should not again bring up a matter that has been formerly closed.

It was agreed with the representatives that the question of stock losses would not be reopened.

The information as enumerated above is to be supplied within the next two weeks.

(Signed) S. A.,
Head Natural Resources Audit Division.

Exhibit G

APRIL 14, 1924.

Memorandum to Mr. S. M. Greenidge, head engineering division.
In re: Col. William Boyce Thompson and O. J. McConnell, New York City.

In the course of the work performed by the metals section during the past year in connection with checking returns of income from royalties and sales of mining leases on mineral land in the tri-State mining district of Kansas, Missouri, and Oklahoma, it was ascertained from returns of information of certain operators and sublessors (substantiating their deductions on account of royalty payments or bonus payments for leaseholds) that one O. J. McConnell had been paid approximately $200,000 in 1917 and $400,000 in 1918 as consideration for subleases or sales of mineral property.

Consequently, the case of O. J. McConnell was requisitioned and it was ascertained from the returns that these amounts had not been returned therein. A waiver was received on the 1917 return in time and the tax assessed. In November, 1923, this taxpayer, with certain legal representatives, appeared in conference in which a protest was presented claiming therein that the March 1, 1913, value of the lands sold and subleased were worth the sales price, hence there was no profit to return in the years 1917 and 1918. No evidence of value was presented with the exception of an affidavit of one Thomas Lennan in which he gave an opinion of a value of $500,000. The contentions of the taxpayer were denied, but he was given a 30-days extension in which to submit engineer's reports as to the value as of March 1, 1913.

Granville S. Borden and William H. Craigue, valuation engineers of the metals section, were on field duty in this district during the next 30 days (December, 1923). While in Joplin they were interviewed by one K. L. Koelker, a mining engineer, who had been employed by Mr. McConnell to report upon the value of the property as of March 1, 1913, as to the nature of the report required, inasmuch as there were only four drill holes on the property as of this date. During the course of the work in the field it was ascertained that Mr. McConnell had made no discovery prior to March 1, 1913, and that the tract in question was 4 or 5 miles distant from any producing property. In conference with various disinterested parties well qualified to give evidence, the fact was conclusively proven that the mineral land in question was undeveloped and that it was unknown as of March 1, 1913, that the property contained a deposit of commercial ore.

During the work in the field it was ascertained that McConnell was the partner of Col. William B. Thompson, of New York City, in this enterprise; i. e., these two parties were to share equally in any profit; Thompson was to contribute the capital and McConnell the services.

The engineering data which the taxpayer agreed to furnish in the November conference was not submitted in the time specified, and then even after another thirty days extension the data failed to appear, and so far as this section has been informed, the data has never been presented. (It is presumed either (1) that the report of Koelker was not satisfactory or (2) that Koelker refused to jeopardize his reputation as an engineer by placing a value on the showing made as of March 1, 1913.)

In January a valuation report by the metals section recommended the assessment for 1918 against McConnell of approximately $100,000 (one-half of $200,000) and for 1918 of $200,000 (one-half of $400,000). (A small deduction was granted as the major portion of the property was acquired in 1912 for $16,000 at execution sale.) As the taxpayer at this time had had ample opportunity to substantiate the value as of March 1, 1913, and had failed, this recommendation should have been conclusive as to the adjudication of this issue by the unit.

The 1917 and 1918 returns of Col. William B. Thompson had been requisitioned by this section from personal audit division. The statute of limitation had run against the 1917 claim for additional tax so that the Government lost a tax on $100,000 additional income (in the high surtax bracket) due to the failure of Mr. Thompson to return the amount received from the sale in 1917. In the course of the audit of the 1918 return, it was revealed that losses of $597,479.66 had been taken without any substantiation, some of which were prima facie not allowable. The auditor proposed to assess the tax for 1918 in A-2 letter dated February 12, 1924 adding to income approximately $200,000 which was received from sale of mineral lands and leases in Oklahoma and $597,479.66 by disallowance of the losses which had never been investigated and some of which were clearly not allowable as losses.

The additional tax for 1918 on this basis amounted to approximately one-half million dollars ($500,000).

Within the past few days the fact has been ascertained that Mr. McConnell and Mr. Thompson have had a conference in the presence of Mr. S. Alexander, head of natural resources audit division, alone on February 28, 1924. A copy of this conference report (the original is initialed by Mr. Alexander) is attached hereto. No other representative of the audit division or any member of the engineering division was present in this conference.

In view of the efforts expended by this section, not only in ascertaining the tax liability in this case (which would have been barred by the statute of limitations were it not for such efforts) but also in investigating the value of these properties as of March 1, 1913, by field work, it feels justified in expressing its vexation at the fact of it being deprived of jurisdiction by Mr. Alexander over this issue.

In the conference report written by Mr. Alexander, he stated, "In view of the lack of information and data in the files, the taxpayers were requested to submit a copy of the contract in order to determine whether the sale was in 1917 or 1918, and any information that would be helpful to the unit in determining the value of the property on March 1, 1913, or about that time."

If Mr. Alexander had referred to the metals valuation files he could have found no less than two copies of the McConnell-Hegar contract submitted in cases of Golden Rod Mining & Smelting Co., Boston Miami Royalty Co. and Miami Zinc Mines Co. If Mr. Alexander had referred to the metals valuation files he could have ascertained that the payments were not made according to stipulations on the face of this instrument and he could have ascertained exactly how they were paid.

The failure on the part of Mr. Alexander to have an engineer from the metals section present at this conference has clearly served to delay the assessment of this tax several months. The fact that the mineral land had little or no value in excess of the cost as of March 1, 1913, could have been proven conclusively from the evidence on hand as of February 28, 1924. The taxpayer had been requested in the November, 1923, conference to present engineering data in support of the alleged March 1, 1913, value and he promised to do so in 30 days. No engineering data was furnished. In the conference held by Mr. Alexander February 28, 1924, he implies a waiver of the necessity of the engineering data but requests a copy of the contract as additional information (although there were copies of the same already in the files). The closing of the case has been delayed in the meantime and to-day the tax is not yet assessed.

As the case of Thompson is to be reopened upon the basis of this failure to report income (which is very close to being fraud), there seems no reason, in the opinion of this section, why the issue as to the heavy losses on stock sales can not be investigated before the case is finally closed. If Mr. Alexander's statements in conference to the taxpayer (which involves in itself about $300,000 additional tax liability) on this point do not bind the unit conclusively, it is recommended that the losses be investigated in accordance with common procedure in other cases. Such a procedure in this case appears to be a failure to administer justice when compared to the procedure in many analogous cases.

It is also recommended that the cases of McConnell and Thompson be sent to special adjustment section and that the commissioner file 1917 "excess profits" tax returns for both parties based on an income of $100,000 each for the year 1917 derived from a trade or business in Oklahoma. This section has clear proof that it was income from their trade or business, and that they had capital invested. Under present conditions it would be apparently futile to offer such a recommendation to the natural resources audit division, as any effort on the part of the auditor would probably in a similar manner be nullified. The fact can be proven conclusively that no reasonable man would place a value of $650,000 on these lands as of March 1, 1913, and under these circumstances it is the opinion of this section that the failure to return any profit is a clear case of fraud.

Mr. Alexander has proposed to close the 1918 case on an additional tax of $182.16, although it is a well-settled rule of procedure that a case may be reopened upon any additional evidence of additional tax due (such as evidence presented in the metal valuation reports).

Reference is made to the following citations:

IT. 1966, III-14-1474 (p. 8):

"The fact that a previous commissioner by an erroneous construction of the law abated an assessment of tax legally due to the United States does not prevent the collection of such taxes by the United States in the manner directed by statute. Therefore, any taxes found to be due may again be assessed, notwithstanding previous abatement thereof, subject to the running of the statute of limitations."

IT. 1968, III-14-1479 (p. 14):

"Returns may be reexamined and the tax redetermined and additional assessments made as the commissioner deems advisable, within the prescribed time for assessments, unless an agreement is made closing the case under section 1312 of the revenue act of 1921. T. D. 3240 (CB-5-313) does not prohibit such procedure."

This is but one of several recent instances in which Mr. Alexander has attempted to settle engineering questions with taxpayer's representatives without consultation with, or authority from, the engineering division.

JOHN ALDEN GRIMES,
Chief Metal Valuation Section.

EXHIBIT H

ENGINEER G. S. BORDEN'S STATEMENT

Memorandum in re William Boyce Thompson, income tax returns for the years 1917 and 1918.

FEBRUARY 28, 1925.

Pursuant to request of Geo. G. Box, chief auditor, I am submitting the following statements:

1. With regard to the reasons why statement of April 14, 1924 was forwarded to Mr. Greenidge by Mr. Grimes, chief metals valuation section.

Mr. William H. Craigue and myself, during a field investigation in Picher, Okla., in December, 1923, ascertained that Col. William Boyce Thompson had received approximately $300,000 profit from the sale of mineral lands during 1917 and 1918. His returns for those years were requisitioned and the fact ascertained that he had not returned any portion of this income. The metals valuation section forwarded a memorandum to the natural resources division, attached to the 1917 and 1918 cases, recommending assessment of the tax based on this additional income. At this time (January 19, 1924) the natural resources audit division and the engineering division were located at Twentieth and C Streets NW. The auditor of the natural resources audit division, Miss Elizabeth Hart, who received the cases of William Boyce Thompson, consulted verbally with the engineers with regard to these engineering matters, and in the course of such consultations, informed the metals valuation section of the fact that she had proposed an additional assessment of approximately $500,000, due to the increase of income from the sale of mineral properties, and the disallowance of the losses claimed by the taxpayer of approximately $597,000 from the sale of securities in 1918.

Later on Miss Hart complained that the head of the natural resources audit division, Mr. Sydney Alexander, had held a hearing with the taxpayer in protest against the proposed additional assessment; and that neither she, nor any conferee, nor any engineer had been present at this conference; furthermore, that Mr. Alexander had conceded to the tax-payer that the matter of the losses from the sale of the securities would not be reopened, but would be dropped. Miss Hart stated in conclusion that she would not work the case upon this basis, even if it were at the sacrifice of her position. In reply to this complaint, Mr. Grimes requested Miss Hart to route the case back to the metals valuation section.

I believe it was about the time that the case was received in the metals valuation section from the natural resources audit division, that Mr. Grimes, with my assistance, prepared a memorandum to Mr. Greenidge, head of the engineering division, under date of April 14, 1924, in which he recited the procedure and facts in the case and recommended that the case of Colonel Thompson be sent to the special adjustment section and that excess profits return be filed by the Commissioner for the year 1917, showing a net income of $200,000, from trade or business.

2. With regard to the reasons why I was sent to the solicitor's office on this matter.

As we had no reply from our memorandum to Mr. Greenidge, as to what action we should pursue in the matter, Mr. Grimes (I believe about April 27, 1924) requested that I go to Mr. Arundel, assistant solicitor of internal revenue, who had been handling many matters relative to mining at the solicitor's office in the past, and state the facts and procedure to him, and request his advice as to the way to proceed. Pursuant to this request, I recited the facts to Mr. Arundale, who instructed me to return to the metals valuation section and prepare a statement in written form and forward it with the case to the solicitor for his attention, together with questions which the metals valuation section desired to have answered.

3. With regard to the report to the solicitor by the metals valuation section.

Pursuant to Mr. Arundel's verbal advice, a memorandum was prepared on April 28, 1924, attached to the case in due form, and routed therewith, through channels which I believed would be through the offices of the engineering distribution center, Mr. Greenidge's office, office of Mr. Bright, Deputy Commissioner, to the Solicitor. I believe from subsequent events that this case, with the attached memorandum to the solicitor, was routed from the engineering distribution section direct to Mr. Alexander's office, head of the natural resources audit division. I have reason to believe this memorandum was never

forwarded to the solicitor's office, and I know that we never had any reply from the solicitor's office with regard to this memorandum, or to the queries contained therein. There is nothing in the records of the case to show that this memorandum was forwarded any farther than the office of Mr. Alexander or Mr. Greenidge.

4. With regard to the instructions which I received from Mr. Shepherd, special conferee of the engineering division, about September 1, 1924.

I heard nothing about the status of this case or nothing in regard to any action taken in this case, from the time that it was routed out of the section, with the exception of such rumors concerning the fact that the case was on Alexander's desk at one time, until approximately September 1, 1924.

At that time I was called to the office of Mr. Greenidge and advised by Mr. Shepherd that he had the case before him, and that I should take the case and revise my former reports to a concise statement of the facts; and that I should exclude all matters not within the jurisdiction of the engineering division; and finally, that I had exceeded my authority in my past actions with regard to this case.

Pursuant to Mr. Shepherd's instruction, which I presumed was in accordance with the authority of the head of the division, I took the case from the office of the head of the division, where it was at that time, back to the metals valuation section, and made such a report as Mr. Shepherd had instructed me to do. I returned the case to Mr. Shepherd and I presume it was routed to the personal audit division for audit on the basis of this revised report.

GRANVILLE S. BORDEN,
Valuation Engineer.

EXHIBIT I

VALUATION REPORT BY METALS SECTION

SEPTEMBER 3, 1924.

In re: Col. Wm. Boyce Thompson, New York City.
1918 taxes: Waiver on file.

The statute of limitations has run against the claim for additional taxes for the year 1917.

This taxpayer shared one half of the profits derived from the sale of mineral lands by O. J. McConnell to Denman Blanchard. The sales price was $650,000, of which $450,000 was paid in the year 1917 and $200,000 in the year 1918.

The taxpayer has protested the proposed assessment by raising the defense that the value of the land sold as of March 1, 1913 was at least equal to the sales price. The taxpayer has failed to substantiate this claim or to rebut the evidence on file in this office showing that the properties sold had only a nominal value as of March 1, 1913.

The property sold to Blanchard for a consideration of $650,000, consisted of the following:

(1) Fee simple subject to ten year term of S. C. Fullerton (at the date of sale the term had run 5 years) on 200 acres located on the N. ½ of the NE. ¼; N. ½ of the NW. ¼ of sec. 20; and the SW. ¼ of the SE. ¼ of sec. 17; all in township 29, range 23, Ottawa County, Okla.

This property was acquired by McConnell at execution sale levied on Quapaw Indian, Netta Tract, and sold in December, 1912 by sheriff on account of debtors, to McConnell for $9,200. (Note the date of this sale is four months prior to March 1, 1913.)

(2) A leasehold royalty right to 7 per cent net royalties in the gross production from the Cardin tract consisting of 200 acres located on the NE. ¼ of sec. 29 and the SW. ¼ of SE. ¼ of sec. 20; all in township 29, range 23, Ottawa County, Okla. The lease was acquired without cost in September, 1913, for 8 per cent royalties. In 1915 McConnell subleased to the Nichols Williams Zinc Co., and the Mihoma Zinc Co., and the Bulls Eye Zinc Co., for 15 per cent royalties of the gross productions. The overriding royalties of 7 per cent was sold as part of the consideration for the $650,000. It is evident that no deduction is allowable as the royalties were acquired without cost after March 1, 1913.

(3) A leasehold royalty right to 8 per cent net royalties in the gross production from the Kenoyer tract consisting of 200 acres located on the S. ½ of the NW. ¼ N. ½ of the SW. ¼ and the SW. ¼ of the SW.¼, all in section 20, township 29 range 23, of Ottawa County, Okla. This lease was acquired without cost in September, 1912, for 10 years. The lease carried a burden of 7 per cent royalties to the fee owner, S. A. Kenoyer. In 1915 McConnell subleased the property to

the Boston Miami Lead & Zinc Co. for 15 per cent royalties in the gross production. It was the 8 per cent overriding royalty that passed as part consideraion to Blanchard for the $650,000. The overriding royalty was secured without cost after March 1, 1913.

Price paid by vendee for property		$650,000
Amount paid as commission to R. S. Hagar		50,000
Price paid to McConnell and Thompson		600,000
Selling price		600,000
One-half selling price to Thompson		300,000
Cost fee lands	$9,200	
Development	8,800	
	18,000	
One-half cost to Thompson		9,000
Profit		291,000
Amount of sales price received by Thompson in 1917		200,000
Return of capital allowed in 1917		9,000
Profit won in 1917 which is taxable income		191,000
Amount of sales price received by Thompson in 1918		100,000
Profit won in 1918 which is taxable income		100,000

As the statute of limitations has run against the 1917 case the tax can not be collected that is due from the profit on the sale won in 1917.

The tax based on a profit won of $100,000 in 1918 should be assessed. Under article 13 of regulations the surtax computed from this income can not exceed $20,000 (which is 20 per cent of the $100,000 sales price received by the taxpayer in 1918).

GRANVILLE S. BORDEN,
Valuation Engineer.

JOHN ALDEN GRIMES,
Chief Metals Section.

EXHIBIT J

MEMORANDUM TO THE SOLICITOR

APRIL 28, 1924.

In re: O. J. McConnell, New York City; Wm. Boyce Thompson, New York City.

(Attention Mr. C. Roger Arundell, assistant solicitor.)

Pursuant to verbal instructions of C. Roger Arundell, assistant solicitor of of internal revenue, the entire files of the aforesaid taxpayers are forwarded for rulings on the following legal questions:

(1) Under the statement of facts to be recited in subsequent paragraphs, are either or both of the aforesaid taxpayers liable for excess-profits tax for the year 1917?

(2) Under the statement of facts, is William B. Thompson liable for penalty on the basis of fraud for individual income tax for the year 1917 based on the income from the sale of mines which was not returned and upon which no assessment could be made because the statute of limitations had run before the income was ascertained by the unit?

If actual fraudulent intent can not be established, would the proof of negligent failure to return and amount which can be clearly shown that the taxpayer knowingly realized during the year, defeat a defense on the statute of limitations?

(3) Under the statement of facts, is O. J. McConnell liable for penalty in addition to the amounts already assessed for the years 1917 and 1918 on account of failure to return the profit derived from the sale of mines during 1917 and 1918?

(4) Under the statement of facts is Wm. B. Thompson liable for penalty in addition to the amount already assessed for the year 1918 on account of failure to return the profit derived from the sale of mines in 1917 and 1918?

(5) Is the 1918 return of Wm. B. Thompson subject to review in its entirety being reopened because of new evidence proving failure to return income which he realized in 1918, or will a former assessment for the year 1918, without field examination and an oral waiver of the right to review certain items by the head of the natural resources audit division in conference with the taxpayer, prevent the further review of an item of $597,479.66 losses claimed as a deduction?

(6) Is the claim by Wm. B. Thompson in the appeal brief in protest to the proposed 1918 assessment based on the fact that the transaction (McConnell-Hager agreement) was closed in 1917, and the statute of limitations had run against the 1917 return, a good defense, although the instrument is clearly a contract to sell and not a contract of sale, and title remained in the vendor until the vendee had fully performed (which was sometime in 1918)?

FACTS

A. As to procedure: In the course of the work performed by the metals valuation section during the past year in connection with checking returns of income from royalties and sales of mining leases on mineral land in the tri-State mining district of Kansas-Missouri and Oklahoma, it was ascertained from returns of information of certain operators and sublessors that one O. J. McConnell had been paid approximately $400,000 in 1917 and $200,000 in 1918 as consideration for subleases or sales of mineral properties. As a consequence thereof the case of O. J. McConnell was requisitioned and it was ascertained from his returns that he had either fraudulently or negligently failed to return the amounts reported paid to him.

In June, 1923, a tax of $121,712.20 was proposed as an additional tax for the year 1917. In November, 1923, this taxpayer with certain legal representatives appeared in conference in which a protest was presented claiming therein that the March 1, 1913, value of the lands sold and subleased were worth the sales price, hence there was no profit derived from the sales in 1917 and 1918, no evidence of value was presented at this conference with the exception of an affidavit of one Thos. Lenan, in which he gave an opinion that the properties had a value of $500,000 as of March 1, 1913. The contention as to value were denied but McConnell was given 30 days within which to submit engineers' reports to prove the value claimed.

Granville S. Borden and William H. Craigue, valuation engineers, were on field duty in this district a portion of the following 30 days (December, 1923). In the course of their duties there they secured conclusive proof that the properties forming the subject matter of this controversy were mere prospects upon which only four drill holes had been drilled prior to March 1, 1913; that the drilling was about 3 miles distant from any operating property; and that the tremendous appreciation occurred during the years 1915 and 1916 when there were numerous new discoveries made upon the tracts coupled with the war prices for zinc. The engineers also ascertained while in the field that O. J. McConnell was the partner of Col. Wm. B. Thompson, of New York City, in this enterprise; that is, these two parties were to share equally in the profits, each contributing half of the capital.

The engineering data which the taxpayer agreed to furnish in the November conference was not submitted in the specified time, and then, even after several repeated promises and extensions of time, the data has failed to appear. It was ascertained in the field that K. L. Koelker, a mining engineer, had been employed to make the valuation so it is presumed that (1) the report was not satisfactory or (2) that Koelker refused to jeopardize his reputation as an engineer by placing a value upon such a prospect as of March 1, 1913.

Upon the return of the engineers, the returns of Wm. B. Thompson for 1917 and 1918 were requisitioned from the personal audit division. It was ascertained that he, too, had failed to file an excess-profit tax return for 1917 and to return as income the profit derived from this transaction. In January, a valuation report by metals section recommended the assessment of taxes based on these profits which amounted to approximately $200,000 additional income for each one for the year 1917 and $100,000 additional income for each for the year 1918. A small deduction from the gross receipts was allowed as the cost of the fee property in December, 1912, amounted to $9,200, a price paid upon acquisition of execution sale.

The auditor of the natural resources audit division could not assess the additional tax against Thompson for the year 1917 as the statute of limitations had run. An overassessment was allowed on the basis of the claim for abatement of McConnell's due to the portion which Thompson had received. The review of Thompson's return for 1918 showed that the personal audit division had not carefully reviewed a loss deduction of $597,479.66, and that no revenue agents report for the year had been filed, so the auditor of the natural resources division disallowed the item although a previous assessment had been made for the same year. This action was in harmony with the rulings cited IT. 1966, III-14-1471, and IT. 1968, III-14-1479. On February 12, 1924, the proposed assessment for 1918 was mailed to Thompson, based on additional income of approximately $100,000, representing the income received from the sale of mining property, and $597,479.66 of losses not substantiated. The proposed additional tax amounted to $573,011.72 in addition to the former assessment by the personal audit division, $182.16.

On February 28, 1924, S. Alexander, head of the natural resources audit division, held a conference with these taxpayers in which no other representatives of the audit or engineering division were present. A copy of the report is in the files.

In this conference report Mr. Alexander has not discussed any reasons given by the taxpayer for not submitting the engineers' reports formerly promised; or the subject of excess profits tax for the year 1917, or the question of fraud or negligence which had been proven quite conclusively as the result of the investigation in the field by the metal section. However, Mr. Alexander in the reports states that he told taxpayer that the losses of $597,479.66 would not be investigated again.

The present status of the case is as follows:

O. J. M'CONNELL

1917: Formerly assessed on profit from entire transaction $121,712.29. Claim for abatement, after ascertaining Thompson was a partner, allowed for $64,767.39, leaving $56,944.90. An appeal against the assessment of the balance is on file.

No excess profits tax return was filed although the record shows beyond a reasonable doubt that the income was derived from his trade and business.

1918: A proposed additional assessment for $36,438.22 was sent February 13, 1924. A protest received March 27, 1924.

WM. B. THOMPSON

1917: Abatement claim allowed, $186,762.70.

No excess profits tax return was filed, although the facts show the taxpayer was financing the enterprise and interest to the extent of receiving reports of progress.

1918: Additional assessment of $482.16 on October 17, 1923.

Second additional assessment proposed February 12, 1924, of $573,011.72.

Protest and appeal received April 4, 1924.

G. As to merits: The property which comprises the subject matter of the sale consists of: (1) Fee 200 acres located on the N. ½ of the NE. ¼; N. ½ of the NW. ¼ of sec. 20, T. 29, R. 23, Ottawa County, Okla.. The taxpayer acquired the fee in December, 1912, subject to a term of 10 years to S. C. Fullerton, at execution sale, for $9,200. This tract will hereafter be referred to as the fee land. (See Exhibit C.)

(2) Lease 200 acres located on the S. ½ of the NW. ¼, N. ½ of the SW. ¼ and the SW. ¼ of the SW. ¼ of sec. 20, T. 29, R. 23. This tract was leased for 10 years from S. A. Kenoyer and Felicia Kenoyer without bonus September, 1912. The lease carried a burden of 7 per cent royalties to Kenoyer. Hereafter this tract will be designated as the Kenoyer tract.

(3) Lease 300 acres located on the SW. ¼ of the SE. ¼ of sec. 29, T. 29, R, 23, and the NE. ¼ of sec. 29, T. 29, R. 23. This tract was leased by McConnell from Louis Cardin without bonus in July 1913 (note the date was subsequent to March 1, 1913). Hereafter this tract will be referred to as the Cardin tract.

In April, 1917, McConnell made the deal with Hagar, who assigned to Blanchard & Co. interest of Boston (Hagar was merely acting as agent). Blanchard & Co. organized various operating units and assigned certain subdivision of the tract to different ones, together with certain aliquot portion of the obligation to pay McConnell. The Miami Zinc Mines Co., one of the companies organized by Blanchard, secured title to the fee land for which it paid McConnell and

Thompson $450,000. The leased lands were subleased to the LaClede Lead & Zinc Co., Dorothy Bill Mining Co., and the Golden Rod Mining and Smelting Co., and for these subleases McConnell and Thompson received $200,000. These payments were made during the years 1917 and 1918. Of the $650,000 the taxpayer admits $50,000 was paid as commissions; $400,000 was received in 1917 and $200,000 in the year 1918. For more complete recital of the conveyances of title to the fee and leaseholds refer to the valuation report by metal section, in re Blanchard & Co., Miami Zinc Mines Co., et al, a copy of which is attached hereto and marked "Exhibit A."

As the Cardin lease was secured without cost after March 1, 1913, no deduction could be allowed from sales price on account of this lease.

Deduction allowable against the $600,000 received will be the cost or March 1, 1913, value of the fee land and the cost or March 1, 1913, value of the Kenoyer lease.

The following evidence is given to prove the failure on the part of McConnel and Thompson to return the profit derived from the sale of these mining properties was fraud.

The taxpayers having returned nothing from which the unit would have knowledge of the transactions now relies on the defense that the March 1, 1913, value was equal to the sales price, hence there was no profit to return.

Starting with the axiom that the market value of the properties in April, 1917, was what they were sold for on that date between a willing buyer and a willing seller, the taxpayers, in order to support their contention, must prove a value as of March 1, 1913, of the properties they owned as of that date, equal to the sales price in April, 1917. In other words the taxpayers' contentions are based on the fact that the properties did not appreciate in value between March 1, 1913, and April, 1917.

It is believed that the following evidence will prove conclusively not only that the taxpayers' contentions are wrong, but also that the taxpayers knew of the appreciation which occurred and have willfully endeavored to defraud the Government out of taxes:

1. Appreciation in general in the Picer lead and zinc district between March 1, 1913, and April, 1917.

The following quotation is taken from an affidavit on file in this office by H. A. Buehler, State geologist of the State of Missouri, relative to the development of the Picer lead and zinc district. It is in the heart of this district that the properties in question are located.

"Prior to 1912 no systematic prospecting had been done in the Picher region; one or two strikes had been made on upper runs and small mills erected. The Commerce Camp to the southwest had been developed several years and was a producing camp. The deeper ore horizon had a general trend to the northeast toward the old camps of Galena and Joplin and this fact, together with strike on Tar River drew attention of Miama, Okla., parties to the possibilities of the entire undeveloped region between Commerce and Joplin, and in 1912 and 1913 first leases were taken over practically the entire area to the Kansas State line. In order to hold the leases drilling was started immediately.

"During 1914 and 1915 the continual discovery of exceedingly rich ore coupled with very high prices due to an acute shortage of zinc attracted nation-wide attention, and soon resulted in a rush of investors and engineers to the field. Hundreds of drill holes were started and strikes were reported almost daily. The condition stimulated feverish excitement, boosting prices and rushing development. * * *

"From 1915 to 1918 the district experienced a phenomenal period of development, and enthusiasm unequaled in the annal of mining in this country.

"Throughout the history of the Missouri, Kansas, Oklahoma zinc fields lease owners have reaped wonderful returns.

"In addition to royalties lease holders demanded large bonuses as a sale price. In 1916 and 1917 this price was frequently out of all proportion to the actual developed worth, although the development at that time indicated extensive ore bodies of hitherto unknown richness.

"The breaking out of the World War in August, 1914, totally changed the whole basis for the fixing of prices for the zinc industry. With Germany controlling her own and the zinc industry of Belgium, the remainder of Europe was practically bereft of any source of supply save the United States. The Allies were forced to obtain their zinc, an important war metal, from America. With America, hitherto producing only sufficient metal to supply her own needs, this demand of a limited supply immediately made itself felt and a rapidly rising

market for zinc from ore to the metal and all its products resulted." (Average prices of zinc concentrate by months during interval March, 1913, to April, 1917, is given in Exhibit B.)

Reference is made to the following quotation from an article written by Mr. R. C. Allen, consulting mining engineer and geologist, former State geologist of Michigan, and former member of the Federal tax advisory board:

"The extraordinary development of the Miami field during the war had all of the familiar characteristics of the boom period of a bonanza camp of the West. It was occasioned by the spectacular rise in the price of zinc in 1915, the discovery not long prior thereto of extraordinarily rich deposits of zinc blende by drilling in this field, and the common belief of zinc operators that unprecedentedly high prices for zinc would prevail throughout the war. It will be recalled that the Belgian zinc smelters had been captured by the Germans in the summer of 1914 at a time when consumption of zinc in manufacture of munitions was rapidly mounting. There followed competitive buying of zinc in the United States by agents of the entente nations, with the result that the Joplin base price of 60 per cent zinc blende concentrates shot upward from $45 per ton on January 1 to $104 per ton at the end of July, 1915, reaching even higher figures in the early part of 1916. This 'skyrocketing' in price of zinc was the impetus which brought on the amazingly rapid development of the Miami district. In 1914 the mines on the ore 'runs' of the old commerce field (1) were nearing exhaustion and those in the vicinity of Lincolnville (Fig. 2) had been proven too lean for profitable working. The operations at Lincolnville, Peoria, Galena, and other points fringing the Ozark hills, together with the general geology of the region, had indicated the possible occurrence of ore bodies in the limestone-chart beds which under cover of shale underlie the plains to the west as they do the surface in the hill country where they have been mined for a half century. About 1908, Messrs. Robinson and Coleman, of Miami, turned the possibility into reality when they discovered the 'runs' at commerce. By 1914 prospecting by drilling had been carried northward from commerce demonstrating a wide extension of ore-bearing territory in that direction in what is now the Miami field. In 1914–15 drilling operations rapidly multiplied the early discoveries, but it was not until 1916 that mills were brought into operation. The rapidity of development is shown in the following table:

TABLE I.—*Growth in productive mill capacity of Miami zinc field* [3]

Date	Number of Mills	Capacity per 20-hour day	Accumulative capacity, rock tons
Jan. 1, 1916	None.	None.	
Jan. 1, 1917	30	18,300	18,300
Jan. 1, 1918	42	25,700	44,000
Jan. 1, 1919	47	24,770	68,770
June 1, 1919	24	12,100	80,870
Total	143	80,870	

[3] Average capacity of 143 mills—550 rock tons daily.

"This amazingly rapid development could not have taken place in peace times. It is distinctly a war phenomenon. The discovery of the possivilities in this field happened to precede by a few months or a year the spectacular rise in the price of zinc referred to above. The war demands for zinc, particularly high grade zinc ore needed in the production of special products of the metal, found here an easily accessible supply which could be rapidly developed for production. Never before in the 60 years of zinc mining in the district centering in Joplin had such a prospect for quick profit presented itself to the zinc miners.

Accordingly, with the fluidity characteristic of mining capital, money flowed into the development of the Miami field, abandoning the older districts where the ores are of lower grade."

2. Appreciation of the specific properties during the interval March 1, 1913 to April, 1917.

The entire cost of the fee lands acquired at execution sale December, 1912 (three months prior to March 1, 1913), was $9,200. The Kenoyer lease was acquired in September (six months prior to March 1, 1913) without cost.

The taxpayer contends the fee land appreciated from $9,200 in December, 1912, to $150,000 on March 1, 1913; that the Kenoyer lease appreciated a value from nothing in September, 1912, to $200,000 in March 1, 1913; it is also contended that no appreciation in value occurred on the fee land, or the Kenoyer tract between March 1, 1913 and April, 1917; and that no appreciation occurred on the Cardin tract from the date of acquisition in July, 1913 to the date of sale in April, 1917.

Records show that as of March 1, 1913, there was no drilling on the fee land and that there were only four holes drilled on the Kenoyer tract. Records show that the nearest operating mines to these properties were at Commerce, 3 or 4 miles distant, and that there were no closer discoveries of ore on any land as of the date than the Bluebird tract, about 1½ miles distant.

Records show that the subsequent attempt of McConnell to exploit the ore proven by the four drill holes that were down as of March 1, 1913, resulted in an economic failure; that the mine was abandoned; that the mill was torn down and removed. A well-known operator and mining engineer of the district in writing on the history of the development of the district has made the following statement:

"O. J. McConnell made a discovery of ore by drilling early in 1913 one mile northeast of the Bluebird mine and later in the year sunk a shaft and built a mill. However, he never found pay dirt and the mine remained a complete failure up to the time the McConnell mill was torn down and removed."

The taxpayer's own statement confirms this by their claim of $75,000 as operating losses as a deduction against sales price.

Records show that all the other equity claiming discovery value on these tracts have made affidavits to the fact that the tracts were not proven tracts on the dates discovery is claimed, none of which are prior to the year 1915. (See valuation date of S. C. Fullerton, W. W. Dobson, Eagle Picher Lead Co., Louis Cardin, S. A. Kenoyer, Boston Miami Royalty Co., Golden Rod Mining & Smelting Co.)

It is a matter of record that the ore deposits at Commerce had been proven by March 1, 1913, to be erratic in their grade and occurrence, and that the continuity of the ore deposit could not be predicted with any degree of certainty beyond the walls of ore exposed. Even now after a decade of drilling and study of the geological conditions in this field a drill hole is no more than a qualitative test, and is in no way a basis of predicting a measurable quantity of ore. Hence four drill holes in ore as of March 1, 1913, in this tract can not be considered to have much weight in computing appreciation in value. The test of value is not future anticipated value but actual cash "market value" of the property as of March 1, 1913. The unit does not deny from a retrospective view that these properties had an unknown value as of March 1, 1913, of $650,000 but it believes only definitely determinable, accurately ascertainable value as of March 1, 1913, can be used for the purpose of computing deductions from sales price.

The fee land was acquired by McConnell in December, 1912. S. C. Fullerton a few months prior to the execution sale secured a 10-year lease from the grantor to McConnell without cost. No development work had been done on this tract prior to March 1, 1913. In October, 1913, S. C. Fullerton subleased to the Picher Lead Co. at 12½ per cent royalties. A dispute arose between Fullerton and McConnell as to their royalty rights and it was compromised on the basis of a 6¼–6¼ per cent so that McConnell then owned the reversion and a 6¼ per cent royalty interest in the lease. Soon after October, 1913, Picher Lead Co. started drilling on the Netta and Perrin tracts (80 of the 200 acres of the fee land) and by June 1, 1916, when the lease on the fee lands were sold to Eagle Picher Lead Co. for stock they had definitely proven the existence of ore bodies on the two tracts which contained approximately 1,779,715 rock tons or 133,405 tons of concentrate. Between October, 1913, and June 1, 1916, the Picher Lead Co. had sunk two shafts and built two mills on these tracts, and before April, 1917, the Eagle Picher Lead Co. had successfully operated the mills and were paying McConnell 6¼ per cent of the gross production from ores mined on these tracts. Presuming the taxpayers knew of this development they could reasonably expected even on a normal price for zinc of $43 per ton, over $350,000 in royalties from these two 40-acre tracts alone.

On the Kenoyer tract, considerable drilling had been carried on during the year 1915 on the SW. ¼ of the NW. ¼; on about January, 1917, McConnell made a contract to lease this 40-acre tract to the LaClede Lead & Zinc Co. for $70,000 and 15 per cent royalties (8 per cent above the 7 per cent for which he was liable to Kenoyer). This contract was subsequently assigned to Blanchard and made a part of the Hagar agreement and the $70,000 subsequently paid by LaClede formed part of the $650,000 purchase price.

There was considerable drilling on other parts of the Kenoyer tract during the interval of March 1, 1913, and April, 1917, but the location and amount is not a matter of record at this time in this office.

Records show too that between the dates of acquisition of the Cardin lease in July, 1913, and April, 1917, there was a considerable amount of drilling done by the Nichols Williams Zinc Co., the Mihoma Zinc Co., and the Bulls Eye Zinc Co., but the extent and location is not a matter of record in this office at this time.

So in conclusion it is evident that between March 1, 1913, and April, 1917, in addition to the general development and the boom period in the field, the McConnell tracts were keeping pace, if not actually exceeding the rate of appreciation of similar properties; during the interval we find the following events tending to appreciate the value of the McConnell tracts; about 200 drill holes had been sunk two or more mills had been built; two or more shafts had been sunk, at least one mine had been successfully operated in 1916; the price of zinc had risen from $44 to $71.35 per ton; Transportation facilities had been improved; and the discoveries coupled with high zinc prices had attracted capitalists and brought about a mining boom.

In April, 1917, the taxpayers contracted to sell for $650,000 and now although the facts outlined above were in their knowledge at the time, they contend that they made no profit on the sale as there was no appreciation of the properties between March 1, 1913, and April 1917. No reference was made to this sale in either of the taxpayers' returns for the years 1917 or 1918, and if the metals section had not made special efforts to ascertain the tax liability they would have escaped all liability. The taxpayers' own records show that the income was derived from their own "trade or business". On this point no better evidence is necessary than McConnell's admission in the file.

Under the facts as outlined above the unit requests rulings by the solicitor which will be mandatory as to the method of procedure on the question of law outlined at the commencement of this memorandum.

Deputy Commissioner.

EXHIBIT B OF J

Monthly average prices of zinc blende ore at Joplin, Mo.

	1913	1914	1915	1916	1917
January			$51.01	$99.82	$74.87
February		$41.15	65.93	108.90	82.78
March	$44.62	38.54	62.73	99.10	82.83
April	40.92	36.75	56.03	101.45	71.35
May	41.76	36.68	69.42	90.14	
June	40.30	38.41	101.84	74.26	
July	40.88	35.58	104.14	67.72	
August	44.54	44.02	79.87	59.11	
September	44.30	41.33	78.49	56.60	
October	40.07	38.46	81.72	64.34	
November	37.50	44.95	92.64	87.26	

The CHAIRMAN. Have you anything for to-morrow, Mr. Manson?

Mr. MANSON. Yes.

The CHAIRMAN. Counsel for the committee says that he wants to go ahead and present some statistics in the record to-morrow.

Mr. MANSON. Yes; I will let you know what they are. I do not know myself, as yet.

The CHAIRMAN. Then we will adjourn until to-morrow morning at 10 o'clock.

(Whereupon, at 11.40 o'clock a. m., the committee adjourned until to-morrow, Tuesday, March 3, 1925, at 10 o'clock a. m.)